Scottish Fiscal Commission

Fiscal Update

August 2026

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ISBN: 978-1-911637-94-3

Published by the Scottish Fiscal Commission, August 2026.

Laying number: SFC/2026/4

Foreword

The Scottish Fiscal Commission (SFC) is the independent fiscal institution for Scotland. We produce Scotland's official, independent economic and fiscal forecasts to accompany the Scottish Government's Budget cycle. We also assess the reasonableness of the Scottish Government's borrowing plans and produce reports on the long-term sustainability of the Scottish Government's public finances. Part of this involves commenting on and analysing the Scottish Government's spending plans.

Our last forecasts were published alongside the 2026-27 Scottish Budget and Spending Review, in January 2026. Since then, there have been economic and political developments, with consequences for funding and spending. The new Scottish Parliament was elected in May 2026, and a new Scottish Government formed. There have also been changes in UK political leadership with the appointment of a new UK Prime Minister and Cabinet. Finally, we have seen outturn data published which affects the Scottish Budget, most significant of which is for Income Tax and confirms the reconciliation that will apply in 2027-28.

This report, alongside the Statement of Data Needs and the Forecast Evaluation Report published today, is our first set of publications for the 7th session of the Scottish Parliament. We aim to support the Parliament's pre-Budget scrutiny and scrutiny of the upcoming 2026-27 Autumn Budget Revision. Our next forecasts will be published alongside the 2027-28 Budget.

We would like to thank once again the hard-working staff of the Commission for their support in the production of our analysis and commentary.

We would like to give special thanks, from ourselves and on behalf of all previous Commissioners, to John Ireland. John has been an outstanding Chief Executive and has worked to establish the organisation since its very early days. He will leave soon for a very well-earned retirement, and we hope he will look back with a lot of pride on what the SFC has achieved under his leadership.

Professor Graeme Roy

Dr Eleanor Ryan

Justine Riccomini

25 August 2026

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Summary

Introduction

1 This report sets out the latest economic developments and changes to the Scottish Government's funding and spending since our last forecasts in January 2026. We explain what the outlook may be for the Scottish Budget and the uncertainties around that outlook. We also call on the Scottish Government to update and be transparent on the progress made towards its planned efficiency savings to identify any new or changing pressures in the 2026-27 and 2027-28 Budgets.

Economic outlook

2 The economic outlook has weakened since our last forecasts in January 2026 and the OBR's last forecasts in March 2026. Inflation is now expected to be higher than previously forecast. Rising global energy prices following the escalation of the conflict in the Middle East have increased energy costs for households and businesses. There is also a risk of higher food prices from high temperatures, wildfires, and drought across the UK and Europe.

3 In January 2026 we expected the outlook for Scottish living standards to remain weak over the next five years, with growth of less than 1 per cent per year. Higher inflation could result in even weaker growth in real household incomes in the future. The impact on living standards will depend on whether earnings increase quickly enough to keep pace with rising prices.

4 Analysis of real disposable incomes across Great Britain shows that growth is not even across income groups. Recent data suggests low-income households have seen real disposable incomes fall since 2021-22, as prices of essentials have risen significantly since then. These households are also likely to be most affected by the food and energy price risks, as they spend a larger share of income on essentials such as energy, food, and housing. Since low-income households have less scope to reduce spending or draw on savings, they are more exposed to rising costs.

5 While the economic outlook appears to be weaker than when we produced our last forecasts, the exact knock-on implications for the Scottish Budget remain uncertain. The OBR will publish updated forecasts alongside the UK Budget on 28 October 2026, and the UK Government's tax and spending decisions will depend on the wider UK fiscal outlook. We will publish updated economic and tax forecasts alongside the 2027-28 Scottish Budget. The effects of the weakening economic conditions on the Scottish Budget will depend on how tax revenues in Scotland are expected to grow compared with those in the rest of the UK.

Funding outlook

6 Our January 2026 report forecast a largely flat funding position for day-to-day spending in 2027-28 and a capital budget that was falling in real terms, this was following real terms growth in funding of 1.1 percent for day-to-day spending and 2.9 per cent for capital in 2026-27. The Scottish Government set its Spending Review based on those funding forecasts. The change in the UK leadership with a new UK Prime Minister and new Cabinet, however, means that the UK Government may change its fiscal plans, and may also change its interpretation of the UK fiscal rules. Any changes to UK spending plans, fiscal policy or the balance of spending between devolved and reserved responsibilities will affect the Scottish Government's funding. Any such changes will be confirmed at the UK Budget on 28 October 2026.

7 Some changes to funding are already known. UK Government spending decisions on Special Educational Needs and Disability (SEND) for England have generated additional funding for the Scottish Government. This includes £533 million in 2026-27 and more than £300 million in 2028-29. However, there is very little new funding in 2027-28. The Scottish Government could choose to carry forward some or all of the additional funding received in 2026-27 through the Scotland Reserve to support future budgets. We show the Scottish Government using this additional funding in 2026-27 as set out in its provisional outturn statement,[1] which means funding for day-to-day spending is now growing by 3.5 per cent in real terms in 2026-27 compared with 2025-26, but in contrast it is expected to fall by 1.2 per cent in real terms in 2027-28.

8 Capital funding is expected to face further pressure. The UK Government has announced higher defence spending through the Defence Investment Plan (DIP). This is being funded, in part, by reducing the capital budgets for all other departments. It is therefore expected to reduce the Scottish Government's capital Block Grant, although the scale of the reduction will not be known until the next UK Budget. In the absence of confirmed Barnett consequentials from the UK Government's DIP, we have assumed a reduction to the capital Block Grant of £70 million in the current year 2026-27, £87 million in the upcoming 2027-28 Budget, and reaching £97 million by 2029-30.

9 In addition, the 2027-28 Scottish Budget will be reduced by £720 million for a negative Income Tax reconciliation. This corrects differences between forecast and outturn Income Tax revenues for 2024-25. Although Scottish Income Tax revenues were £209 million lower than forecast, our smallest ever error for a Budget setting forecast, stronger-than-expected growth in UK Government income tax revenues has resulted in a much larger negative adjustment to the Scottish Budget. While the Scottish Government can borrow to manage the reconciliation, it is likely to exceed available borrowing capacity, reducing funding available for public services in 2027-28.

[1] Paragraph 3 of Scottish Government (2026) Scottish Budget – provisional outturn 2025-2026: briefing note – 18 June 2026.

Spending outlook

10 The Scottish Spending Review and 2026-27 Budget, published in January 2026, included £563 million of planned savings in 2026-27 across portfolios. In 2026-27, 44 per cent of these savings are expected to come from NHS boards. However, Audit Scotland found that in 2024-25 only 15 per cent of territorial boards achieved similar planned savings. If planned savings are not delivered in 2026-27, additional funding will be required, increasing pressure on both current and future budgets.

11 In January 2026, we highlighted that the outlook for 2027-28 was particularly challenging because spending plans assumed pay awards below the rate of inflation. The outlook for higher inflation increases the likelihood of pressure for pay deals to be higher than currently budgeted for. Higher inflation in 2026-27 means several pay deals with inflation protection clauses will be reviewed and increased, increasing workforce costs in 2026-27 and future years.

12 Some of the pressures from workforce costs may be offset by lower employer pension contributions from 2027-28 following the revaluation of public sector pension schemes. This is likely to reduce workforce costs for the Scottish Government. It will also reduce UK Government workforce costs, which could lead to lower UK departmental budgets and a corresponding reduction in Scottish Government funding through the Block Grant. But since the devolved workforce is larger per head of population than the UK average and is relatively higher paid, the saving the Scottish Government gains from lower employer pension contributions may be larger than a corresponding reduction in the Block Grant.

13 The Scottish Government also planned to reduce the size of the public sector workforce, with a target to decrease it by 0.5 per cent a year on average from 2025-26 to 2029-30. There is little sign of progress towards this target in the latest published figures, with the workforce growing over 2025-26. This means larger reductions will be required from 2026-27 onwards if the target is to be met.

14 The overall impact of pay and workforce on the Budget will depend on the balance between funding changes, pay pressures, and progress on workforce reductions, as well as the Scottish Government's approach to pay policy from 2027-28 onwards. This should become clearer following the next UK and Scottish Budgets.

15 Ahead of the Scottish Budget, to support parliamentary committees in carrying out their pre-Budget scrutiny, the Scottish Government should set out progress on the planned efficiencies, developments on public sector pay and workforce, and how the spending pressures it faces have changed since the Spending Review in January 2026.

16 The Autumn Budget Revision presented by the Scottish Government in September 2026 will be the first opportunity for the new government to amend the 2026-27 Budget. It should set out any changes to the funding position, including how much of the additional funding received from the UK Government will be used in 2026-27. It should also explain any changes in spending plans and make clear whether these reflect new policy commitments or because planned efficiencies have not been delivered.

Chapter 1
Introduction

1.1 To support the new Scottish Parliament in its pre-Budget scrutiny, in this report we explain what changed in the economic and fiscal outlook since our last forecasts.

1.2 We did not produce forecasts in the spring because of the May 2026 Scottish election. Therefore, our latest forecasts in January 2026 are now eight months old. We will produce new forecasts in the winter, alongside the 2027-28 Scottish Budget.

1.3 This publication is structured as follows:

- Chapter 2 covers economic developments since our last forecasts in January 2026. We look at the latest picture for inflation, Gross Domestic Product, earnings and the labour market, and the potential impact of external factors like the Middle East conflict.

- Chapter 3 covers the latest outlook for the devolved finances, including the effects of UK Government announcements made since January 2026, the impact of the 2024-25 Income Tax reconciliation, and what options the Scottish Government has within the fiscal framework to manage funding for the 2027-28 Budget.

- Chapter 4 covers developments on the spending outlook. We look at the risk of spending pressures from planned efficiency savings, which underpinned the 2026-27 Budget allocations, not being achieved. We also analyse data on public sector workforce and pay rises to estimate the latest position on paybill pressures.

- Chapter 5 brings together all developments and changes to the funding and spending outlooks, to explain how this will shape two important events in the coming months: the 2026-27 Autumn Budget Revision and the 2027-28 Budget.

- Annex A covers the latest funding positions from 2024-25 to 2026-27, and how they have changed since our last forecasts in January 2026. For latest funding positions since 2020-21 see supplementary figures S3.1 and S3.2 accompanying this report and available on our website.

- Annex B explains why we are removing Employability Services from our social security spending forecasts.

- Annex C sets out our forecast of Air Departure Tax, to be introduced in April 2027.

1.4 This Fiscal Update is part of a group of reports published at the same time. In our Statement of Data Needs (SDN) we set out what data we require to perform our duties and what improvements on its presentation would facilitate our work.[2] In our Forecast Evaluation Report (FER) we compare budget setting forecasts with recently published outturn data, explain the sources of error, and learn lessons to improve our modelling.[3]

1.5 Income Tax is covered in two of our publications. In the FER, we explain the outturn for 2024-25 Scottish Income Tax revenue and how that relates to our budget setting forecast. In this Fiscal Update, we explain the impact on the Budget of the reconciliation between the forecast and outturn.

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[2] Scottish Fiscal Commission (2026) Statement of Data Needs – August 2026.

[3] Scottish Fiscal Commission (2026) Forecast Evaluation Report – August 2026.

Chapter 2
Economy

2.1 Our latest forecast of the Scottish economy, published in January 2026, showed positive but slow growth in Gross Domestic Product (GDP) and living standards, a softening labour market with slightly increasing unemployment in the near term, and continued uncertainty. Since then, several geopolitical and climate-related events have weakened the economic outlook. As well as the ongoing conflict in Ukraine and tariff uncertainty, these include the surge in global energy prices at the end of February 2026 following the escalation of the conflict in the Middle East and risks of higher food prices from high temperatures, wildfires, and drought across the UK and Europe. All these external factors have caused concerns about rising inflation and cost-of-living pressures in the coming months.

2.2 In this chapter, we look at the current picture for inflation, GDP, earnings, and the labour market in Scotland and we consider how emerging events may affect the Scottish economy. However, we cannot say with a meaningful degree of precision what these events will mean for our next forecast, as global economic conditions remain volatile and can still change.

2.3 While the economic outlook appears to be weaker than when we produced our January 2026 forecasts, the exact knock-on implications for the Scottish Budget remain uncertain. Across the UK, rising prices will erode public spending in real terms, meaning higher spending will be required to maintain existing provision of public services, but inflation can also boost tax revenues. For Scotland, the fiscal framework means the Scottish Government's funding from the UK Government will depend on the UK Government's tax and spending decisions, which will be based on the OBR's updated forecasts to be published alongside the UK Budget on 28 October 2026.

2.4 We will publish an updated economic and fiscal outlook alongside the next 2027-28 Scottish Budget. This will incorporate the latest information available at the time and provide our view of the Scottish economy, including the most recent global developments and OBR forecasts.

Developments since our last forecast

Current geopolitical and climate-related events pose risks of higher inflation and slower economic growth

2.5 At the time of our January 2026 forecast, inflation had been falling and we expected it to reach 2.4 per cent in 2026 Q2 before returning to the Bank of England's 2 per cent target by 2027 Q1. Outturn inflation for 2026 Q2 was 2.8 per cent.

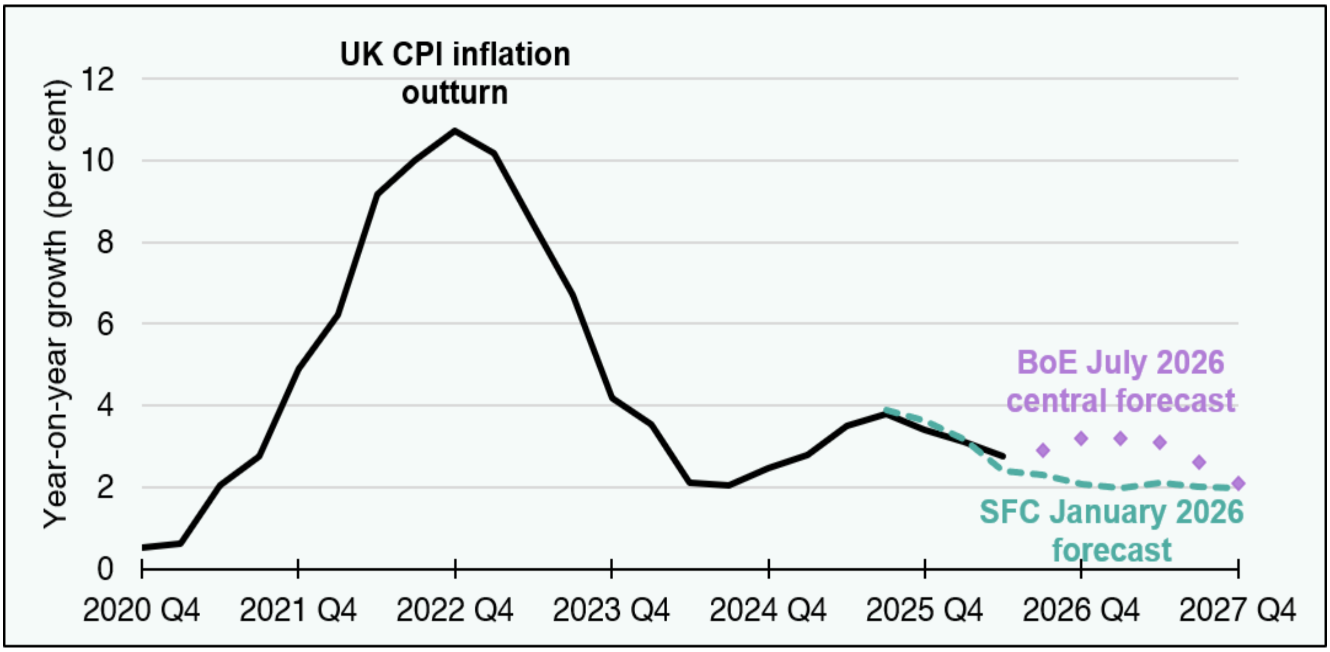
2.6 The surge in global energy prices in early 2026, following the escalation of the conflict in the Middle East, is yet to fully feed through to consumer prices. However, some cost pressures have risen, mainly due to the direct impact of the initial energy price shock on motor and heating fuel prices and on energy bills.

2.7 Figure 2.1 shows that the Bank of England (BoE) currently expects inflation to increase and remain above target in the near term, with its July 2026 central forecast peaking at 3.2 per cent in 2026 Q4 and returning to target by the end of 2027.

2.8 This reflects the 13 per cent rise in the Ofgem Energy Price Cap from July 2026, which includes higher global energy prices between March and May, as well as businesses passing on some of their increased energy costs to consumer prices to retain profit margins. It also takes into account the UK Government's removal of VAT from household electricity bills from October 2026 to March 2027.[4] In addition, there may be inflationary pressures from higher food prices due to extreme weather events. The Ofgem cap will next be updated in October 2026, and then January 2027. While partly dependent on how global energy prices evolve, it is currently predicted to remain elevated through to March 2027.[5]

Figure 2.1: Consumer Price Index (CPI) inflation, UK, year-on-year growth

Inflation now expected to rise, mainly due to recent energy price shock, with BoE's last central forecast peaking at 3.2 per cent in 2026 Q4 and returning to target by end of 2027



Description of Figure 2.1: Line chart of CPI inflation outturn and forecasts. CPI inflation rose from early 2021 up to a peak of 11 per cent at the end of 2022, before returning to target by mid-2024. It increased again to a lower peak of 3.8 per cent in 2025 Q3, then fell to 2.8 per cent in 2026 Q2. The latest SFC forecast published in January 2026 falls to 2 per cent in 2027 Q1 and stays at target. The latest Bank of England central forecast from July 2026 rises to a rate of 3.2 per cent in 2026 Q4 and 2027 Q1, then falls to 2.1 per cent in 2027 Q4.

