FPA/S6/25/2/2

Finance and Public Administration Committee
2nd Meeting 2025 (Session 6)
Tuesday 14 January 2025

Scrutiny of the Scottish Budget 2025-26

Purpose

1. The Committee is invited to take evidence from Shona Robison MSP, Cabinet Secretary for Finance and Local Government as part of its scrutiny of the Scottish Budget 2025-26. The Cabinet Secretary will be accompanied by the following Scottish Government officials—

   - Jennie Barugh, Director of Exchequer Strategy,
   - Richard McCallum, Director of Public Spending,
   - Ellen Leaver, Acting Director for Local Government, and
   - Lorraine King, Deputy Director, Tax Strategy, Engagement and Performance

2. The Committee agreed to build on the themes in its pre-budget 2025-26 report, published on 7 November 2024, by focusing its scrutiny of the Scottish Budget 2025-26 on the Scottish Government's approach to—

   - taxation, including its Tax Strategy,
   - growing the economy, and
   - public service reform.

3. This paper sets out key issues in the Scottish Budget 2025-26 and accompanying Scottish Fiscal Commission's (SFC's) Economic and Fiscal Forecasts – December 2024, as well as the Scottish Government's Tax Strategy, and its Public Sector Pay Policy 2025-26 all of which were published on 4 December 2024. It also includes themes arising from evidence-taking in relation to budget 2025-26 scrutiny, as well as relevant extracts from the Committee's pre-budget 2025-26 report and the Scottish Government's response to it. Background information on the UK context to the Scottish Budget is provided at Annexe A.

4. A SPICe briefing on the Scottish Budget 2025-26 was published on 6 December.

5. On 7 January 2025, the SFC published a report containing its estimate of the cost of mitigating the two-child limit, and the impact this will have on the Scottish Budget. The SFC was unable to include a formal costing in its December 2024 Forecasts due to late notification of the policy. This report was provided by the SFC to assist the Committee with its scrutiny of the Scottish Budget. Further details of the costings are included in this paper.

6. Official reports of the Committee's evidence sessions on the Scottish Budget 2025-26 are available on the Committee's web pages.

Economic and fiscal context

7. The SFC states in its December 2024 Economic and Fiscal Forecasts that "the outlook for the Scottish economy is higher GDP growth in 2025-26 than in 2024-25, in part as a result of the UK Government's fiscal expansion, and inflation is also expected to be slightly higher in 2025-26 than in 2024-25". It goes on to explain that although UK decisions have resulted in additional funding for the Scottish Government through the Block Grant in both 2024-25 and 2025-26, "… the working of the fiscal framework and larger upward revisions to UK income tax revenue forecasts than our Scottish forecasts mean the income tax net position used to set the Scottish Budget has reduced funding by £575m between 2024-25 and 2025-26". It adds "this means that the overall changes in the Scottish Budget are more modest". The SFC further notes that—

   - Over the past year, "the Scottish economy and labour market have performed slightly better than we expected in December 2023, but are broadly on track with our last forecast".
   - GDP has increased marginally after being flat since early 2022, and "nominal earnings growth has remained relatively strong in a still tight labour market". The SFC's Forecasts show GDP growth rising to 1.6% in 2025-26, before returning to its trend rate of 1.4% by 2027-28, "which reflects our higher migration and population assumption".
   - Stronger earnings growth, combined with lower inflation than expected a year ago, has resulted in living standards recovering more rapidly from their fall in 2022-23.
   - Consumer Price Index (CPI) inflation is expected to rise to 2.6% across the UK in 2025-26, revised up from 1.6% in the SFC's last forecast, which "feeds through to higher nominal earnings growth in both Scotland and the UK in 2025-26".
   - The SFC's view is that the labour market in Scotland is still tighter than in the UK, consistent with regional data on job vacancies and worker shortages. This, it suggests, implies faster earnings growth in Scotland compared to the UK in 2025-26. In addition, it expects "the extra demand from the fiscal expansion will have a greater effect on earnings in Scotland, providing a small additional boost to Scottish earnings growth in 2025-26".