Source: Scottish Fiscal Commission (2026) Scotland's Economic and Fiscal Forecasts – January 2026, Bank of England (2026) Monetary Policy Report – July 2026, ONS (2026) Consumer price inflation tables.

[4] UK Government (2026) New PM cuts tax on household electricity bills to give breathing space on cost of living.

[5] Cornwall Insight (2026) Energy Bills Forecast to Hit Three-Year High – 19 August, Cornwall Insight (2026) Household energy costs look set to remain high through winter – 30 June, Ofgem (2026) Energy price cap will rise by 13% from July.

2.9 The Bank of England's latest inflation outlook is higher than our January 2026 forecast but well below the levels of the previous inflation shock in 2022-23. While the early 2026 surge in global energy prices is largely the result of disruptions to energy supplies (supply-side shock), the inflation spike in 2022 was due to a combination of multiple factors (demand and supply) related to both the COVID-19 pandemic and the energy price shock caused by Russia's invasion of Ukraine in February 2022.[6,7] By early 2022, before the conflict in Ukraine started, inflation had already increased to around 6 per cent.

2.10 Turning to GDP, higher energy prices and global supply chain issues following the escalation of the conflict in the Middle East appear to have had little impact on overall economic output so far, although some sectors (such as manufacturing, transport, wholesale) are more exposed than others.[8,9] As Figure 2.2 shows, most of the recent independent forecasts for Scotland and the UK are broadly unchanged compared with those available at the time of our January 2026 forecast publication.

Figure 2.2: Forecast comparison, GDP growth rates in calendar years

GDP growth rate (per cent)	2025 outturn	2026 previous [1]	2026 latest	2027 previous [1]	2027 latest
Scotland: SFC	1.3	1.3	blank	1.3	blank
Scotland: FAI	1.3	1.0	1.0	1.1	1.1
UK: OBR	1.3	1.4	blank	1.5	blank
UK: NIESR	1.3	1.2	1.1	1.2	1.1
UK: BoE	1.3	1.2	1.1	1.6	1.1
UK: HMT average of forecasters	1.3	1.1	1.0	blank	1.0

Source: Scottish Fiscal Commission (2026) Scotland's Economic and Fiscal Forecasts – January 2026, Fraser of Allander Institute (2026) FAI Economic Commentary Q2 2026, OBR (2025) Economic and fiscal outlook – November 2025, NIESR (2026) UK Economic Outlook – Summer 2026, Bank of England (2026) Monetary Policy Report – July 2026, HM Treasury (2026) Forecasts for the UK economy: July 2026, Scottish Government (2026) GDP Quarterly National Accounts: 2026 Quarter 1 (January-March), ONS (2026) GDP quarterly national accounts, UK: January to March 2026.

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[6] Since mid-2021, during the post-COVID -19 pandemic recovery period, there had been global cost pressures from excess demand because global demand had been rising at a fast pace (as economies were reopening after the COVID-19 pandemic) while supply was still constrained due to global supply chain disruptions and labour shortages.

[7] In addition, currently, the economy and labour market are weaker than in 2022. This can reduce companies' ability to raise prices and workers' ability to bargain for higher nominal wages in response to higher inflation.

[8] The disruption to shipping through the Strait of Hormuz and other transit routes as well as the damage to key energy infrastructure led to rapidly increasing oil and gas prices in early 2026 and ongoing uncertainty over energy supplies.

[9] Scottish Government (2026) GDP Monthly Estimate: May 2026, Fraser of Allander Institute (2026) Scottish Business Monitor Q2 2026, Fraser of Allander Institute (2026) Almost two-thirds of Scottish businesses now using AI.

[1] As available at the time of our January 2026 forecast.

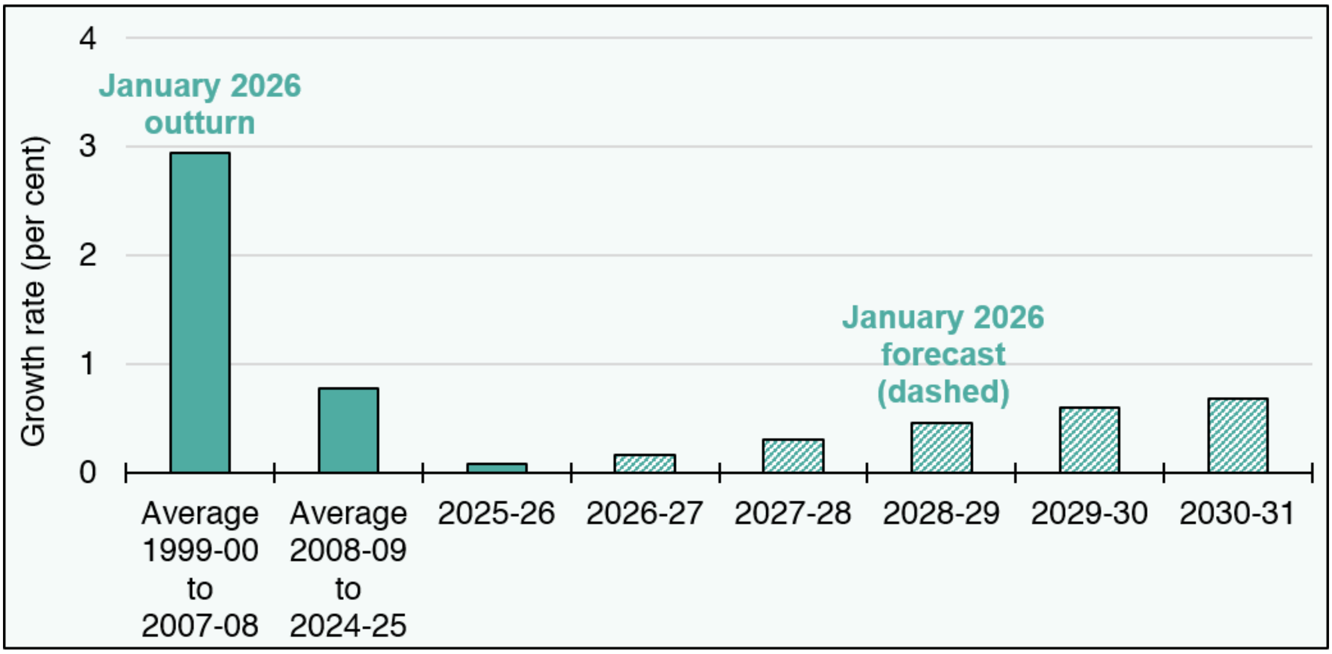
Current cost-of-living pressures could add to an already challenging outlook for living standards

2.11 As we discussed in our February 2026 Fiscal Sustainability Perspectives report, living standards – as measured by real disposable income per person – have grown slowly since the 2008-09 Global Financial Crisis. Real disposable income is a total estimate of how much money, on average, people can spend or save after accounting for tax (including Council Tax), social contributions (such as employee and self-employed NICs), interest payments on mortgages and other loans (net of all interests received), as well as inflation.[10]

2.12 As Figure 2.3 shows, real disposable income per person improved at an average of 3 per cent per year from 1999-00 to 2007-08. Since then, it has grown by less than 1 per cent per year on average. In 2022-23, it fell sharply in Scotland and the UK largely because of rising inflation and interest rates following Russia's invasion of Ukraine but has since recovered to its 2021-22 level.

Figure 2.3: Growth in real disposable income per person, Scotland

In January 2026 we expected Scottish living standards to grow by less than 1 per cent per year over the next five years



Description of Figure 2.3: Column chart showing growth in living standards, both for longer-term averages (1999-00 to 2007-08 and 2008-09 to 2024-25), and for each year of our January 2026 forecast (up to 2030-31). The forecast growth is much lower than the pre-2008 trend, tending towards the post-2008 average only towards the end of the forecast horizon.

[10] We use the National Accounts measure of nominal household disposable income published by the Scottish Government and we adjust this for inflation using the Consumer Expenditure Deflator (CED). Some non-discretionary payments such as rental payments and utilities are not directly included in nominal disposable income but can be considered as being implicitly reflected in real disposable income, because they are part of household final consumption expenditure and disposable income is adjusted for inflation using the CED price index.

Source: Scottish Fiscal Commission (2026) Scotland's Economic and Fiscal Forecasts – January 2026, Scottish Fiscal Commission (2026) Fiscal Sustainability Perspectives: what Scotland's finances mean for the next parliament – February 2026.

Data for 2025-26 includes a short-run forecast as well as outturn.

2.13 In January 2026 we expected the outlook for Scottish living standards to remain weak over the next five years, with growth of less than 1 per cent per year. Higher inflation could result in even weaker growth in real household incomes in the future but the impact on living standards will depend on whether earnings increase quickly enough to keep pace with rising prices.

2.14 In Box 2.1 we discuss living standards growth for households across the income distribution, and the implications for the public finances. We focus on social security spending, but the distribution of income growth can also affect economic growth and tax revenues, as well as having equalities implications.

Box 2.1: Living standards and disability payments

We think the recent cost-of-living pressures have been a factor in the increase over the last five years in the number of people receiving disability payments, in both Scotland and the rest of the UK. The proportion of people reporting having a disability has increased, especially for more deprived households.

We do not think the poor economic conditions are the sole driver for the increase in the number of people receiving disability payments. There has also been an effect from worsening population health, including the effect of the COVID-19 pandemic. This coincided with the launch of new disability payments in Scotland, which also contributed to an initial spike in applications. However, we think the cost-of-living pressures have led to people who are already disabled becoming more likely to apply for disability payments.

Living standards by income groups

Using household disposable income data from the Department for Work and Pensions (DWP) which is broken down by income groups, Figure 2.4 suggests that the lowest-income households tend to be relatively more exposed to cost-of-living pressures.[11] This is because they spend a larger share of income on essentials such as energy, food, and housing for which price levels have increased substantially from 2021-22, and they have less scope to reduce spending or draw on savings to cover rising costs. However, in 2026-27 the rise in Universal Credit standard allowance and removal of the two-child limit could ease some of the pressure on low-income households.[12]

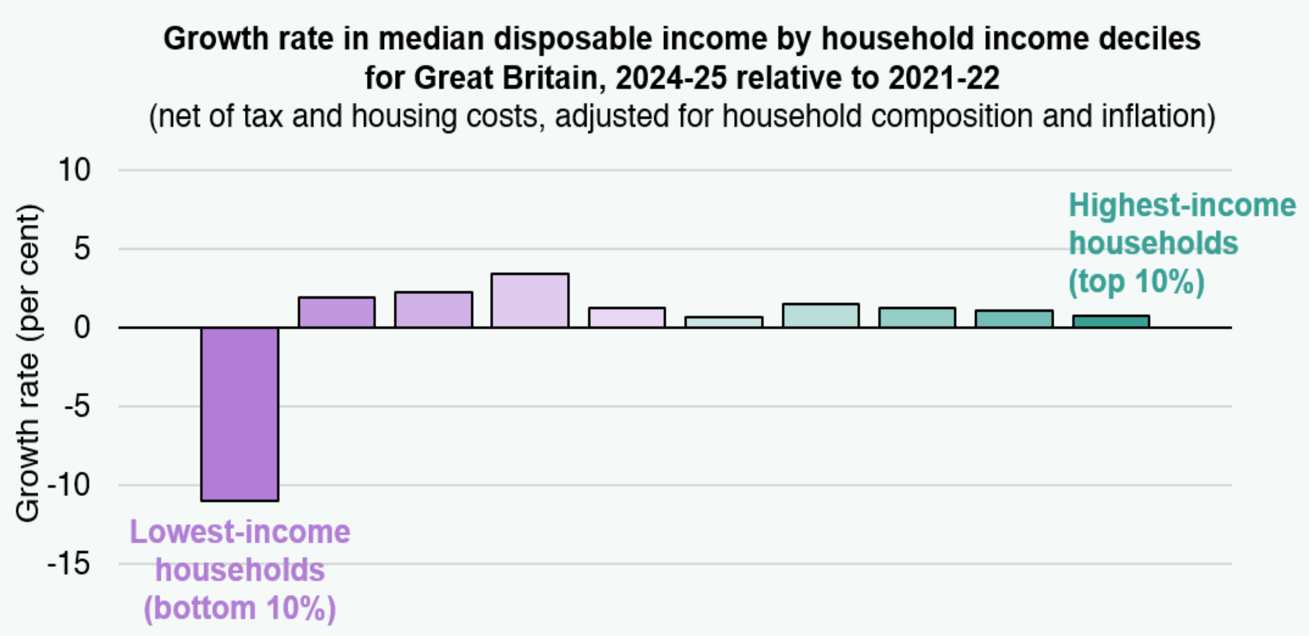
[11] This is a measure of living standards based on Households Below Average Incomes (HBAI) data, which is derived from DWP's Family Resources Survey (FRS), and it can differ from the National Accounts measure used in Figure 2.3. Resolution Foundation (2026) Measuring household income.

[12] Resolution Foundation (2026) Living Standards Outlook 2026.

The growth rates in Figure 2.4 are for illustrative purposes only. They show the change in real average disposable income between two specific points in time, that is between 2021-22 (the year before the inflation shock of 2022-23) and 2024-25 (the latest year for which this data is currently available). They are also based on data for Great Britain because there is insufficient Scottish data at present for this detailed analysis of living standards by income groups. We will aim to explore the available data for Scotland in future.

Figure 2.4: Growth in average disposable income by income groups, Great Britain

In Great Britain, the recent cost-of-living crisis had uneven effects on households across the income distribution



Description of Figure 2.4: Column chart of median disposable income growth by deciles, showing an 11 per cent fall in 2024-25 relative to 2021-22 for the lowest-income households in Great Britain while all other income groups experienced no change or some growth in living standards over that period.

Source: Scottish Fiscal Commission, Department for Work and Pensions (2026) Stat-Xplore: Household Below Average Income – Data from 2021/22 (admin-linked).

Implications for disability payments

People not in the workforce due to ill health may be eligible to receive an out-of-work ill-health benefit (such as Universal Credit with a limited capability for work component). Although eligibility for devolved disability payments is not based on income or employment status, a rise in the number of working-age people in receipt of out-of-work ill-health benefits could lead to an increase in the number of people receiving disability payments. Evidence from DWP suggests that, in some cases, people seeking advice on additional sources of income to meet rising costs also received advice on disability payments.[13] Around two-thirds of people in England and Wales in receipt of an out-of-work ill-health benefit also receives a disability benefit.[14]

[13] Department for Work and Pensions (2026) Timms Review of Personal Independence Payment: interim report – Annex B.

[14] Department for Work and Pensions (2026) Stat-Xplore: Benefit combinations.

What this means for the next Scottish Budget

In our January 2026 forecast, we already expected a weak outlook for living standards over the next five years. The financial impact of this slow growth in living standards will vary for different households, with those on lower incomes struggling the most. There is a risk this could lead to a rise in applications for disability payments from these households, adding further pressure on social security spending. However, if there was a similar effect for disability benefits in England and Wales then there would be little effect on the Scottish Budget, as social security BGA funding would also increase.

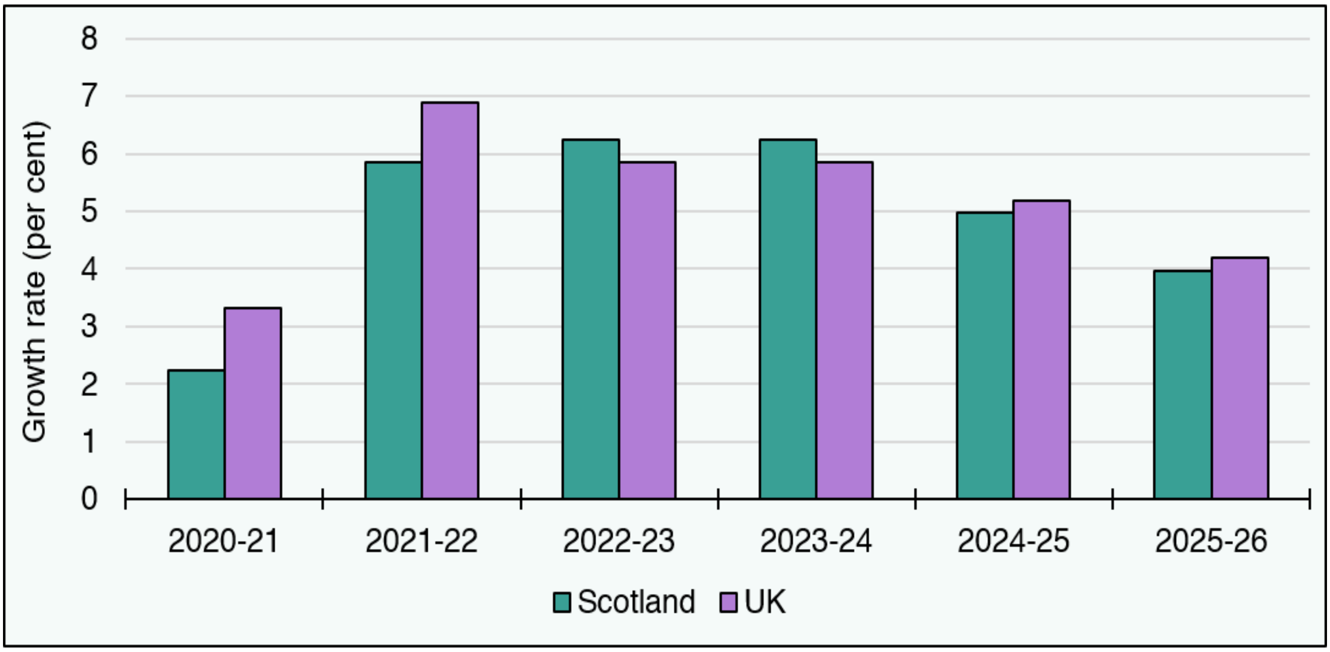
Scotland's average earnings growth has been slightly below UK average, partly due to slower earnings growth in the North East

2.15 Average earnings growth is an important economic indicator. It is one of the most timely indicators of the performance of the Scottish economy, as well as a key input into calculations of living standards. It is also one of the main determinants of the Income Tax net position – that is, the extent to which the Scottish Budget benefits from devolved taxation – when compared with average earnings growth in the UK.

2.16 Over 2024-25 and 2025-26, we have seen average earnings growth in Scotland and the UK gradually slowing from the higher, inflation-driven growth seen from 2021-22 to 2023-24. In our January 2026 forecast, we expected average earnings to grow by 5.2 per cent in 2025-26, before slowing sharply to 2.9 per cent in 2026-27 as inflation also fell towards the Bank of England's 2 per cent target. Based on the latest Real Time Information (RTI) data, Figure 2.5 shows earnings growth slowing sooner than expected, to 4.0 per cent in 2025-26 for Scotland.

Figure 2.5: Scotland and UK nominal average earnings growth (RTI)

Earnings growth over 2024-25 and 2025-26 has slowed across the UK, in line with falling inflation, with Scotland's growth turning slightly below UK average in these two years



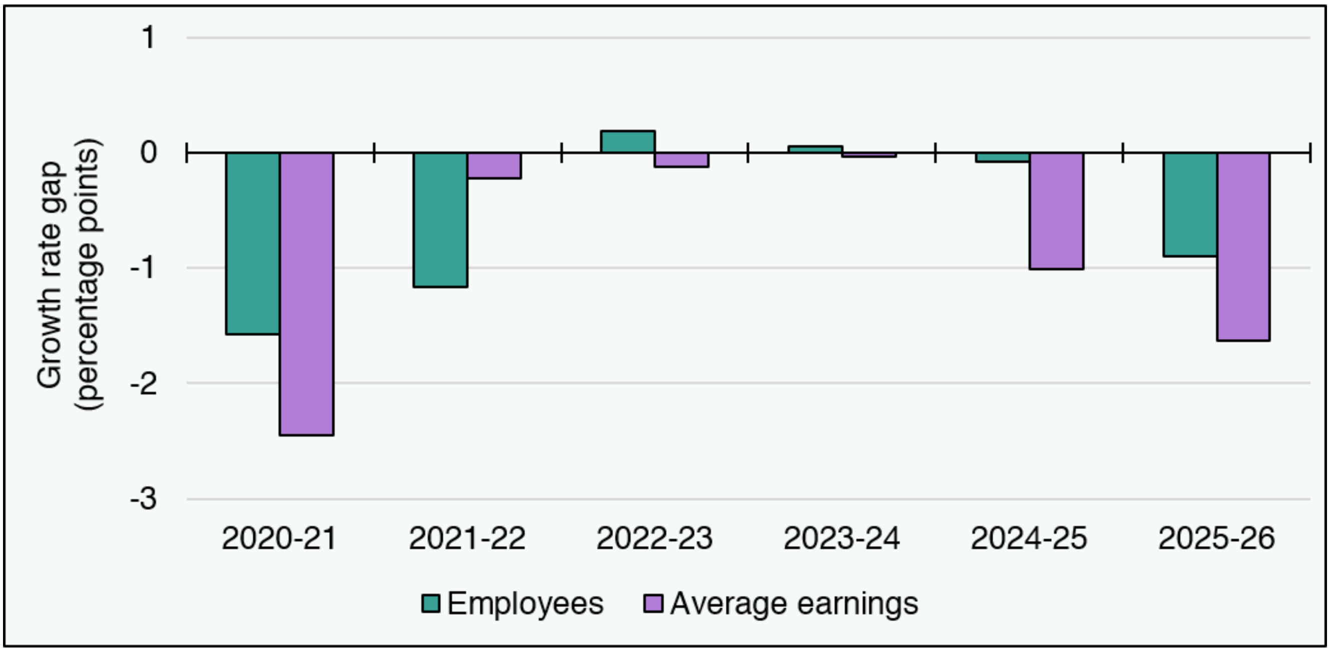
Description of Figure 2.5: Column chart showing nominal average earnings growth in Scotland and UK from 2020-21 to 2025-26. Growth in both economies slowed from around 6 per cent per year from 2021-22 to 2023-24 to 5 per cent in 2024-25 and 4 per cent in 2025-26. In the last two years, Scottish growth was 0.2 percentage points below UK, after two years where it had been slightly faster.

Source: Scottish Fiscal Commission, ONS (2026) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – July 2026.

2.17 Scotland's earnings growth trailed the UK average by around 0.2 percentage points in 2024-25 and 2025-26. In part, this is because of slower earnings and employment growth in Aberdeen, related to declining oil and gas activity. Figure 2.6 shows the difference in Aberdeen City and Aberdeenshire's earnings and employment growth relative to the Scottish average. In 2024-25 and 2025-26, earnings and employment growth in Aberdeen City and Aberdeenshire has been acting as a drag on growth in Scotland as a whole, and this has contributed to slower earnings growth in Scotland compared with the UK. We saw the same trend in 2020-21 and 2021-22.

Figure 2.6: Gap in Aberdeen City and Aberdeenshire's earnings and employment growth relative to the Scottish average

In 2024-25 and 2025-26, earnings and employment growth in Aberdeen has been a drag on growth in Scotland overall, contributing to Scotland's slower growth relative to UK



Description of Figure 2.6: Column chart showing the gap in Aberdeen City and Aberdeenshire's average earnings and employment growth relative to the respective Scottish averages, from 2020-21 to 2025-26. In 2020-21 and 2021-22, Aberdeen under-performed Scotland on both measures. In 2022-23 and 2023-24, Aberdeen's growth was in line with the Scottish average (gaps around zero). In 2024-25 and 2025-26, it was again below the Scottish average (in 2025-26, negative gaps of 1.6 percentage points for earnings and 0.9 percentage points for employees).

Source: Scottish Fiscal Commission, ONS (2026) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – July 2026.

2.18 While there will be many factors affecting earnings and employment in Aberdeen City and Aberdeenshire, the long-term decline in North Sea activity is the main driver of slower earnings and employment growth in this region. In the shorter term, fluctuations in oil and gas prices, demand for fossil fuel products, production decisions, and offshore investment are likely to contribute to volatility in earnings and employment.

2.19 As North Sea oil and gas activity continues to decline, its impact on future Scottish earnings and employment growth will lessen. Over the last decade, Aberdeen City and Aberdeenshire have moved from being the region with the highest earnings in Scotland to third place behind the City of Edinburgh and Glasgow City. Aberdeen City and Aberdeenshire's share of total Scottish earnings has fallen by around 25 per cent over this time. In the future, Scotland's economic performance will be driven more by Edinburgh and Glasgow and the sectors dominating these economies including financial and professional services and public administration.

Chapter 3
Funding

3.1 Funding for the Scottish Budget comes from many sources. Some, like the Block Grant and the Block Grant Adjustments (BGAs) are determined or influenced by UK Government decisions. Others, like devolved tax revenues, borrowing or drawdowns from the Scotland Reserve are controlled or at least influenced by the Scottish Government.

3.2 In this chapter we discuss developments since January 2026 that are important for the funding outlook.

The UK Spring Forecast 2026 led to more Block Grant funding

3.3 Shortly after the Scottish Parliament passed the 2026-27 Budget, the UK Spring Forecast confirmed a significant increase in the Block Grant in 2026-27 and 2028-29.[15]

3.4 This largely came from two UK Government decisions related to Special Education Needs and Disability (SEND) announced earlier in February 2026.

- Writing off 90 per cent of the debts English local authorities had accrued in relation to SEND, up to and including 2025-26.[16] This measure, worth £5.6 billion, required an increase in the resource budget for the Ministry of Housing, Communities and Local Government (MHLGC).[17]

- Increasing the Department for Education (DfE) budget by £3.5 billion in 2028-29 so that schools are better equipped for children with SEND.[18]

3.5 Figure 3.1 shows the additional Block Grant funding resulting from these UK Government decisions on devolved spending. Most comes in the current financial year, almost £542 million in 2026-27, with a small addition in 2027-28 and almost £345 million in 2028-29. The level of funding beyond 2028-29 will be confirmed at the next UK Spending Review.

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[15] HM Treasury (2026) Spring Forecast 2026: The right economic plan for Britain. This was the first time an OBR forecast was not accompanied by new welfare or tax policies. Instead, tax policies that had been announced since the last forecasts were included, such as Business Rates reliefs.

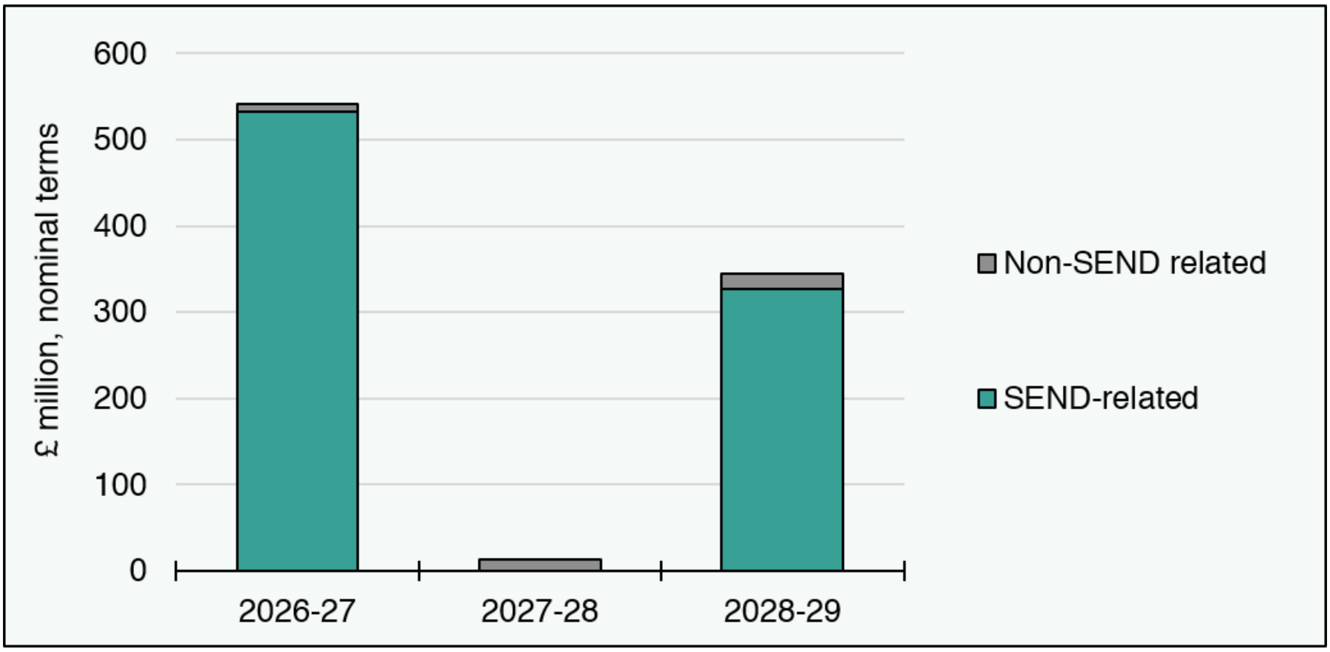
[16] Ministry of Housing, Communities and Local Government (2026) Communities set to benefit from fairer funding.

[17] The deficits had added to annually managed expenditure (AME) as loans were taken out by local authorities. Writing off 90 per cent of that debt was therefore fiscally neutral from a UK-wide perspective (a move from AME to departmental budgets). However, the resulting Barnett consequentials for devolved administrations were new spending.

[18] Department for Education (2026) Specialist SEND support in every school and community.

Figure 3.1: Additional Block Grant funding from the UK Spring Forecast 2026

Large increases to the Block Grant in the current year and 2028-29, but not in 2027-28



Description of Figure 3.1: Column chart showing increases to the Scottish Block Grant from 2026-27 to 2028-29. Most of the new funding is in 2026-27 and 2028-29, with almost nothing in 2027-28. Most of it is related to Special Education Needs and Disability (SEND) policies. There was £38 million of further funding in 2026-27 for the SEND debt write off which is not included in this chart.

Source: Scottish Fiscal Commission, HM Treasury, Scottish Government.

The UK Government is placing greater priority on defence

3.6 In Autumn 2024, the then newly elected UK Government substantially increased overall investment, leading to large increases to the capital Block Grant. However, the uplift was mostly frontloaded. The Spending Review in June 2025 confirmed capital budgets were expected to remain broadly flat in nominal terms after the uplift, leading to real-terms reductions to the capital Block Grant from 2027-28 onwards.

3.7 In June 2026, the UK Government published the Defence Investment Plan (DIP).[19] The DIP had an associated funding package of £15 billion above the Spending Review settlements concluded in June 2025. To partly fund the plan, £6.8 billion worth of reductions to departmental capital budgets were announced. This is one per cent of capital budgets for most departments, but more than that for the Department for Transport (DfT) and the Department for Energy Security and Net Zero.

[19] UK Government (2026) The Defence Investment Plan Funding explainer.

3.8 This reprioritisation from devolved areas to the reserved area of defence will affect the capital Block Grant. The Scottish Government does not get extra Block Grant funding when the UK Government increases defence spending, because the MoD spends it on behalf of the whole of the UK. As devolved UK Government spending will reduce to pay for the DIP, the capital Block Grant is likely to fall further than we had expected before the plan was unveiled.

3.9 There also remains £7 billion of capital spending in the DIP which is unfunded.[20] How this is to be funded is to be confirmed at the next UK Budget on 28 October 2026.

Overall resource funding for the Scottish Budget will depend on how the UK Government deals with recent fiscal pressures

3.10 Since the UK Spring Forecast 2026, there have been other UK Government announcements which will affect both devolved and reserved spending and tax revenues.

3.11 There have been changes to reserved taxes. In May 2026, the UK Government announced extra reliefs on fuel duty and road tax in response to rapidly rising fuel costs as the conflict in the Middle East escalated.[21] Following the change in the UK Prime Minister in July 2026, the UK Government announced cuts to VAT on household electricity bills.[22] All those reliefs will reduce UK tax revenues compared with the OBR's March 2026 forecasts.[23]

3.12 We discussed in Chapter 2 how increasing inflation can increase tax receipts. However, it also adds to the spending pressures on the UK Government. Inflation increases the cost of servicing the national debt, because many gilts are inflation-linked. It also increases the cost of borrowing further, as markets demand greater returns. The cost of delivering public services increases, both directly as goods and services are purchased, and through demand for higher pay rises in the public sector. And since the UK Government generally chooses to uprate benefits in line with inflation, it also adds to welfare spending.

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[20] The DIP Funder Explainer states that £4.7 billion is what is currently unfunded. We understand that the £2.4 billion of HM Treasury support, while slightly different to an increase to the MoD's budget, is also unfunded. UK Government (2026) The Defence Investment Plan Funding explainer.

[21] HM Treasury (2026) Chancellor protects drivers and businesses from rising fuel costs.

[22] UK Government (2026) New PM cuts tax on household electricity bills to give breathing space on cost of living.

[23] The VAT relief is to be paid by cancelling the Digital ID programme, but that programme itself was not funded when it was announced in October 2025: it was after the Spending Review had concluded and the subsequent UK Budget 2025 did not allocate new money to it.

3.13 The UK Budget on 28 October 2026 will be important in setting the direction of the new UK Government. The UK Government will have to balance changes in revenue forecasts, new spending commitments, and higher costs of delivery, against achieving its fiscal rules. The UK Government has some headroom against those – in March 2026 this was forecast to be £24 billion by 2029-30. The UK Government could also increase taxes or reduce other spending, or a combination of all of them. Any changes in devolved areas will result in changes to devolved funding.

3.14 If spending cuts or tax rises are in devolved areas, the Scottish Government's resource funding levels will fall through several channels:

- Reductions in departmental budgets would reduce the Block Grant
- Cuts to welfare would reduce the social security BGAs, reducing funding
- UK Government tax rises would increase the tax BGAs, reducing funding

3.15 The overall effect on the Scottish Budget will depend on the extent to which spending cuts or tax rises are in devolved areas. If there is a reduction in resource funding, it is then up to the Scottish Government to decide how to respond. It could choose to reduce spending in some areas, raise more from devolved taxes, or a combination of the two.[24]

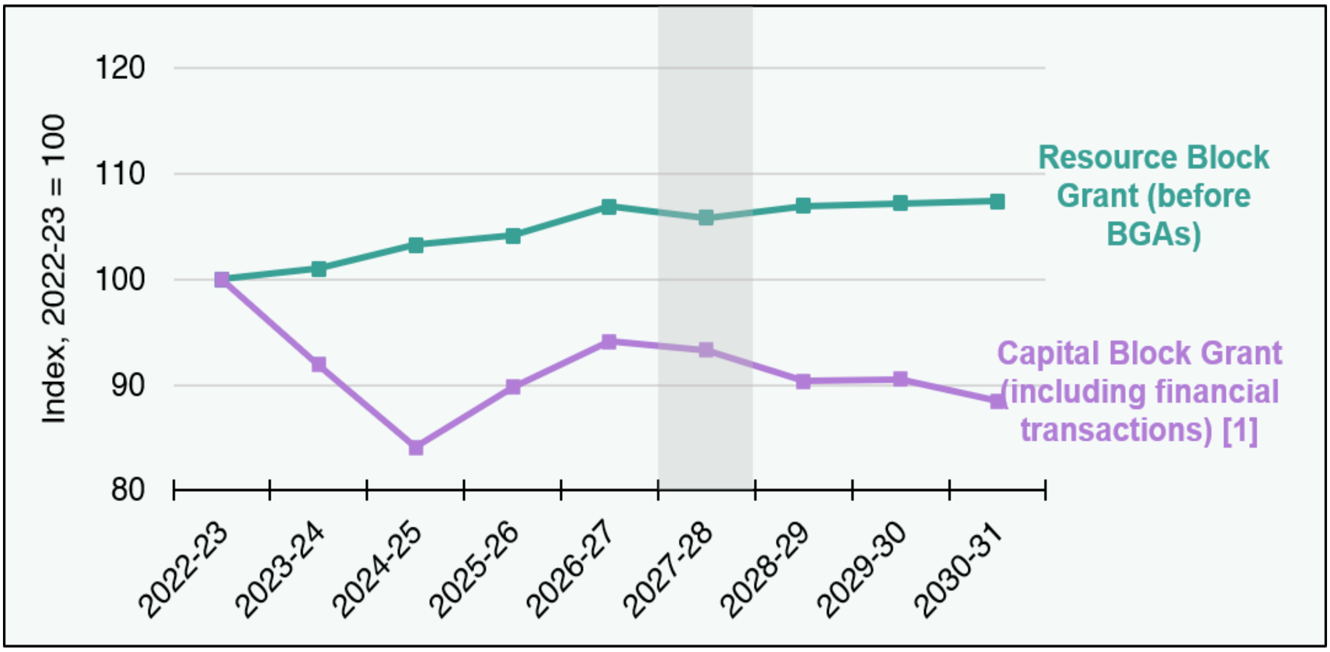
Before these developments, the Block Grant for 2027-28 was already expected to fall in real terms for both resource and capital

3.16 Figure 3.2 shows the latest position for the Block Grant. This shows real terms falls in both the resource and capital Block Grants for the next budget year, 2027-28. While real-terms falls had been seen already for capital in 2023-24 and 2024-25, it is the first time since 2022-23 that the resource Block Grant is expected to fall.