8. In relation to funding for the Scottish Government, the SFC highlights that—

   - Overall funding for 2025-26 is now £58,772 million (m), a real terms increase of 2.1% on 2024-25 (ABR figures). Resource funding is forecast to be £51,429m in 2025-26, a real terms increase of 0.8%.
   - Capital funding in 2025-26 is forecast to be £7,344m, a 12% increase in real terms on 2024-25. The Scottish Government plans to borrow the maximum amount possible in 2025-26 of £472m, and use £326m of ScotWind proceeds to support capital investment on green projects for the first time.

- While UK Government capital spending is set to rise in the next two years before flattening off at a higher level, Scottish Government capital funding peaks in 2025-26 before falling in 2026-27 and then broadly staying flat. The SFC explains the reason for this is that the Scottish Government plans to borrow less in 2026-27 than in 2025-26, and there is no planned use of ScotWind proceeds in 2026-27.
- The tax net position positively contributes to 2025-26 funding but less so than it did in 2024-25, and less so than expected in December 2023, when the SFC last forecast funding in 2025-26. The tax net position for 2025-26 is £1,175m which is £549m or 32% lower than in 2024-25. This, the SFC explains, is mostly because of improved forecasts of UK income tax revenues[1].

9. These issues were explored further during an evidence session with the SFC on 10 December 2024.

Scottish Government's taxation and spending plans

Overview

10. In its December 2024 Forecasts, the SFC explains that the Scottish Government has seen some large increases in funding as a result of the UK Autumn Budget 2024, "in particular there is more capital funding in real terms in 2025-26 than in previous years". However, it goes on to state that "after accounting for the working of the fiscal framework the increase is more modest for day-to-day (resource) spending which is the majority of the budget". It goes on to say that "existing and new social security commitments mean funding for other areas is lower in real terms in 2025-26 than in 2024-25".

11. The Cabinet Secretary for Finance and Local Government explained in her Foreword to the Scottish Budget 2025-26 that "this is a Budget by Scotland, for Scotland", suggesting that decisions are informed by views gathered through widespread engagement, including with opposition members. The Scottish Government states that "we can only build a more productive and innovative economy if we invest in infrastructure that delivers high quality public services, build more affordable homes for the families of children living below the poverty line and make decarbonisation a reality". It goes on to say that the Budget therefore "prioritises major investment in the foundations of our economy, such as housing, transport, digital connectivity, and delivering critical infrastructure for a green and growing economy".

Taxation policy

12. The Scottish Government states in the Scottish Budget 2025-26 that "our policy decisions at this budget will continue to deliver our progressive approach in Scotland, while raising substantial revenue to support the

[1] The latest OBR forecasts suggest larger UK revenues in 2024-25 which would reduce the tax net position in the current year.

delivery of our public services", adding "this means we are asking those with the broadest shoulders to contribute more". Key tax decisions in the Scottish Budget 2025-26 include—