[24] The Scottish Parliament has powers over Non-Domestic Rates, Income Tax for non-savings, non-dividend income, Land and Buildings Transaction Tax, Scottish Landfill Tax, and Scottish Aggregates Tax. Air Departure Tax is to be devolved from April 2027.

Figure 3.2: Resource and capital Block Grant trends since 2022-23

Both the resource and capital block grants are expected to fall in real terms in 2027-28



Description of Figure 3.2: Line chart showing trends for the resource and capital Block Grants since 2022-23. The resource Block Grant grows steadily until 2026-27 but falls in 2027-28 for the first time. It rises again slightly in 2028-29 and then remains broadly flat for the remaining of the period, ending up 7.5 per cent above 2022-23 levels in 2030-31. The capital Block Grant falls rapidly in the first two years, having lost by 2024-25 15 per cent of its value relative to 2022-23 levels. But it recovers rapidly over the following two years. From 2027-28 onwards it falls in real-terms again, more slowly than initially, and by 2030-31 it ends up almost 10 per cent below its 2022-23 level.

Source: Scottish Fiscal Commission, Scottish Government.

Shaded area shows the next Budget year (2027-28).

Real-terms amounts have been calculated applying the latest OBR forecasts of growth in the GDP deflator (March 2026) to the latest funding positions for each year. For more details on those, see supplementary figures S.3.1 and S3.2.

[1] Includes a reduction from the UK Government's Defence Investment Plan, based on SFC assumptions.

3.17 For resource, the Block Grant is forecast to grow again slightly in 2028-29 mainly because of the SEND consequentials. The Scottish Government assumes Block Grant funding will keep growing slightly beyond the Spending Review period. This is both because it has assumed that the increase to DfE's budget in 2028-29 is a permanent uplift, and because it assumes that the overall Block Grant will grow by 0.2 per cent in real terms.[25]

[25] This in line with the Scottish Government methodology, when setting the 2026-27 Budget in January 2026, on how to forecast the Block Grant beyond the current UK Spending Review.

3.18 For capital, the trend of real-terms falls is expected to continue well into the medium term. In the absence of confirmed Barnett consequentials from the UK Government's DIP, we have assumed a reduction to the capital Block Grant from 2026-27 to 2029-30 based on the announced measures that partly fund the plan. This reduces the capital Block Grant by £70 million in the current year 2026-27, by £87 million in the upcoming 2027-28 Budget, and reaching £97 million by 2029-30.

3.19 These forecasts of the Block Grant are likely to change following the UK Budget in October 2026. As the UK Prime Minister and Chancellor have changed in July 2026, it is likely there will be updates to the short-term and long-term fiscal plans for the UK and the relative balance of spending between devolved and reserved areas. The UK Budget on 28 October 2026 will confirm how these changes translate to the Scottish Government's Block Grant.

The Income Tax reconciliation applying to the next budget will reduce resource funding further

3.20 Funding for the Scottish Budget in 2027-28 will be reduced by £720 million as a result of a negative Income Tax reconciliation, which corrects funding for forecast errors in the 2024-25 Budget. This is the largest Income Tax reconciliation to date, despite our forecast for 2024-25 having our smallest ever error for a Budget setting forecast. The large reconciliation occurs because both our and OBR forecast errors mean a reduction in funding for the Scottish Budget, combining to make a large negative reconciliation.

3.21 The Scottish Government can borrow to offset the effect of the £720 million reconciliation in 2027-28, but the reconciliation is likely to exceed the expected borrowing limit.[26] This means there will likely be a reduction to resource funding in 2027-28 even if the Scottish Government borrows the maximum possible. This section explains the reconciliation in more detail.

3.22 The contribution of Income Tax to the Scottish Budget is based on forecasts from both, us and the OBR. When outturn data on tax revenues in Scotland and the rest of the UK becomes available, the forecast error is calculated, and adjustments are made to a later Scottish Budget. This process is known as a reconciliation.[27]

3.23 In the 2024-25 Scottish Budget, Income Tax funding was set by comparing our December 2023 Scottish Income Tax (SIT) forecast to the Income Tax BGA forecast at the time, which was based on the OBR's November 2023 forecast of Non-Saving, Non-Dividend (NSND) revenues in England and Northern Ireland.

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[26] Since 2024-25, the borrowing limit rises in line with inflation. It will be uprated with the OBR's forecast of growth in the GDP deflator in 2027-28, which will be published in October 2026. Based on the latest OBR forecasts in March 2026, we estimate the limit in 2027-28 would be £670 million.

[27] For more details, see Scottish Fiscal Commission (2026) Understanding Scottish Income Tax reconciliations.

3.24 Final Income Tax outturn data for 2024-25 was published by HMRC in July 2026.[28] Figure 3.3 shows that Scottish Income Tax revenues were £209 million lower than the budget setting forecast, while the Income Tax BGA, which reduces funding for the Scottish Budget, has become £512 million more negative. Both errors have a negative effect on Scottish funding and combine to make a larger negative reconciliation.[29]

Figure 3.3: SIT and BGA outturn for 2024-25 compared with budget-setting forecasts

£ million	Scottish Income Tax (SIT)	Block Grant Adjustment (BGA) [1]	Income Tax net position
December 2023 (budget-setting)	18,844	-17,432	1,412
July 2026 outturn	18,635	-17,943	692
Change	-209	-512	-720

Source: Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023, HMRC (2026) Scottish Income Tax Outturn Statistics: 2024 to 2025.

[1] Tax BGAs are negative because they reduce funding for the Scottish Budget.

Figures may not sum because of rounding.

3.25 The resulting negative £720 million reconciliation to be applied in the 2027-28 Scottish Budget is the largest Income Tax reconciliation since it was devolved to the Scottish Parliament. This is despite a record low forecast error for Scottish Income Tax, and a modest forecast error in the BGA.

3.26 Figure 3.4 shows that the Scottish Income Tax and BGA forecast errors in 2024-25 are a lot smaller than in the three preceding years. Between 2021-22 and 2023-24 there was a period of unexpectedly high inflation. This meant that nominal earnings growth in those years was a lot higher than both we and the OBR had forecast. Consequently, Scottish Income Tax and BGA outturn were a lot higher than the budget setting forecasts for those years. However, these errors cancelled each other out, which resulted in reconciliations that were smaller than the underlying errors.

3.27 For 2024-25, even though the errors are smaller than in recent years, they both lead to a reduction in funding. They combine to result in a larger reconciliation than each underlying error. The possibility of this outcome is a feature of the fiscal framework and a risk we have highlighted in recent publications.[30]

[28] HM Revenue and Customs (2026) Scottish Income Tax Outturn Statistics: 2024 to 2025.

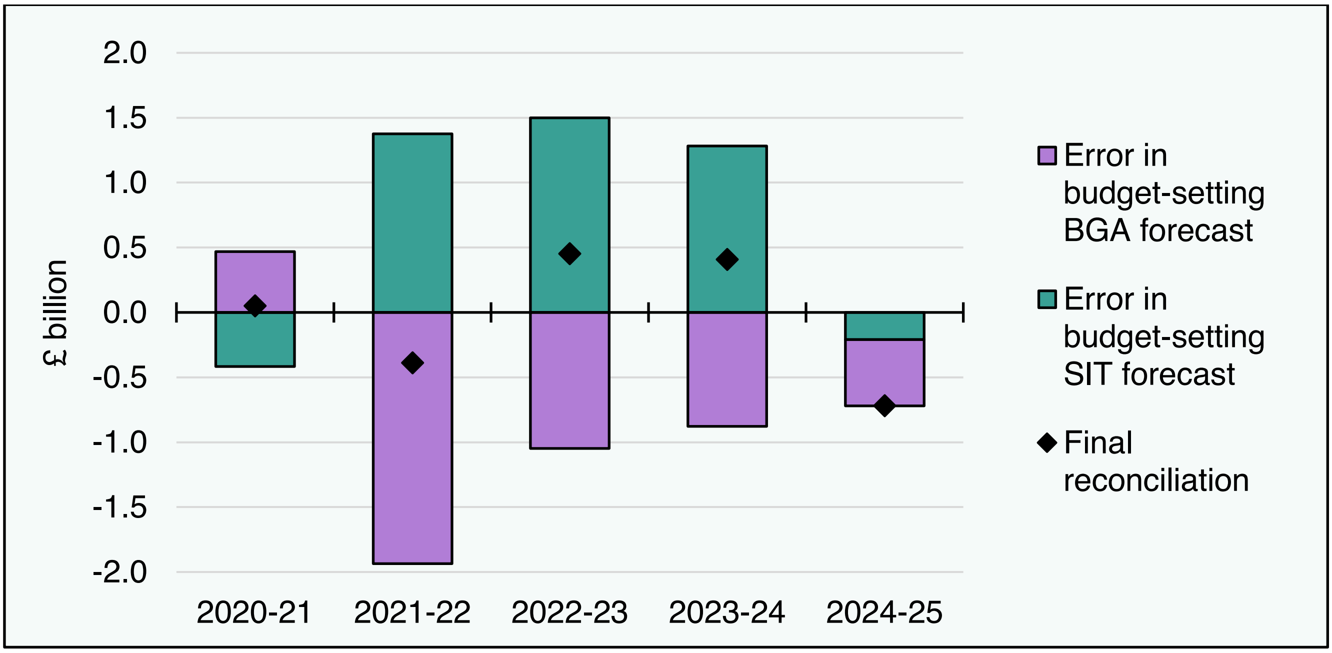
[29] For more details, see Scottish Fiscal Commission (2026) Forecast Evaluation Report – August 2026

[30] See section Probability of Income Tax reconciliation in Scottish Fiscal Commission (2025) Fiscal Update – August 2025.

3.28 Income tax revenues are uncertain and both our and OBR forecast errors can be positive or negative. It will not be unusual to have our and OBR forecast errors that point in opposing directions and combine to make larger reconciliations. Looking back over the last five years of reconciliations in Figure 3.5, the more unusual feature may be having our and OBR forecast errors offsetting each other, leading to smaller reconciliations.

Figure 3.4: Make-up of Income Tax reconciliations since 2020-21

Even though errors for the 2024-25 reconciliation were relatively small, they compounded and led to the largest reconciliation to date



Description of Figure 3.4: A combined stacked column and scatter chart. The stacked columns show how changes in the BGA and SIT forecasts compare with outturn. The scatter markers show the final reconciliation resulting from these changes. From 2020-21 to 2023-24, both errors broadly offset each other, leading to relatively small reconciliations. For 2024-25, both errors were relatively small, but it is the first time they both negatively contribute, resulting in the largest reconciliation to date.

Source: Scottish Fiscal Commission.

3.29 Figure 3.5 shows how the negative £720 million reconciliation compares with previous years. There were negative reconciliations applied to the 2021-22 and 2024-25 Budgets, but these were both within the borrowing limits at the time. In 2021-22, the reconciliation was fully covered by borrowing, so that the impact could be smoothed out over a few years. In 2024-25 no resource borrowing was used, even though it was available, because of the large in-year increase to the Block Grant following the UK Budget 2024.

3.30 Scottish Income Tax revenues have risen by 57 per cent from £11.9 billion in 2020-21 to £18.6 billion in 2024-25 largely because of increased earnings through a period of high inflation, while tax thresholds have remained largely frozen. As revenues increase, Scottish Income Tax and BGA forecast errors also tend to increase, making larger reconciliations more likely. The latest reconciliation at £720 million is almost double the £390 million reconciliation for 2021-22, but it represents a similar share of total revenue.

3.31 Our previous modelling suggests that we are likely to see both positive and negative reconciliations of a similar magnitude to the £720 million reconciliation for 2024-25 fairly frequently. In addition, with Income Tax revenues rising over time, in part simply because of inflation and rising nominal earnings, reconciliations are also likely to get larger over time. This is a feature of the fiscal framework, and the Scottish Government must be prepared for the possibility of similar or larger reconciliations occurring in future. The Scottish Government's borrowing limit rises in line with inflation, but this may be less than the likely trajectory for future reconciliations which will grow with nominal earnings.

Figure 3.5: Outturn Scottish Income Tax reconciliations, 2017-18 to 2024-25

Budget year	Reconciliation (£ million)	Borrowing limit (£ million) [2] [3] [4]	Relates to Income Tax collected in	Reconciliation (percentage of SIT revenue in collection year)
2020-21	-198	300	2017-18 [1]	-1.8
2021-22	-302	600	2018-19 [1]	-2.6
2022-23	-28	600	2019-20 [1]	-0.2
2023-24	50	600	2020-21	0.4
2024-25	-390	610	2021-22	-2.8
2025-26	451	629	2022-23	3.0
2026-27	406	657	2023-24	2.4
2027-28	-720	670	2024-25	-3.9

Source: Scottish Fiscal Commission.

[1] Reconciliations include the corrected outturn as published in HMRC's 2021-22 statistical release. There was a reduction of around £7 million in each year compared with the reconciliation applied in the Budget.

[2] A Scotland-specific economic shock, as defined in the original 2016 fiscal framework, was triggered in January 2021 following our economic and fiscal forecasts, doubling the borrowing limit for the next three financial years (2021-22 to 2023-24).

[3] Following the 2023 fiscal framework review, the higher borrowing limit of £600 million became the standard and from 2024-25 has risen with inflation as measured by growth in the GDP deflator.

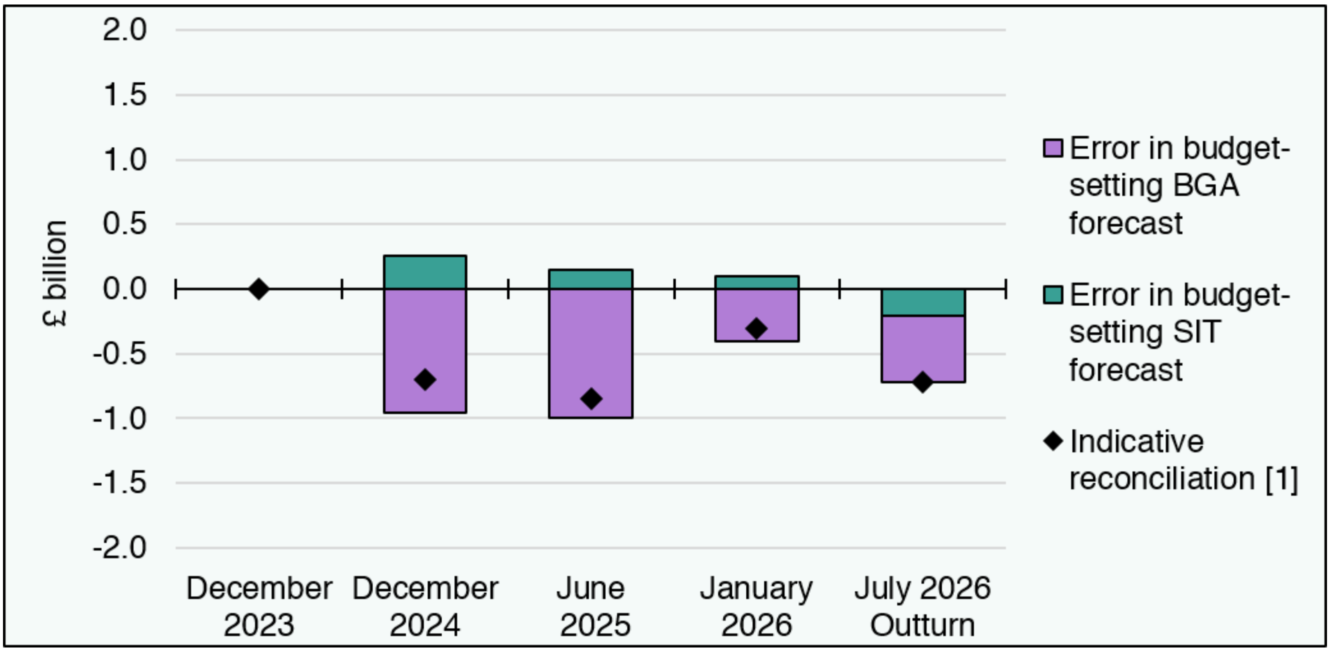
[4] The 2027-28 borrowing limit is indicative, based on the latest OBR's March 2026 forecast of growth in the GDP deflator for 2027 28. It will be uprated in line with the OBR forecast alongside the UK Budget 2026 on 28 October 2026.

Indicative 2024-25 reconciliations

3.32 Since the December 2023 budget setting forecast we have been projecting indicative reconciliations by comparing our more recent forecasts to those of the OBR. These have informed the forecast of resource funding in 2027-28 both in the 2025 Medium-Term Financial Strategy (MTFS) documents and the Scottish Spending Review of January 2026. Figure 3.6 shows how changes to our Scottish Income Tax forecast and changes to the BGA based on the OBR's forecast of Income Tax in England and Northern Ireland have affected the indicative reconciliations for 2024-25. The changes to the BGA have been much larger than changes to Scottish Income Tax.

Figure 3.6: Change in the 2024-25 indicative reconciliations over time

The variation in indicative reconciliations is mostly attributed to changes in the BGA



Description of Figure 3.6: Stacked column chart showing changes in SIT and BGAs, from the budget setting forecasts in December 2023 to outturn in July 2026. It also has a marker showing the indicative reconciliation at each forecast, and at outturn. The indicative reconciliation hovers around negative £500 million at each of the forecasts after December 2023 but always driven more by changes in the forecast BGA. The outturn position of negative £720 million is the first time that the errors on both sides add up rather than offset each other.

Source: Scottish Fiscal Commission.

[1] July 2026 shows the final reconciliation.

In an inflationary environment, past decisions to raise Income Tax rates and freeze thresholds could accelerate fiscal drag

3.33 The Income Tax net position was projected to grow, approximately from £1.0 billion in 2026-27 to £1.4 billion in 2027-28. But this was based on forecasts from both us and the OBR produced in January 2026 and November 2025 respectively.

3.34 Neither us nor the OBR could have included in the forecast the effects of the unexpected global events like the escalation of the conflict in the Middle East. Therefore, there is high uncertainty around the net position for 2027-28.

3.35 Higher inflation tends to increase tax revenues, especially for Income Tax. If higher inflation in 2027-28 is sustained, it is likely to mean somewhat higher nominal earnings growth in both Scotland and the rest of the UK. This would push up both our forecasts of Scottish Income Tax, and those of OBR for England and Northern Ireland, which underpin the Income Tax BGA. As we have discussed in previous reports, higher nominal earnings growth can lead to higher revenue growth in Scotland than the rest of the UK due to lower frozen tax thresholds.[31,32] This could lead to a modest improvement in the tax net position if average earnings growth in Scotland keeps pace with the UK.

3.36 On the other hand, Income Tax outturn data was £300 million less for 2024-25 than we had last forecast in January 2026. In isolation, this data will reduce our forecasts of Scottish Income Tax revenues by a similar amount. In addition, the outturn data showed the Income Tax BGA to be slightly higher than anticipated, further reducing the Income Tax net position, and we may see this effect impacting future forecast years.

3.37 The projected tax net position will become clearer when we and the OBR produce new forecasts towards the end of 2026. These will factor in Scottish Government policies for its 2027-28 Scottish Budget and UK Government policies in its 2026 Budget respectively as well as updated economic forecasts.

Outturn data shows a lower net position than expected, and a larger tax base performance gap between Scotland and the UK

3.38 Under the current fiscal framework, the Income Tax net position can move up and down because of differences in tax policies and the performance of the tax bases in Scotland and the rest of the UK. The tax base performance gap measures how the performance of the tax base in Scotland compares with that of the rest of the UK.

3.39 To calculate this, we look at an illustrative scenario where we assume Scotland's tax base grew in line with the UK, by matching the rest of the UK in earnings and employment growth.

3.40 In this illustrative scenario, which we refer to as 'policy-only', we show how much funding the Scottish Budget could have received purely from the generally higher Scottish tax rates compared with those in place in the rest of the UK. We last updated it in January 2026 and Figure 3.7 shows a policy-only net position of £1,579 million for 2024-25. When compared with the outturn net position, we can calculate a negative tax base performance gap of £888 million in 2024-25. This is £410 million larger than our January 2026 figure because of the lower than projected outturn net position.

3.41 The tax base performance gap occurs because of many factors. The most significant is slower aggregate earnings and employment growth in Scotland than in the rest of the UK. Behavioural responses from taxpayers to policy changes, differences in the sectoral make-up of the Scottish economy, and the different distribution of incomes in Scotland and in the rest of the UK are important factors.

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[31] See Box 4.1 in Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023.

[32] For more detail on fiscal drag, see Scottish Fiscal Commission (2026) Fiscal drag drives revenues – 24 February 2026.

Figure 3.7: Tax base performance gap, 2020-21 to 2024-25

Collection year	Policy-only Income Tax net position (£ million)	Income Tax net position (£ million)	Tax base performance gap (£ million)	Tax base performance gap (percentage of SIT revenue)
2020-21	637	96	-540	4.6
2021-22	747	85	-662	4.9
2022-23	877	260	-617	4.1
2023-24	1,227	730	-497	2.9
2024-25	1,579	692	-888	4.8

Source: Scottish Fiscal Commission (2026) Scotland's Economic and Fiscal Forecasts – January 2026, HMRC (2026) Scottish Income Tax Outturn Statistics: 2024 to 2025.

3.42 The policy-only net position rises by £352 million between 2023-24 and 2024-25. This accounts for the continued cumulative effect of policy differences up to 2023-24 and the effect of new policies introduced in 2024-25. In that year, the Scottish Government introduced the advanced rate for taxpayers with income above £75,000 and increased the top rate from 47 per cent to 48 per cent.

3.43 The actual Income Tax net position decreased by £39 million between 2023-24 and 2024-25. This does not necessarily mean that the policy changes did not raise additional revenue. Our December 2023 policy costings forecast the changes would raise £82 million in 2024-25. The Income Tax net position will have most likely fallen due to the ongoing slower growth in earnings and employment in Scotland (see next section), which widened the tax base performance gap.

3.44 Scottish Income Tax revenues have increased from around £12 billion in 2020-21 to almost £19 billion in 2024-25 following a period of high inflation. It is important to view the tax base performance gap in this context. Figure 3.7 shows that the gap is similar to what it was at the start of the decade when taken as a percentage of Scottish Income Tax revenue.

Slower growth in earnings and employment levels in Scotland still explains most of the tax base performance gap

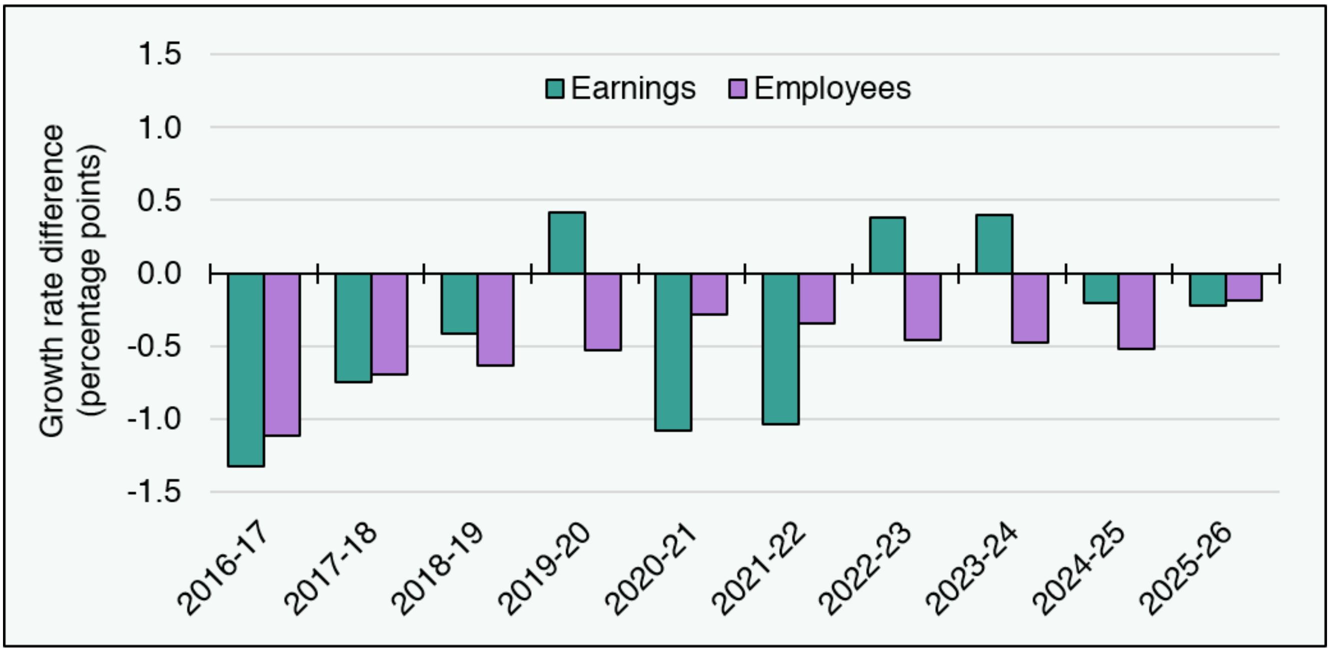
3.45 Growth in average earnings and the number of employees in Scotland lags behind the UK, based on RTI data, as shown in Figure 3.8. We believe these are the main drivers behind the tax base performance gap.

3.46 Over the last ten years, average earnings in Scotland have grown, on average, by 0.4 percentage points less than in the UK year-on-year. The latest data for 2025-26 points to a smaller gap, with Scotland lagging the UK by a more modest 0.2 percentage points. Since 2016-17, average earnings in Scotland have fallen from being over 94 per cent of the average seen across the UK as a whole, to less than 92 per cent in 2025-26. This slower growth in average earnings will have a direct effect on Scottish Income Tax revenues, the Income Tax net position and the tax base performance gap.

3.47 The UK tends to have higher population growth than Scotland, by around 0.2 percentage points on average, and this can be expected to lead to faster growth in the number of employees in the UK. The calculation of the Income Tax BGA takes account of the difference in total population growth. However, even controlling for differences in population growth, the growth in the number of employees in Scotland has also lagged the UK, further contributing to the negative tax base performance gap.

Figure 3.8: Difference between Scottish and UK earnings and employee growth

Scottish average earnings and employee growth has been below the UK as a whole for most of the last decade



Description of Figure 3.8: A column chart showing the difference between annual growth in average earnings and the number of employees in Scotland and the UK as a whole. Employee numbers have since 2016-17 always grown more slowly in Scotland than in the UK. That is also the case for average earning, except for three years (2019-20, 2022-23, 2023-24) when Scottish earnings growth outpaced that of the UK.

Source: Scottish Fiscal Commission, ONS (2026) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – July 2026.

3.48 This slower growth in average earnings and employees in Scotland is the main contributor to the negative and widening tax base performance gap. To close it, Scotland would need to see a sustained period of earnings and employment growth above the UK, reversing the picture seen in Figure 3.8.

Some Scottish Government decisions could lift funding levels in 2027-28, but come with trade-offs

3.49 While the Block Grant is the most significant source of devolved funding, there are other sources over which the Scottish Government has discretion.

3.50 Since 2022-23, the growth of the resource Block Grant has generally been lower than growth in other resource funding sources. The Block Grant is currently expected to fall by 1 per cent in real terms in 2027-28, with the latest plans and forecasts for the other resource funding sources pointing to a larger real-terms fall by 1.9 per cent. As a result, overall resource funding is currently expected to fall by 1.2 per cent between 2026-27 and 2027-28.

3.51 Many unknowns remain until the UK Budget on 28 October 2026 and subsequent Scottish Government tax decisions for its next 2027-28 Scottish Budget. However, some decisions to be made next month for 2026-27 at the Autumn Budget Revision (ABR), the first opportunity for the new Scottish Government to amend the 2026-27 Budget, could be reviewed in light of the likely challenging funding position for 2027-28.

3.52 For example, the 2026-27 Budget was set based on £150 million being drawn down from the Scotland Reserve for resource spending. Final outturn for 2024-25 and provisional outturn for 2025-26 confirms that more than this balance is available, which is £312 million. Figure 3.9 is based on an assumption the Government will draw down all the money available from all accounts of the Scotland Reserve (resource, capital and financial transactions) in 2026-27 as set out in its provisional outturn statement.[33] The extra Block Grant from the UK 2026 Spring Forecast gives a substantial funding increase in 2026-27, but very little in 2027-28. Alternatively, the Scottish Government could retain some of that extra Block Grant funding in the Reserve to use in 2027-28. Doing so with the full amount would mean that resource funding would no longer fall in real terms in 2027-28.

3.53 However, that would mean lower real-terms growth in 2026-27. In addition, the Scotland Reserve would be near its limit, which in 2026-27 is £782 million.[34] This could restrict the level of underspends in the current year which could be stored for future years and make in-year budget management more difficult. That is because, if underspends exceed the room left in the reserve, those funds will be lost to the Scottish Government.

[33] Paragraph 3 of Scottish Government (2026) Scottish Budget – provisional outturn 2025-2026: briefing note – 18 June 2026.

[34] The reserve limit will be uprated again in 2027-28 based on the OBR's forecast of growth in the GDP deflator at the UK Budget in October 2026. The OBR's forecasts from March 2026 imply a limit of £797 million in 2027-28.

Figure 3.9: Balances in other discretionary sources of funding as of August 2026

£ million, nominal terms	2022-23 outturn	2023-24 outturn	2024-25 outturn	2025-26 outturn [1]	2026-27 plans [2]	2027-28 plans
Scotland Reserve [3]						
Opening balance	699	327	411	598	361	0
Drawdowns	-699	-327	-409	-595	-361	0
Additions	327	411	595	358	0	0
Closing balance	327	411	598	361	0	0
Crown Estate						
Opening balance	755	659	659	713	723	644
Drawdowns	-96	0	0	0	-80	-328
Additions	0	0	54	10	0	0
Closing balance	659	659	713	723	644	316

Source: Scottish Government, Scottish Fiscal Commission.

[1] Provisional outturn. Final outturn will be confirmed when the Scottish Government Consolidated Accounts for 2025-26 are published in late 2026 or early 2027.

[2] Assumes the Scottish Government draws down all available balance from the Scotland Reserve in 2026-27 as set out in its provisional outturn statement.

[3] Resource, general capital, and financial transactions combined.

Figures may not sum because of rounding.

Other Scottish Government choices could make the funding position for 2027-28 less challenging with less financial risk

Crown Estate Scotland

3.54 In our 2025 Fiscal Update, we showed how the Scottish Government has reduced its use of the Scotland Reserve since 2022-23.[35] This coincided with a substantial new stream of revenues from Crown Estate Scotland, ScotWind. The use of Crown Estate revenues is not subject to the same limits as the Scotland Reserve, and it can be used for capital or day-to-day spending. Therefore, the Scottish Crown Estate has been used as a flexible tool that supplements the Scotland Reserve in helping the Scottish Government balance its budget within and between years.

[35] See Figure 3.2 in Scottish Fiscal Commission (2025) Fiscal Update – August 2025.

3.55 As shown in Figure 3.9, the 2026-27 Budget also planned to use almost £80 million of Crown Estate revenues for resource spending. The Scottish Government has generally planned to use revenues from the Crown Estate to support the resource budget and then reduced this planned use towards the end of the year as it became clearer the Budget could be balanced without this funding.

3.56 Using the Crown Estate revenues avoids the issues with the limit of the Scotland Reserve. Therefore, given the increase in resource funding for 2026-27, there is also scope for the Scottish Government to revise its planned use of Crown Estate revenues.

Non-Domestic Rates

3.57 Revenue from Non-Domestic Rates (NDR) is included in the Scottish Budget as the Distributable Amount. These are the revenues redistributed to local authorities. They are different from what is collected (the Contributable Amount). The NDR pool reflects the balance between the two. It does not have to exactly balance each year, but generally the Scottish Government plans to bring the pool into balance in a future year.

3.58 Non-residential properties are revalued every three years, and 2026 is a revaluation year. Following a revaluation there are often many appeals, which can lead to refunds. NDR revenues therefore fall at points of the revaluation cycle, and we expect such a reduction in 2027-28.

3.59 Current plans are for the Distributable Amount to be smaller in 2027-28 than in 2026-27, and for this reduction to be larger than the fall in the Contributable Amount we last forecast in January 2026.

Capital borrowing

3.60 The Scottish Government's ability to offset future real-terms falls in the capital Block Grant through borrowing is now more limited. Under current plans to borrow around £300 million each year from 2027-28, debt will reach 91 per cent of the limit by the end of our last forecast horizon in 2030-31. While the Government could borrow more in any one year, it would mean reaching the overall capital borrowing limit sooner.

3.61 In its last Infrastructure Delivery Pipeline (IDP), the Scottish Government said it is actively exploring the use of private financing structures to overcome constraints to capital funding.[36] Previous private finance options did increase capital funding levels in the short term, but we note that they reduced resource funding in later years and have been proven to be more expensive than investment through direct borrowing.[37]

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[36] Scottish Government (2026) Infrastructure Delivery Pipeline 2026.

[37] "The Scottish Futures Trust calculated in April 2019 that lifetime costs of NPD and hub private finance projects signed under the pipeline approach were on average 2.9 times the construction cost of the assets. This compares with lifetime costs of 1.5 times the construction cost when using capital grants and between 1.9 and 2.6 times the construction cost when using public sector borrowing. The Scottish Government accepted these additional costs to allow additional infrastructure investment to be funded." Audit Scotland (2020) Privately financed infrastructure investment: the Non-Profit Distributing (NPD) and hub models.