- **A commitment not to increase the number of bands, or rates, of Scottish income tax for the remainder of this parliamentary session**[2]. The SFC forecasts that, in 2025-26, the freezing of the top three tax bands will add £76m in revenues, rising to £244m at the end of the forecast period. The SFC estimates that the behavioural response reduces the overall yield of this policy by £10m in 2025-26, reaching £31m by 2029-30.
- **Increasing the basic and immediate thresholds for income tax in 2025-26**. The SFC forecasts that these "above inflation" increases to thresholds will lower revenue by £24m in 2025-26, and that there is minimal expected behavioural response from the policy.
  The SFC states that income tax policy decisions taken together will raise additional revenue of £52m in 2025-26. It further estimates that "because of decisions on Scottish tax rates and thresholds, an additional £1,676m income tax will be raised in 2025-26 than would be the case if tax rates and thresholds from the rest of the UK were applied in Scotland". However, it explains that the income tax net position is only expected to be £838m, largely because of slower economic growth in Scotland since income tax was devolved. It notes, therefore, in return for Scottish income taxpayers paying £1,676m more in income tax, the Scottish Budget is only benefitting by £838m. The SFC describe this as an "economic performance gap".
- **A commitment to work with businesses across Scotland "to understand the cumulative impacts of tax on competitiveness".**
- **Maintaining current residential and non-residential rates and bands of Land and Buildings Transaction Tax (LBTT) at current levels**, while continuing first-time buyer reliefs. Additional Dwelling Supplement (ADS) rates will increase from 6 to 8% from 5 December 2024, which the SFC forecasts will raise £32m in additional revenue in 2025-26. In total, LBTT is forecast to raise £1,019m in 2025-26.
- **Increasing Scottish Landfill Tax (SLfT) rates in line with those in the rest of the UK**, to £126.15 per tonne for the standard rate, and £4.05 per tonne for the lower rate. Revenues from SLfT are forecast to reduce after the biodegradable municipal waste ban is introduced at the end of 2025, from £54m in 2024-25 to £40m in 2025-26.
- **Non-Domestic Rates (NDR) policy changes include freezing the Basic Property Rate and extending hospitality reliefs**. This includes maintaining the 100% relief for hospitality premises on islands, which was introduced in 2024-25, along with a new 40% relief, which will be available for "the 92% of hospitality premises liable for the Basic Property Rate, capped at £110,000 per business", as well as for grassroots music venues with a capacity of

[2] This is in line with the Scottish Government's Tax Strategy published alongside the Scottish Budget 2025-26.

below 1,500. The SFC estimates that this new 40% relief will cost £22m in 2025-26, in addition to the £5m cost of hospitality relief for the islands.
- **No cap on how much local authorities can raise council tax by next year**, although the Cabinet Secretary has suggested that there is "no reason for large increases" in council tax.

13. The SFC forecasts that, after taking account of behavioural changes, the combined effect of all the Scottish Government's tax policies amount to an extra £54m in 2025-26 and that devolved taxes[3] will raise a total of £24.6 billion (bn) in revenues in 2025-26.

Spending policies

14. The Scottish Government states in the Scottish Budget 2025-26 that it will focus resources across its four priorities, including growing the economy, delivering "almost £64bn of funding in 2025-26 towards these and to ensuring that we continue to protect the policies at the heart of our social contract[4], including delivering funding for a universal Pension Age Winter Heating Payment". Key spending decisions across all portfolios include—

- A "record investment" of £21bn in health and social care, including an increase in capital spending of £139m from 2024-25, to increase capacity and access to primary care "to shift the balance of care to preventative and community-based support and substantially reduce delayed discharge".
- A "record" £15bn in funding for local government,
- Providing £768m for affordable homes "enabling over 8000 new properties for social rent, mid-market rent and low-cost home ownership to be built this coming year".
- Restoring a universal winter heating payment to all pensioners. The SFC estimates this new policy will cost £69m more than associated funding from the UK Government in 2025-26.
- Developing systems necessary to "effectively scrap the impact of the two-child cap in 2026" (see paragraphs 16 to 18 below).
- Uprating all benefits in line with September 2024 CPI inflation and investing in a package of benefits and payments only available in Scotland totalling £644m in 2025-26. The SFC explains that social security spending is forecast to account for 13.5% of day-to-day spending in 2025-26, £1,334m higher than the corresponding funding provided by the UK Government[5].

[3] Scottish income tax, Land and Buildings Transaction Tax, Scottish Landfill Tax and Non-Domestic Rates.

[4] The Scottish Budget 2025-26 states that the Scottish Government will "protect the social contract at the heart of this Government's approach: continuing free prescriptions; ensuring that no Scotland student pays tuition fees; access to free bus travel for almost 2.3 million people".

[5] The SFC notes that this has grown significantly since 2022-23 when social security accounted for 9.7 per cent of day-to-day spending and was £481 million above UK funding.

- Allocating £25m to increase the number of jobs available in the green energy supply chain.
- Providing £3m for a Bright Start Breakfasts pilot, while continuing to invest in early learning, and
- Delivering a £34m uplift to the culture budget.