Chapter 4
Spending

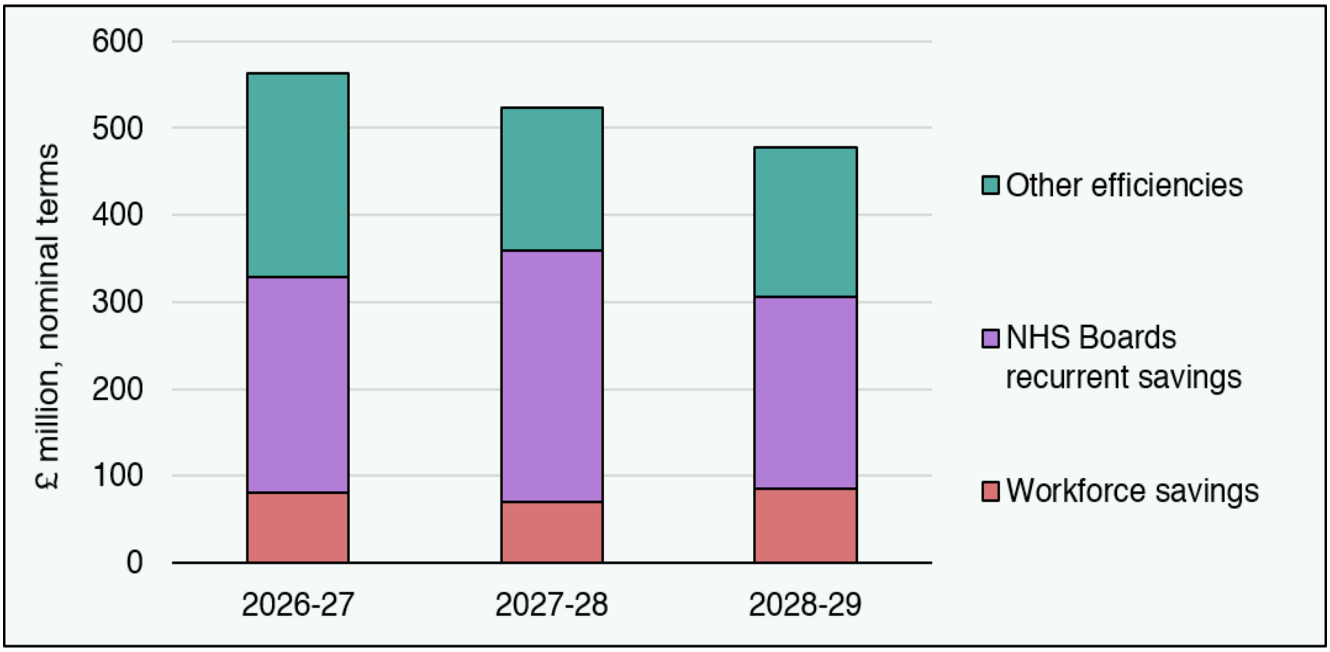
4.1 In this chapter we discuss developments since January 2026 that are important for the Scottish Budget's spending outlook.

Portfolios might need some of the extra funding in 2026-27 if not enough progress has been made to achieve planned savings

4.2 In January 2026, alongside the Scottish Spending Review (SSR), the Scottish Government published saving measures for each portfolio with varying level of detail.[38] Some measures had been outlined six months before in the Fiscal Sustainability Delivery Plan (FSDP) and in the Public Service Reform Strategy, but the SSR translated them into spending allocations.[39] Figure 4.1 shows that these were largest in the current financial year, 2026-27.

Figure 4.1: Efficiency savings factored into spending plans

Efficiencies built into Spending Review plans were an important part of how the Scottish Government balanced the budgets



Description of Figure 4.1: Stacked column chart showing the efficiency savings built into the spending plans for the years 2026-27 to 2028-29 at the Scottish Spending Review. The efficiencies are largest in 2026-27 and then decrease gradually. NHS Boards recurrent savings are the largest component in all cases, and they are greatest in 2027-28. Workforce savings also stand out as a concrete measure of savings in all three years.

Source: Scottish Fiscal Commission, Scottish Government.

For a breakdown of these planned efficiency savings by Scottish Government portfolio, see supplementary figure S4.1.

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[38] See 'Annex B: Portfolio Efficiency and Reform Plans' in Scottish Government (2026) Scottish Spending Review 2026.

[39] Scottish Government (2025) Fiscal sustainability delivery plan, Scottish Government (2025) Scotland's Public Service Reform Strategy: Delivering for Scotland.

4.3 Of the more than £1.5 billion efficiencies built into the spending allocations over the three years, almost half is expected to come from NHS boards finding recurrent savings of 3 per cent a year, which they can retain to fund other spending. These are planned to be largest next year, 2027-28.

4.4 The Institute for Fiscal Studies set out in a report before the recent Scottish election that NHS Scotland faces productivity challenges. It noted that, despite having 14 per cent more staff than before the COVID-19 pandemic, NHS Scotland was delivering fewer outpatient appointments than pre-pandemic.[40] And in its last thematic report, Audit Scotland stated that only 15 per cent of territorial boards and 37.5 per cent of special boards had achieved such levels of recurrent savings in 2024-25. Boards had required the highest level to date of in-year financial support from the Scottish Government of £230 million to balance its budgets.

4.5 The 2026-27 Budget was set in March 2026 with £563 million of efficiencies built into its spending plans. If not enough progress is being made on achieving them, there is a risk that portfolios will experience pressures and will need more funding to keep operating.

4.6 The Scottish Government has not yet reported on progress towards achieving these savings. But if there are spending pressures arising from this, the 2026-27 Autumn Budget Revision in September 2026 provides an earlier opportunity for the Government has to change its spending plans in 2026-27. As outlined in Chapter 3, even though more funding is available in 2026-27, using it all in-year would likely mean bigger challenges and more difficult decisions needed to balance the next Budget.

4.7 Figure 4.1 shows that another significant portion of those efficiencies of 15 per cent were to come specifically from workforce savings. Publicly available data shows there has been little progress reducing the size of the public sector workforce.

Little sign of progress towards reducing the size of the workforce

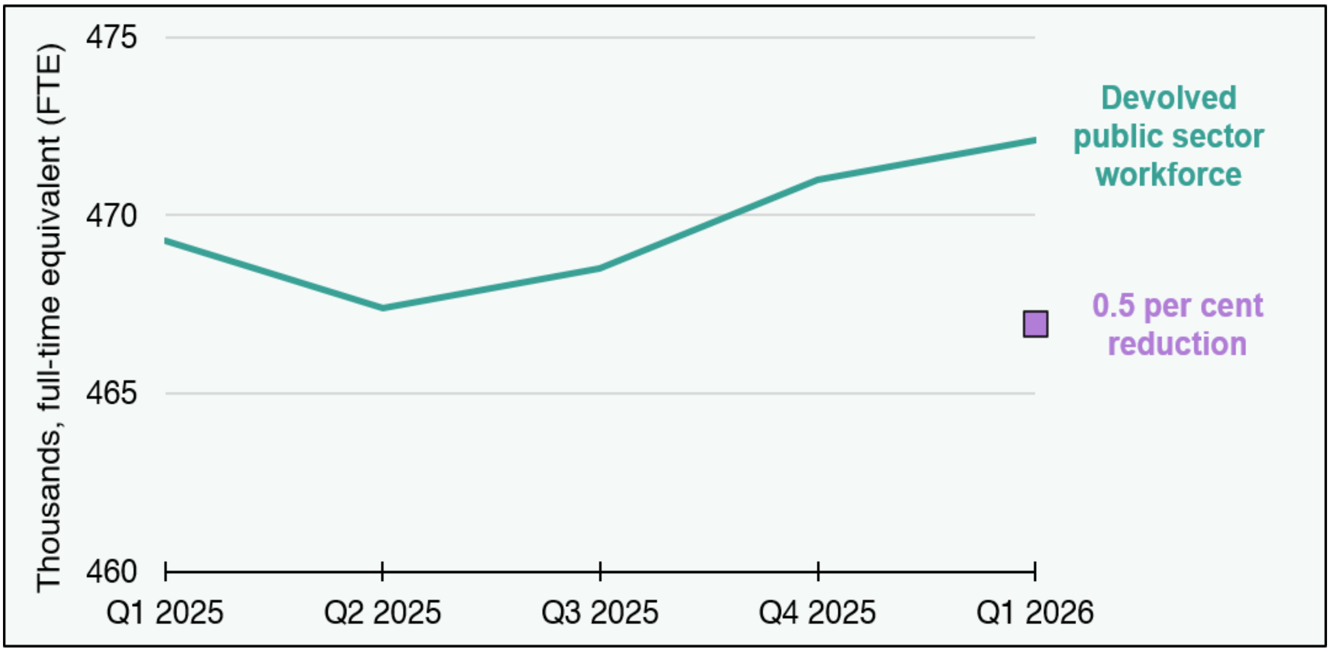
4.8 The Fiscal Sustainability Delivery Plan (FSDP) set out measures to close the fiscal gap projected in the 2025 Medium-Term Financial Strategy (MTFS). One of the most concrete measures was to reduce the public sector workforce by 0.5 per cent a year on average from 2025-26 to 2029-30.

4.9 Public sector employment statistics currently cover all of 2025-26, the first year for which the FSDP set out workforce reduction goals. Figure 4.2 shows that the devolved public sector workforce was higher at the end of 2025-26 than at the start.

[40] Institute for Fiscal Studies (2026) Public service spending and performance in Scotland.

Figure 4.2: Changes in devolved workforce size, quarter-to-quarter

In 2025-26 workforce size has not evolved in line with the FSDP targets



Description of Figure 4.2: Line chart showing the evolution of the devolved public sector workforce (in full time equivalent) from the end of the first quarter of 2025 to the end of the first quarter of 2026 (the 2025-26 financial year), with the vertical axis starting at 460,000 to zoom into the trend. The workforce shrank slightly in the second quarter of 2025, consistent with the goal in the Fiscal Sustainability Delivery Plan (FSDP) but grew in all subsequent quarters. It ended 2025-26 with around 5,100 more staff than the FSDP goal.

Source: Scottish Fiscal Commission, Scottish Government (2026) Public sector employment in Scotland.

4.10 The largest devolved public sector employer, NHS Scotland, ended 2025-26 with around 2,600 more staff. Public corporations also saw their workforce growingly rapidly, ending 2025-26 with around 1,000 more staff. [41] And although the Scottish Government has had for some years recruitment controls in place for its core workforce, the devolved civil service as a whole also finished the financial year with around 400 more staff.[42]

4.11 To meet the 2029-30 target set out in the FSDP, reductions of more than a 0.5 per cent a year are required in 2026-27 and beyond. This target was also based on the Scottish Government's pay policy at the time, and as we discuss next the latest inflation outlook means pay assumptions made in the FSDP and in the SSR may have been too low, meaning larger workforce reductions will be required.

[41] Public corporations are independent legal entities (normally limited companies) that cover more than 50 per cent of their operating costs from business revenues but are controlled by the government. Scottish Government's public corporations include Scottish Water, Prestwick Airport Limited, and Crown Estate Scotland.

[42] Scottish Government (2024) Progress on Scottish Government workforce reform.

Inflation protection clauses are likely to lead to higher pay rises than budgeted for

4.12 Pay deals in 2026-27 for the NHS Agenda for Change (the largest group of devolved public sector workers), Police Scotland, Scotrail, and the Scottish Prison Services all included inflation protection clauses. Figure 4.3 shows the number of staff covered, the inflation protection clause and the current value of the relevant inflation measure.

Figure 4.3: Devolved pay deals in 2026-27 and inflation protection clauses

Workforce	Staff headcount	Inflation protection	Reference measure	Current value (per cent)
NHS Agenda for Change [1]	Almost 170,000	Highest of 3.75 per cent or CPI + 1 per cent	Average of monthly CPI during 2026	4.1 [2]
Police Scotland	Around 22,000	Highest of 3.5 per cent or CPI + 1 per cent	Average of monthly CPI during 2026	4.1 [2]
Scotrail and Caledonian Sleeper	Around 5,300	Highest of 3 per cent or RPI	Jan 2026 RPI	3.8
Scottish Prison Service	Around 5,000	Highest of 3.5 per cent or CPI + 1 per cent	Average of monthly CPI during 2026	4.1 [2]

Source: Scottish Fiscal Commission, Scottish Government (2025) NHS pay deal agreed and Police Negotiating Board for Scotland – Circular 2025-09 Pay Agreement, Unite (2025) Scotrail workers accept two-year pay offer, Scottish Police Authority (2025) Multi-year pay deal agreed for officers, Office for National Statistics (2026) RPI percentage change over 12 months, Bank of England (2026) Monetary Policy Report – July 2026.

[1] Covers most NHS Scotland staff other than doctors and senior executives.

[2] Scottish Government central scenario is that average of monthly CPI will be 3.1 per cent. The measure in the pay deal was CPI + 1 per cent, therefore 4.1 per cent.

4.13 The latest inflation forecasts indicate that all four pay deals would see the clauses triggered. The Scottish Government estimates that this will cost £43 million more than the 2026-27 Budget had allocated to staff pay across all workforces. As we explained in Chapter 2, average CPI during 2026 could rise further as the effects of fuel price rises fully feed through to consumer prices.

This makes the pay policy for 2027-28 more challenging to deliver

4.14 In January 2026 we reported that, with pay deals agreed for 2025-26 and 2026-27, adhering to the existing Public Sector Pay Policy (PSPP) overall ceiling of 9 per cent over three years would imply real-terms pay cuts for most workforce groups in 2027-28. For the purposes of our economy and Scottish Income Tax forecasts, we assumed that public sector wages in 2027-28 would rise in line with CPI.[43]

4.15 Inflation protection clauses already pushed pay higher in 2025-26 and seem likely to do so too in 2026-27. That leaves even less scope for pay rises in 2027-28 that would meet the PSPP's overall ceiling. In January 2026 the Scottish Government committed to reviewing the PSPP for 2027-28 as part of that year's Budget process.[44]

Changes in employer pension contributions could mean lower staffing costs for the Scottish Government in 2027-28

4.16 We have outlined pressures on the devolved public sector paybill. Inflation protection clauses are pointing towards greater-than-budgeted-for pay deals, and planned reductions to the workforce are not yet being achieved. However, another element of staffing costs – employer pension contributions – could offset part of the pressure. Employer pension contributions are a staffing cost to the Scottish Government, directly and indirectly, when staff are employed in the devolved public sector.

4.17 The level of employer contributions for public sector pensions is regularly reviewed.[45] The last revaluation means that, from 2027-28, employer pension contributions for the civil service pension scheme and for other public sector pension schemes will fall.

4.18 In the past, when the opposite happened – that is, when employer pension contributions rose – UK Government departments received more budget from HM Treasury. The Scottish Government then received extra Block Grant funding through the Barnett formula. With the lower employer pension contributions, UK departments could have their budgets reduced, resulting in a reduction to the Block Grant.

4.19 The Scottish Government has more highly paid and more public sector workers per head of population than in the rest of the UK. Therefore, the saving the Scottish Government will get from lower employer pension contributions is likely to be larger than the reduction in the Block Grant. This may ease some pressures created by rising wages and a workforce that is not yet shrinking.

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[43] Scottish Fiscal Commission (2026) Scotland's Economic and Fiscal Forecasts – January 2026.

[44] Scottish Government (2026) Scottish Budget 2026 to 2027: integrated public sector pay and workforce policy.

[45] These reviews are based on actuarial calculations of a discount factor known as SCAPE ('Superannuation Contributions Adjusted for Past Experience'). It is linked to inflation (as measured by CPI) and long-term GDP growth prospects (OBR projections).

4.20 While lower employer pension contributions from 2027-28 may reduce overall workforce costs, the Scottish Government needs to consider that any decisions on pay are locked into future budgets. These make it harder to manage the paybill over time, especially if the workforce cannot be reduced as much as planned.

In an inflationary environment, devolved social security takes up more resource funding

4.21 In Scotland, nearly all devolved social security is uprated in line with inflation. The fiscal framework is designed to insulate the Scottish Budget from UK-wide fiscal pressures on devolved taxes and social security. We would expect funding from social security Block Grant Adjustments (BGA) to rise as the UK Government also uprates its own payments.

4.22 However, because of Scottish Government choices, uprating of social security payments in Scotland is more expensive than in the rest of the UK. There are several reasons for this:

- The delivery of some replacement payments has led to relatively higher caseloads than their UK Government equivalents in England and Wales. For example, Adult Disability Payment, which replaced Personal Independence Payment, has seen more applications given the Scottish Government's policy to maximise take-up, and fewer people exiting through award reviews.
- Two payments in Scotland (Winter Heating Payment and Pension Age Winter Heating Payment) are uprated with inflation, but their UK Government equivalents (Cold Weather Payments and Winter Fuel Payments) are not.
- Some payments, like the Scottish Child Payment, have no UK Government equivalent. As such, the cost of uprating falls wholly on the Scottish Budget.

3.62 For these reasons, in a recent Insights short article we estimated that only around 85 per cent of the costs of social security uprating are matched by a corresponding increase in BGA funding.[46]

3.63 As we explained in Chapter 2, the latest Bank of England forecasts suggest an increase in inflation because of the escalation of the conflict in the Middle East, but far less acute than the peak seen in 2022, and one that would not last into the medium term. But if inflation remained higher for a longer period, social security would account for a larger share of the Budget, reducing funding for other devolved public services like health or education.

[46] Scottish Fiscal Commission (2026) Insight: Social security uprating.

Chapter 5
Implications for upcoming fiscal events

5.1 In previous chapters we explained the economic and fiscal developments since January 2026 and gave broad indications of what they mean for the Scottish Government's funding and spending outlooks.

5.2 In this chapter we outline how these will affect the 2026-27 Autumn Budget Revision (ABR) and the 2027-28 Scottish Budget, both of which are due to be presented to the Scottish Parliament before the end of 2026.

5.3 The Scottish Spending Review (SSR) allocations presented in January 2026 were underpinned by commitments to efficiency savings. We have highlighted how failure to achieve these savings would present difficulties this year and increase pressure on future budgets. The Scottish Government should provide a clear update on progress towards these planned efficiency savings and identify any new or changing pressures in the 2026-27 and 2027-28 Budgets.