15. The Budget document notes that "as a result of the progress made to reach a balanced budget in 2024-25, this total investment will include over £300 million of ScotWind revenues in 2025-26 … on a range of projects for longer term benefits for Scotland – to deliver our ambitions to tackle climate change, invest in growing the economy and to create jobs, and to drive forward reform". It also confirms that it no longer expects to draw down around £424m of ScotWind funding in 2024-25 to meet resource funding demands. This figure has, following the UK Autumn Budget, been reduced to £160m.

Mitigating the two-child cap

16. As noted earlier in this paper, the SFC published a report containing its estimate of the cost of mitigating the two-child limit, and the impact this will have on the Scottish Budget on 7 January 2025, to assist the Committee and Parliament with scrutiny of the Scottish Budget. The SFC states in the report that "we would have liked to include a costing in our Forecasts, but the Scottish Government did not inform us of the policy until 28 November 2024". This, it notes, "was very late in the Budget process and a week and a day after the deadline for final policy measures".

17. The report states that the Scottish Government has announced that it plans to implement mitigation in 2026 but "will seek to accelerate the timetable if at all possible". The SFC's costings assume that mitigation will be paid from April 2026, with full-year costs for 2026-27. The SFC forecasts that, assuming the Scottish Government is able to implement this policy for all affected children, the cost would be £155m in 2026-27, rising to £198m in 2029-30. This increases the SFC's forecasts of social security spending overall from £7.5 billion to £7.6 billion for 2026-27, and from £8.8 billion to £9 billion for 2029-30. The SFC goes on to explain that—

> "By 2029-30 the additional spending on the proposed mitigation payments would account for 0.3 per cent of the Scottish Government's total resource funding. This would increase the share spent on social security to 14%, with a corresponding reduction in the amount available to fund other public services. This reflects the Scottish Government's approach to disability payments and its priorities to use the devolved social security system to support those on low incomes and pensioners and tackle child poverty, but it does mean that spending in other areas is constrained."

18. The SFC anticipates that the proposed mitigation payments would not generate large behavioural responses over and above the ways that families may already have adapted to the Scottish Child Payment. It further notes that "recent Scottish Government analysis did not find evidence of a large labour

market response to the introduction and expansion of Scottish Child Payment in recent years".

Public Sector Pay Policy 2025-26

19. Alongside the Scottish Budget 2025-26, the Scottish Government published its Public Sector Pay Policy 2025-26 which, it states, provides "pay metrics that are fair, sustainable and realistic within a multi-year pay envelope of 9% over 2025-26, 2026-27 and 2027-28 set against an expected inflation forecast of 7%, ensuring a level of pay restoration". Flexibility is being provided for employers to configure three-year proposals within the 9% pay envelope, "provided they have a fiscally sustainable approach". Any employer that does not agree a three-year pay deal will be restricted to a maximum 3% pay uplift for 2025-26.

20. In its December 2024 Forecasts, the SFC states that "although the Scottish Government has been clearer this year in setting out its pay policy, risks remain that paybill growth may be larger than planned either as a result of pay pressures or workforce changes". It went on to say that—

> "There may also be other factors which affect pay pressures such as pay progression within pay-bands, changes in the structure of grades within the public sector, vacancies and turnover which will also need to be accommodated by portfolios within their allocations as the Scottish Government has not made provision for increases in the paybill other than the 3 per cent pay award. The size of the workforce is also an important lever to manage the paybill. The Scottish Government has indicated that it will set out further detail on what this means for the public sector in Scotland as part of a Fiscal Sustainability Delivery Plan published alongside the MTFS, noting protection for frontline staffing, such as in the NHS."

21. The SFC has therefore, in addition to the 3% basic pay award, assumed that "the other factors such as pay progress add, based on historical data, an additional 1.5 percentage points to average pay growth, summing to 4.5% average pay growth in total in 2025-26". It goes on to say that "while there have been improvements in the information provided by the Scottish Government, there is still a need for greater clarity and monitoring of pay costs and workforce plans in the Scottish Budget".