2026-27 Autumn Budget Revision

5.4 A new Scottish Government was formed following the general election in May 2026. The ABR will be the first opportunity the new government has to amend the 2026-27 Budget. It is normally presented to the Scottish Parliament around September.

5.5 In Chapter 3 we discussed how there has been significant unanticipated extra Block Grant funding from UK Government spending decisions made in early 2026. In Chapter 4 we discussed how the Scottish Government balanced the 2026-27 Budget assuming that around £0.6 billion of efficiencies would be achieved across all portfolios. The inability in previous years of most NHS boards to achieve 3 per cent of recurrent savings, the latest public sector workforce statistics, and the latest inflation forecasts point to in-year spending pressures.

5.6 Even with an assumed reduction of the capital Block Grant in 2026-27 because of the Defence Investment Plan (DIP), in Annex A we estimate that overall funding in this year has increased by £859 million. The Scottish Government may choose to use all or part of this in 2026-27 and set that out in the ABR.

5.7 In January 2026 we expected a largely flat resource funding position for 2027-28 and a capital budget that was falling in real terms. The Scottish Government set its Spending Review based on those funding forecasts. However, the change of the UK Prime Minister and Cabinet means that the UK Government may change its fiscal plans or its interpretation of the fiscal rules. Changes to departmental budgets, tax policy or the balance of spending between devolved and reserved responsibilities will affect the Scottish Government's funding. Any such changes will be confirmed at the UK Budget on 28 October 2026. One change expected for 2027-28 is a reduction in the capital Block Grant, following the UK Government's announcement that departmental capital budgets will be reduced to partially fund the Defence Investment Plan.

5.8 The 2026-27 Budget was set with a £150 million assumed resource drawdown from the Scotland Reserve. Provisional outturn for 2025-26 confirms more than this is available.[47] The Scottish Government also planned to use almost £80 million of Crown Estate revenues to increase resource spending levels. Because funding in 2026-27 overall has increased, the Government may choose to use less funding from these sources to instead use that money to support spending in 2027-28 or beyond.

2027-28 Scottish Budget

5.9 The 2027-28 Scottish Budget is expected before the end of 2026, typically a few weeks after the UK Budget.

5.10 In Chapter 3 we have outlined how the funding position, especially for resource, is very challenging in 2027-28, although the Block Grant funding position is uncertain until the UK Budget in October 2026. Moreover, the escalation of the conflict in the Middle East may exacerbate spending pressures if it results in sustained higher inflation. Costs of delivering public services increase as energy costs increase, it is likely there will be greater pressure for public sector pay increases and devolved social security payments are uprated by inflation.

5.11 The additional Block Grant funding in 2026-27 from UK Government spending decisions on Special Educational Needs and Disability (SEND) does not recur in 2027-28. While some extra funding has been confirmed for 2028-29, there is no guarantee that it will all be made permanent for the next UK Spending Review. Therefore, the Scottish Government may choose to carry some of this additional funding forward to 2027-28 through the Scotland Reserve, subject its size limits, although that would come with budget management risks for 2026-27.

5.12 In addition to tax policy decisions, there are other decisions the Scottish Government can make to have more funding next year. It can change the timings for bringing the Non-Domestic Rates (NDR) pool back into balance, smoothing changes in NDR revenues across years. It can also defer plans to use revenues from the Crown Estate which, as things stand, are to be used in 2026-27.

[47] Scottish Government (2026) Scottish Budget – provisional outturn 2025-2026: briefing note.

5.13 On spending, given historical trends and the evidence available to date, we see limited progress in managing the paybill either through workforce reductions or pay restraint. In January 2026 the Scottish Government committed to reviewing the Public Sector Pay Policy (PSPP) for 2027-28 as part of that year's Budget process.[48] Any decisions on pay rises are locked into future budgets and make it harder for the Government to manage pay costs over time.

[48] Scottish Government (2026) Scottish Budget 2026 to 2027: integrated public sector pay and workforce policy.

Annex A
Changes to funding levels

A.1 In this annex we show the changes to funding levels for the last three years: 2024-25 to 2026-27. We last reported on the funding positions in January 2026.[49]

2024-25

A.2 We previously reported the position for 2024-25 based on provisional outturn. There have been small changes as final outturn was confirmed, shown in Figure A.1. This position is consistent with the Scottish Government Consolidated Accounts and is final.[50]

A.3 Final funding levels for 2024-25 decreased by £47 million for resource and £17 million for capital compared with provisional outturn. This was because:

- For resource, the underspend was £49 million larger than calculated at provisional outturn in June 2025. This increased how much was added to the reserve to draw down in later years, but reduced funding in 2024-25. This was partly offset by fully devolved tax revenues being £2 million higher in Revenue Scotland's final accounts for 2024-25 than had been previously estimated.

- For capital, the underspend, which again adds to the reserve for use in later years but reduces funding in 2024-25, was £9 million larger than as calculated at provisional outturn. We have also reduced our estimate of the in-year drawdown from the Reserve by £2 million to align with Scottish Government outturn. For financial transactions, there was a repayment to HM Treasury of £25 million, agreed between both parties as the final outturn position became clearer.

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[49] The most recent funding position for all years we have tracked is summarised in supplementary figures accompanying this report and available on our website: supplementary figures S3.1 for resource and S3.2 for capital.

[50] Scottish Government (2025) Consolidated Accounts for the year ended 31 March 2025. Numbers presented here are consistent with the accounts but are on a different basis. The accounts measure underspends against the Spring Budget Revision (SBR), which still had some funding sources, like reserve drawdowns and borrowing, based on plans. Accounts also measure underspends against areas that are classed as annually managed expenditure (AME) and therefore outside the budget limits applying to the Scottish Government.

Figure A.1: Latest 2024-25 resource funding position

Source of funding (£ million)	January 2026	Changes since June 2025	Latest position
Block Grant	**39,626**	**blank**	**39,626**
Spending Review 2021 settlement	35,576	blank	35,576
Non-Barnett funding	715	blank	715
Barnett consequentials	3,336	blank	3,336
Post-2016 fiscal framework	**6,299**	**-47**	**6,252**
Devolved revenues [1]	19,802	+4	19,803
Tax and non-tax BGAs [2]	-18,110	blank	-18,110
Social security BGAs [2]	5,182	blank	5,182
Adjustment for forecast error, of which:	-338	blank	-338
Reconciliations	-338	blank	-338
Resource borrowing	0	blank	0
Net Scotland Reserve drawdown, of which:	-236	-49	-285
In-year drawdowns	265	blank	265
Underspends added after year-end	-501	-49	-550
Other sources	**3,367**	**blank**	**3,367**
Other funding [3]	299	blank	299
Non-Domestic Rates distributable amount	3,068	blank	3,068
Less: resource borrowing costs	-132	blank	-132
Less: capital borrowing costs	-135	blank	-135
Resource funding available for discretionary spend	**49,026**	**-47**	**48,979**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Budget-setting forecasts for Income Tax, but outturn amounts for LBTT and SLfT. No non-tax revenues from Fines, Forfeitures and Fixed Penalties (FFFPs) were used in this year.

[2] Budget-setting forecasts for Income Tax, but adjusted in-year for everything else based on OBR Autumn 2024 forecasts.

[3] For a breakdown of the latest amount for other funding, see supplementary figure S3.3.

Figures may not sum because of rounding.

Figure A.2: Latest 2024-25 capital funding position

Source of funding (£ million)	June 2025	Changes since June 2025	Latest position
General capital	**6,048**	**+7**	**6,055**
Block Grant, of which:	5,696	-38	5,658
Spending Review 2021 settlement	4,690	blank	4,690
Non-Barnett funding [1]	670	-38	632
Barnett consequentials	336	blank	336
Capital borrowing	139	blank	139
Net Scotland Reserve drawdown, of which:	112	+7	119
In-year drawdowns	143	-2	140
Underspends added after year-end	-31	+9	-22
Other funding [1] [2]	101	+38	139
Financial transactions (FTs)	**102**	**-24**	**78**
Block Grant, of which:	123	+53	176
Spending Review 2021 baseline	176	blank	176
Barnett consequentials [1]	-53	+53	0
Net Scotland Reserve drawdown, of which:	-21	+1	-20
In-year drawdowns	4	-0	4
Underspends added after year-end	-25	+1	-24
Other funding [1]	blank	-53	-53
Less: repayments to HM Treasury	blank	-25	-25
Capital funding available for discretionary spend	**6,150**	**-17**	**6,133**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Neutral reclassification between Non-Barnett funding and 'Other funding' to align with how changes are reflected in memoranda of Supply Estimates for the Scotland Office.

[2] For a breakdown of the latest position by UK fiscal event, see supplementary figure S3.4.

Figures may not sum because of rounding.

2025-26

A.4 In January 2026 we reported funding in 2025-26 based on the latest position. There have been several changes since then:

- The Spring Budget Revision (SBR), presented in February 2026, implemented the £510 million funding reduction we reported in January 2026 (£283 million for resource, £227 million for general capital).[51] It also included an assumption on funding from the UK Supplementary Estimates 2025-26. These, presented to the UK Parliament a few weeks later, confirmed the assumed extra Barnett funding as the UK Government topped up departmental budgets from unallocated reserves. They also confirmed Budget Cover Transfers (BCTs), some of which had not been assumed.[52]

- Scottish Government's year-end funding decisions made in March 2026 on reserve drawdowns and borrowing, following the confirmation of funding from the UK Supplementary Estimates, to manage the size of the projected underspend.

- The compilation of provisional outturn in June 2026, which gave a first indication of underspends that will flow into the Scotland Reserve.[53]

A.5 Figure A.3 shows all the changes for resource. We estimate that resource funding levels in 2025-26 fell by £336 million compared with January 2026. The drivers were:

- An increase of £13 million to the resource Block Grant. This is the result of two movements in opposite directions. On the one hand, there were consequentials confirmed at Supplementary Estimates (£21 million). On the other hand, there was an £8 million reduction because of resource City Deals and Debt Advice Levy funding had been included by mistake also in the settlement from the Spending Review. The Scottish Government rectified this at the SBR.

- A fall of £59 million in fully devolved tax revenues, in line with Revenue Scotland's provisional outturn, which we have used for our August 2026 Forecast Evaluation Report.[54]

- A net fall of £273 million in the use of the Scotland Reserve. This is the result of drawing down £39 million more at the SBR, but having a provisional underspend of £312 million added to the reserve for drawdown in later years. Part of it was a managed underspend to be able to fund the £150 million drawdown assumption with which the 2026-27 Budget was set in January 2026.

- A fall of £17 million in other resource funding, which was mostly a year-end Scottish Government decision at the to not use the £23 million of Crown Estate

51 Scottish Government (2026) Spring Budget Revision 2025-26 – Supporting document.

52 HM Treasury (2026) Supplementary Estimates 2025-26. For a definition of Budget Cover Transfers, see our Explainers.

53 Scottish Government (2026) Scottish Budget – Provisional outturn 2025-26 briefing note.

54 Scottish Fiscal Commission (2026) Forecast Evaluation Report – August 2026.

revenues it had planned to at the SBR, partly offset by £6 million more BCTs from the UK Government than anticipated at the SBR.

Figure A.3: Latest 2025-26 resource funding position

Source of funding (£ million)	January 2026	Changes since January 2026	Latest position
Block Grant	**41,325**	**+13**	**41,337**
Spending Review 2025 settlement [1]	40,791	+342	41,133
Barnett consequentials [1]	534	-329	205
Post-2016 fiscal framework	**7,964**	**-332**	**7,632**
Devolved revenues [2]	21,566	-59	21,507
Tax and non-tax BGAs [3]	-20,415	blank	-20,415
Social security BGAs [3]	5,803	blank	5,803
Adjustment for forecast error, of which:	500	blank	500
Reconciliations	500	blank	500
Resource borrowing	0	blank	0
Net Scotland Reserve drawdown, of which:	511	-273	238
In-year drawdowns	511	+39	550
Underspends added after year-end	0	-312	-312
Other sources	**3,371**	**-17**	**3,354**
Other funding [4]	257	-17	240
Non-Domestic Rates distributable amount	3,114	blank	3,114
Less: resource borrowing costs	-142	blank	-142
Less: capital borrowing costs	-160	blank	-160
Resource funding available for discretionary spend	**52,358**	**-336**	**52,022**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Funding-neutral reclassification of the £350 million deduction to the Block Grant for the move to UK-funded annually managed expenditure (AME) of police and fire services employer pension costs. The deduction has been reversed from the Spending Review settlement line and is instead made to the Barnett consequentials line. This is because agreement was reached at the UK Budget 2025 – after the conclusion of the current Spending Review.

[2] Budget-setting forecasts for Income Tax, but provisional outturn amounts for LBTT, SLfT, and non-tax revenues from Fines, Forfeitures and Fixed Penalties (FFFPs).

[3] Budget-setting forecasts for Income Tax but adjusted in-year for everything else (except FFFPs) based on OBR November 2025 forecasts.

[4] For a breakdown of the latest amount for other funding, see supplementary figure S3.3.

Figures may not sum because of rounding.

A.6 Figure A.4 shows the changes to capital funding since January 2026. Overall, levels fell by £220 million (£179 million for general capital, £41 million for FTs).

A.7 The main causes were:

- The Block Grant rose by £36 million for general capital, but fell by £10 million for FTs, both because of the UK Government's Supplementary Estimates 2025-26. Unlike previous years, this position was close to the assumption made for the SBR. Therefore, the Scottish Government dealt with these changes in funding in-year rather than deferring them to the next financial year.

- The net use of the Scotland Reserve fell by £60 million (£55 million for general capital, £5 million for FTs). This is the combination of year-end Scottish Government decisions to draw down £14 million less than it had planned in January 2026, and a provisional underspend of £46 million being added to the reserve to support spending in later years.

- Other capital funding fell by £161 million, mostly because of a year-end decision to not use any Crown Estate revenues to support capital spending – plans at the SBR had been to use £153 million. Although confirmed City Deals funding was £48 million less than assumed at the SBR, the shortfall was broadly offset by £46 million of unanticipated BCTs.

- Finally, the Scottish Government anticipates a repayment of gross FTs to HM Treasury of around £25 million, based on the year-end's budget monitoring. This number will be reviewed as provisional outturn position becomes clearer.

A.8 At this point, the outstanding funding decision is how much FTs funding to repay to HM Treasury. Funding levels will only change as that is decided and we move to final outturn when fully devolved tax revenue is published in Revenue Scotland's accounts.

A.9 Provisional outturn for 2025-26 has given us an initial estimate of underspends. These, to be confirmed at final outturn, will support the funding position in 2026-27 onwards through the Scotland Reserve.

Figure A.4: Latest 2025-26 capital funding position

Source of funding (£ million)	January 2026	Changes since January 2026	Latest position
General capital	**7,003**	**-179**	**6,824**
Block Grant, of which:	6,255	+36	6,291
Spending Review 2025 settlement	6,255	blank	6,255
Barnett consequentials	0	+36	36
Capital borrowing [1]	430	+0	430
Net Scotland Reserve drawdown, of which:	35	-55	-20
In-year drawdowns	35	-13	22
Underspends added after year-end	blank	-42	-42
Other funding [2]	284	-161	123
Financial transactions (FTs)	**192**	**-41**	**151**
Block Grant, of which:	167	-10	157
Spending Review 2025 settlement	167	blank	167
Barnett consequentials	0	-10	-10
Net Scotland Reserve drawdown, of which:	25	-5	20
In-year drawdowns	25	-1	24
Underspends added after year-end	blank	-4	-4
Other funding [2]	0	blank	0
Less: repayments to HM Treasury	0	-25	-25
Capital funding available for discretionary spend	**7,195**	**-220**	**6,975**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Changes since January 2026 are £0.3 million but they round down to zero.

[2] For a breakdown of the latest amount for other funding, see supplementary figure S3.4.

Figures may not sum because of rounding.

2026-27

A.10 When we last reported on 2026-27 it was when the budget for this year was being presented to the Scottish Parliament in January 2026.

A.11 As the Budget Bill moved through Stages 2 and 3, some changes to discretionary funding sources were made to ensure the bill's passing. Since then, there have also been Barnett consequentials from new UK Government spending decisions at the Spring Forecast 2026 and Main Estimates 2026-27.[55,56]

A.12 Figures A.5 and A.6 show the changes in resource and capital funding, respectively, since January 2026. Overall, we estimate funding levels have increased by £863 million (£831 million for resource, £32 million for capital).

A.13 The main drivers were:

- On the Block Grant, extra Barnett consequentials of £625 million for resource, but negative £63 million for capital. It is the combination of new funding arising mostly from the Spring Forecast 2026, the UK's 2026-27 Main Estimates, and our assumed Barnett impact of the UK Government's Defence Investment Plan.
- A net £9 million increase in the Block Grant Adjustments (BGAs), based on the OBR's March 2026 forecasts. These are indicative only – the actual in-year adjustment will be based on the OBR's October 2026 forecasts.
- An increase of £210 million in Scotland Reserve drawdowns (£162 million for resource, £44 million for general capital, £4 million for FTs). Provisional outturn for 2025-26 confirms such balances are available. We assume the Scottish Government draws down all the available balances from the Scotland Reserve in 2026-27 as set out in its provisional outturn statement.
- An increase of £84 million in 'Other funding', (£41 million for resource, £43 million for capital) because of unanticipated BCTs confirmed at Main Estimates 2026-27.
- A rise of £7 million in the cost of capital borrowing. The loan taken out at the end of 2025-26 is to be repaid in ten years, rather than the fifteen originally planned.

[55] HM Treasury (2026) Spring Forecast 2026: The right economic plan for Britain

[56] HM Treasury (2026) Main Supply Estimates 2026 to 2027

Figure A.5: Latest 2026-27 resource funding position

Source of funding (£ million)	January 2026	Changes since January 2026	Latest position
Block Grant	**42,671**	**+625**	**43,296**
Spending Review 2025 settlement	42,671	blank	42,714
Barnett consequentials [1]	0	+625	582
Post-2016 fiscal framework	**8,030**	**+171**	**8,201**
Devolved revenues [2]	22,651	blank	22,651
Tax and non-tax BGAs [3]	-21,449	-25	-21,474
Social security BGAs [3]	6,323	+34	6,358
Adjustment for forecast error, of which:	354	blank	354
Reconciliations	354	blank	354
Resource borrowing	0	blank	0
Net Scotland Reserve drawdown, of which:	150	+162	312
In-year drawdowns	150	+162	312
Underspends added after year-end	0	blank	0
Other sources	**3,729**	**+41**	**3,770**
Other funding [4]	255	+41	296
Non-Domestic Rates distributable amount	3,474	blank	3,474
Less: resource borrowing costs	-121	blank	-121
Less: capital borrowing costs	-194	-7	-201
Resource funding available for discretionary spend	**54,115**	**+831**	**54,946**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Different breakdown in January 2026 from the numbers published then, but adding to the same amount. The Spending Review 2025 settlement included a change in Barnett funding from the UK Budget 2025. These are now reflected as a Barnett consequential instead.

[2] Including £25 million of Scottish Government forecast of revenue from Fines, Forfeitures and Fixed Penalties (FFFPs).

[3] Based on the OBR's forecasts in March 2026. Indicative only. The forecasts that will determine the in-year funding adjustment will be the OBR's October 2026 ones.

[4] For a breakdown of the latest amount for other funding, see supplementary figure S3.3.

Figures may not sum because of rounding.

Figure A.6: Latest 2026-27 capital funding position

Source of funding (£ million)	January 2026	Changes since Jan 2026	Latest position
General capital	**7,324**	**+24**	**7,347**
Block Grant, of which:	6,712	-63	6,649
Spending Review 2025 settlement [1]	6,689	blank	6,689
Barnett consequentials [1]	23	-63	-40
Capital borrowing	491	blank	491
Net Scotland Reserve drawdown, of which:	blank	+44	44
In-year drawdowns	blank	+44	44
Underspends added after year-end	blank	blank	0
Other funding [2]	120	+43	163
Financial transactions (FTs)	**245**	**+4**	**249**
Block Grant, of which:	245	blank	245
Spending Review 2025 settlement [1]	245	blank	245
Barnett consequentials [1]	blank	+0	0
Net Scotland Reserve drawdown, of which:	0	+4	4
In-year drawdowns	0	+4	4
Underspends added after year-end	blank	blank	0
Other funding [2]	0	blank	0
Less: repayments to HM Treasury	0	blank	0
Capital funding available for discretionary spend	**7,568**	**+28**	**7,596**

Source: Scottish Fiscal Commission, Scottish Government.

[1] Different breakdown in January 2026 from the numbers published then, but adding to the same amount. The Spending Review 2025 settlement included a change in Barnett funding from the UK Budget 2025. These are now reflected as a Barnett consequential instead.

[2] For a breakdown of the latest amount for other funding, see supplementary figure S3.4.

Figures may not sum because of rounding.

Annex B
Employability Services

Background

B.1 In this annex we explain our decision to remove Employability Services from our forecasts of social security spending. We set out the reasons for our decision and show the effect of removing Employability Services from the spending forecast and funding position. Figures B.1 presents our current social security forecasts after excluding the spending in Employability Services.

B.2 Since December 2024, our Employability Services forecast had consisted of the combined spending on Fair Start Scotland, up to its conclusion in 2026-27, and an indicative forecast of the elements of No One Left Behind that fall under our remit. Removing Employability Services from our social security spending forecast means excluding non-material spending in Fair Start Scotland in 2026-27, and all No One Left Behind spending.[57]

B.3 Most of our social security spending forecasts are based on demand-led principles, where we forecast based on the total number of eligible people who apply for and receive each social security payment. However, the current employability support services provided by the Scottish Government are based on the Government's spending allocation and are not demand-led social security spending.

B.4 No One Left Behind provides support to a wide range of people. However, the elements of No One Left Behind under our remit only include spending intended to assist specific types of clients. These are clients with disabilities and those claiming reserved benefits who are at risk of long-term unemployment to select, obtain, and retain employment. We cannot identify with certainty the spending allocated specifically to those under our remit because the available data does not include this detail. For all these reasons, we believe our forecast at present does not inform the Scottish Budget and has limited value for users.

User engagement

B.5 We have engaged with selected stakeholders on the proposal of not including Employability Services in our social security forecasts.

[57] We have set materiality thresholds under which policies will not be costed. The threshold for negligible policies is £5 million. For more details, see Scottish Fiscal Commission (2025) Statement of Voluntary Application of the Code of Practice for Statistics and Error Policy.

B.6 All stakeholders expressed support for the proposal. Comments highlighted that the change was sensible because employability spending is not demand-led and largely reflects the Scottish Government's budget decisions. It was also noted that it could lead to misleading comparisons within social security spending and Block Grant Adjustments (BGAs) funding transfer.

B.7 Stakeholders also emphasised that removing Employability Services from our social security forecasts would improve clarity and transparency in reporting. Overall, there were no objections, and feedback described the proposal as logical and helpful, and that the change would improve the presentation of social security spending.

B.8 We plan to continue to monitor the Scottish Government's approach to employability support services. We will review our approach if changes arise that might require forecasts to inform the Scottish Budget. We will consider Employability as a Level 4 spending line in the Budget as part of our future work on non-social security spending.

Effect on spending forecast

B.9 Excluding the No One Left Behind and the non-material spending in Fair Start Scotland, reduces our headline social security spending forecast by £70 million from 2026-27. This change does not reflect a decrease in spend on employability support services provided by the Scottish Government but a change in our forecasting scope.

B.10 Figure B.1 shows the effect of removing Employability Services forecast from the headline figures for social security spending.

Figure B.1: Effect of excluding Employability Services on social security spending forecast

£ million	2026-27	2027-28	2028-29	2029-30	2030-31
January 2026	7,405	7,888	8,300	8,758	9,226
Employability Services	-70	-70	-70	-70	-70
August 2026	7,335	7,818	8,230	8,688	9,156

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Effect on funding position

B.11 We estimate the effect of social security spending on the Scottish Budget by looking at the difference between social security BGA funding and our social security forecast. Social security spending exceeds the BGA funding each year, with a net cost of over £1 billion to the Scottish Budget. Excluding the forecast of Employability Services spending narrows this estimate by £70 million. This only changes our measure, it does not affect the overall funding or spending positions of the Scottish Government, as it continues to fund employability support services through Fair Start Scotland and No One Left Behind.

Figure B.2: Effect of social security spending forecast on the Scottish Budget

£ million	2026-27	2027-28	2028-29	2029-30	2030-31
January 2026	-1,082	-1,137	-1,167	-1,200	-1,202
August 2026 [1]	-1,011	-1,067	-1,097	-1,130	-1,132
Change [2]	70	70	70	70	70

Source: Scottish Fiscal Commission.

[1] Based on the 2026-27 budget setting forecasts using OBR November 2025 forecasts.

[2] Change appears as positive because the reported spending has decreased and the funding has not changed.

Figures may not sum because of rounding.

Annex C
Air Departure Tax forecast

C.1 In this annex we present our forecast for Air Departure Tax (ADT). Following the devolution of Air Passenger Duty (APD), the Scottish Government plans to introduce ADT from 1 April 2027. We forecast 14 million tax liable passengers and total revenue of £428 million in 2027-28.

Figure C.1: Air Departure Tax forecast summary

	2027-28	2028-29	2029-30	2030-31	2031-32
Tax liable passengers (thousands)	13,822	13,963	14,265	14,360	14,690
Forecast revenue (£ million)	428	447	470	487	509

Source: Scottish Fiscal Commission.

C.2 ADT will replace UK APD for the carriage of passengers on any flight that begins at an airport in Scotland and will be administered by Revenue Scotland. In the Scottish Budget 2026-27, the Scottish Government stated that, in its first year of operation, ADT will have the same tax rates as APD in the rest of the UK.

C.3 ADT will be paid by airlines and other aircraft operators in relation to the carriage of passengers on flights departing from Scottish airports. The amount paid for each passenger is based on the distance to the final destination, which determines the band, and type of seat, which determines the rate. Figure C.2 presents bands and rates for 2027-28. From 2028-29 we assume that ADT rates will be increased in line with forecasts for Retail Prices Index (RPI) inflation. This is consistent with the approach the OBR uses to forecast UK APD rates.

Figure C.2: ADT tax rates from April 2027

Distance and band	Standard Rate (Economy)	Premium Rate (Premium Cabins)	Special Rate
Domestic	£8.26	£16.52	£146.63
Band A (less than 2,000 miles)	£15.49	£33.04	£146.63
Band B (2,001-5,500 miles)	£105.33	£251.95	£1,132.76
Band C (more than 5,500 miles)	£109.46	£261.25	£1,178.20

Source: Scottish Fiscal Commission, Scottish Government (2026) Ministerial Foreword – Delivering Scotland's Air Departure Tax, HMRC (2018) Rates for Air Passenger Duty.

C.4 To account for the revenue the Scottish Government will receive from the introduction of ADT, there will be a corresponding tax Block Grant Adjustment (BGA) that removes funding from the Scottish Budget. As Scottish ADT rates will match UK APD rates in the first year of operation, the overall effect of the introduction of ADT on the Scottish Budget will be limited in 2027-28. The Scottish and UK Governments have not finalised the approach to calculating the BGA for ADT.

Forecast approach

Introduction

C.5 To forecast the ADT revenue, we first forecast the number of tax liable passengers by band and rate, and then apply the tax rates. As there is no Scotland-level breakdown of UK APD revenue available from HMRC APD statistics, we used a variety of data sources to inform the Scottish ADT forecast.

C.6 We will review our forecasting approach once the tax has been introduced and outturn data is available from Revenue Scotland. We outline our data requirements in our August 2026 Statement of Data Needs.[58]

Air passenger forecasts

C.7 We have reliable data on the number of air passengers in Scotland up to 2025-26 from Civil Aviation Authority (CAA) data.

C.8 To forecast the number of passengers we apply a growth rate based on forecasts from the Department for Transport (DfT).[59] These incorporate a wide range of inputs, including UK GDP, foreign GDP, fuel prices, exchange rates, and a geographic split which factors in airport capacity.

Child and connecting flights exemptions

C.9 Children under two years old without a seat and children under 16 and in the lowest class of travel are exempt from ADT. We use HMRC statistics on the cost of the exemption in UK APD to give an exemption rate of 1.9 per cent, which we apply to passenger forecasts to remove exempt children from tax liable passengers.[60]

C.10 Passengers on connecting flights are exempt on the second or next flight of their journey. We exclude these from our forecast of tax liable passengers using proportions from 2018 CAA survey data for Scottish airports. This gives us an estimate of 1.7 per cent of departing passengers being on connecting flights.[61]

58 Scottish Fiscal Commission (2026) Statement of Data Needs – August 2026.

59 Department for Transport (2026) UK aviation forecast 2026.

60 HM Revenue and Customs (2024) Non-structural tax reliefs.

61 UK Civil Aviation Authority (2018) Passenger survey report 2018.

Allocation to bands and rates

C.11 There is limited recent data on the split of passengers across bands and rates for APD in Scotland. We use a combination of sources and assumptions for this part of the forecast.

C.12 To allocate passengers into bands we use outputs from the 2018 CAA survey. This is a large-scale survey of people at airports that provides detailed information on the routes that people were travelling on. Although there have not been updates to this survey since 2018, we think it is appropriate to use in this forecast because HMRC APD data at UK level shows there has been limited movement between band groupings between 2018-19 and 2024-25.

C.13 Within the destination bands we allocate passengers to rates using HMRC UK-level data on APD.

Highlands and Islands exemption

C.14 The tax rates for ADT in Scotland will match those for APD in the UK for the first year of operation, but the exemptions for Highlands and Islands airports will change at the point of introduction. Under APD, passengers on flights leaving Highlands and Islands airports are exempt from the tax. This includes passengers travelling via direct and connecting flights for non-UK airports. ADT retains the exemption for passengers on flights leaving Highlands and Islands airports to other UK airports, and extends the exemption to passengers travelling on flights from all Scottish airports to Highlands and Islands airports. However, the exemption for passengers carried on flights leaving Highlands and Islands airports where the final destination is outside the UK, including passengers travelling via connecting flights, is being removed in ADT. To illustrate this with an example, a passenger flying from Inverness to Dubai via a connecting flight through Heathrow would have been exempt from APD but will not be exempt from ADT.

C.15 We use the 2018 CAA survey data to estimate the proportion of passengers travelling from non-Highlands and Islands airports on flights to Highlands and Islands airports, for example from Edinburgh to Kirkwall, allowing us to capture that aspect of the exemption.

C.16 We also use this data to estimate the proportion of passengers departing Inverness airport for other airports in the UK. However, the same data is not available for passengers departing from other Highlands and Islands airports. Therefore, we have assumed that the volume of passengers travelling from other Scottish airports to Highlands and Islands airports will match the number of passengers travelling in the opposite direction. This gives us an estimate of exempt passengers travelling to other Scottish airports.

C.17 For the remainder of passengers from other Highlands and Islands airports (who are travelling within the Highlands and Islands, to the rest of the UK, or internationally), we have allocated passengers to rates and bands based on the breakdown for Inverness airport. Figure C.3 shows that the estimated cost of the Highlands and Islands exemption is £7 million in 2027-28.

Figure C.3: Effect of the Highlands and Islands exemption

£ million	2027-28	2028-29	2029-30	2030-31	2031-32
Revenue pre-exemption	436	454	478	495	518
Effect of Highlands and Islands exemption	-7	-8	-8	-8	-9
Forecast revenue	428	447	470	487	509

Source: Scottish Fiscal Commission, Civil Aviation Authority.

Figures may not sum because of rounding.

Forecast uncertainty

C.18 There is a general uncertainty for the forecast in relation to future economic growth. For ADT we think this aspect of uncertainty is consistent with the level of uncertainty that exists for our forecasts of other taxes. In addition, as we highlighted in Chapter 2, there are a range of external factors that have emerged since our January 2026 forecast and could affect the economic outlook, including the conflict in the Middle East. We have not factored in any potential jet fuel shortages resulting from events in the Middle East and disruption to shipping in the Strait of Hormuz in 2026. The risk of large-scale cancellations of flights that was highlighted in spring 2026 has not materialised, but this is something we will continue to monitor in our preparation of forecasts for the Scottish Budget 2027-28.

C.19 There is a specific risk for our forecast of ADT from the lack of data, with the largest area of uncertainty is around the allocation of passengers into bands. This is because there is a lack of up-to-date Scotland-level data on the split across bands and the lack of HMRC data on APD revenue from Scottish airports. The large difference in the tax rate between bands A and B mean that a small variation in our assumption for allocation to bands would lead to a material change in the forecast. For example, a one percentage point switch of passengers from band A to band B would lead to around a £10 million increase in annual revenue.

Additional information

Abbreviations

ABR	Autumn Budget Revision
ADT	Air Departure Tax
AME	Annually managed expenditure
APD	Air Passenger Duty
BCTs	Budget Cover Transfers
BGA	Block Grant Adjustment
BoE	Bank of England
CAA	Civil Aviation Authority
COVID-19	Coronavirus disease 2019
CPI	Consumer Prices Index
DWP	Department for Work and Pensions
EfW	Energy from Waste
EIA	Employment Injuries Assistance
FAI	Fraser of Allander Institute
FER	Forecast Evaluation Report
FFFPs	Fines, Forfeitures, and Fixed Penalties
FSDP	Fiscal Sustainability Delivery Plan
FTs	Financial transactions
GDP	Gross domestic product
HMRC	His Majesty's Revenue and Customs
HMT	His Majesty's Treasury
LBTT	Land and Buildings Transaction Tax
MoD	Ministry of Defence
MTFS	Medium-Term Financial Strategy
NDR	Non-Domestic Rates
NHS	National Health Service
NICs	National Insurance contributions
NIESR	National Institute of Economic and Social Research
NSND	Non-savings, non-dividend
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PSPP	Public Sector Pay Policy
RPI	Retail Prices Index
RTI	Real Time Information
SBR	Spring Budget Revision
SCAPE	Superannuation Contributions Adjusted for Past Experience
SDN	Statement of Data Needs

SFC	Scottish Fiscal Commission
SIT	Scottish Income Tax
SLfT	Scottish Landfill Tax
SSR	Scottish Spending Review
UK	United Kingdom
VAT	Value Added Tax

A full glossary of terms is available on our website: Glossary.

Professional standards

The SFC is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Co-operation and Development (OECD).[62] [63]

The SFC also seeks to adhere to the highest possible standards for analysis. While we do not produce official statistics, we voluntarily apply as far as possible the UK Statistics Authority's Code of Practice for Statistics. Further details and our statement of voluntary application can be found on our website.[64]

Correspondence and enquiries

We welcome comments from users about the content and format of our publications. If you have any feedback or general enquiries about this publication or the SFC, please contact info@FiscalCommission.scot. Press enquiries should be sent to press@FiscalCommission.scot.

All charts and tables in this publication have also been made available in spreadsheet form on our website. For technical enquiries about the analysis and data presented in this paper please contact the responsible analyst:

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[62] OECD (2014) Recommendation of the Council on Principles for Independent Fiscal Institutions.

[63] OECD (2025) OECD Review of the Scottish Fiscal Commission 2025.

[64] Scottish Fiscal Commission (2025) Statement of Voluntary Application of the Code of Practice for Statistics and Error Policy.

This publication is available at www.FiscalCommission.scot

ISBN: 978-1-911637-94-3

Published by the Scottish Fiscal Commission, August 2026