National outcomes

22. The Committee has a continuing interest in the National Performance Framework and has repeatedly recommended the need for a clearer link between national outcomes and budgets. The Scottish Budget 2025-26 includes information on each portfolio's "intended contributions to the national outcomes", split by primary and secondary national outcomes.

23. The FPA Committee and other committees recently reported to Parliament on the Scottish Government's proposed national outcomes as part of the

statutory review. In the FPA Committee's debate on these reports on 8 January 2025, the Deputy First Minister advised that—

> "Over the next year, we propose to start again with the national performance framework—in other words, to look again at every aspect of it in order to develop and implement a stronger and more strategic and impactful framework for Scotland."

24. She went on to say that "we recognise that Government needs to lead on that work, but we are committing this afternoon to properly reviewing the national performance framework for the longer term, … and working with Parliament to ensure that we set out some clear goals that we can base Scotland's progress on."

Scottish Budget 2025-26: growing the economy

25. As one of the Scottish Government's four key priorities, the Scottish Budget 2025-26 includes a section on 'growing the economy' (pages 5 to 8) which states that—

> "We are focused on Scotland's long term growth and prosperity, with our investments targeted to enable us to make the most of our nation's many economic opportunities. This is a Budget that will set us up to prosper over these coming years, with public money used to support and encourage higher levels of private investment in key sectors, including energy. We are backing entrepreneurs and innovators, emerging tech including Artificial Intelligence (AI) and robotics and investing specifically to support growth in local economies."

26. The Scottish Government goes on to state that "our strategic investment in offshore wind in 2025-26 is designed to catalyse private investment in the infrastructure and manufacturing facilities critical to the growth of the sector, as part of our total investment of up to £500 million over five years which is expected to leverage £1.5 billion in private sector investment, supporting thousands of jobs, and helping deliver a sustainable supply chain". It further notes that "a stable tax system provides businesses with the confidence to plan and make investment decisions, supporting the conditions needed for a growing economy". Specific spending commitments include—

- providing "a further £200m (net) to the Scottish National Investment Bank, to ensure continuation and advancement of work to create jobs, support innovation and attract investment",
- providing over £7bn in investment in infrastructure, including £150m for offshore wind, expanding regeneration funding to £62m to invest in communities across Scotland, £100m for continued rollout of digital connectivity programmes across Scotland, almost £1.1bn for rail services and infrastructure and maintenance of the rail network, over £237m investment in maintaining ports, harbours and ferry fleets, and £550m investment in safety, maintenance and improvements in the trunk road network,

- continuing to invest over £2bn in Scotland's colleges, universities, and skills development programmes,
- providing £321m for the enterprise agencies to support Scottish businesses "to start and scale, be more productive, and access finance and attract investment",
- providing £15m to "expand support for female entrepreneurs and boost the economic impact of universities and fund the development of business clusters in advanced manufacturing and deeptech", and
- a "revitalised multi-million Rural Tourism Infrastructure Fund".

27. The SFC Forecasts note that capital funding is around 10% of the Scottish Budget and covers investment in assets such as roads and hospitals, and financial assets, adding that "after accounting for inflation, [this funding] is forecast to rise by 12% in 2025-26, before dropping in 2026-27 and remaining broadly flat".

Pre-budget recommendations and responses: economy

28. A summary of recommendations in the Committee's pre-budget 2025-26 report relating to growing the economy are set out below, along with relevant points made the Scottish Government in its response to the report (in italics)—

- The Committee welcomed the Cabinet Secretary's commitment to consider what more the Scottish Government can do to support research and development, recognising the important role that universities play in attracting investment, supporting Scotland's world-leading sectors, and building a highly skilled workforce. *In response, the Scottish Government states that it has prioritised funding to continue to support high-quality research and knowledge exchange across Scotland, increasing investment in higher education capital to over £350m for 2024-25. It also highlights that it "continues to fund innovation centres, interface and alliances for research challenges (ARCs) and enterprise agencies also invest in the commercialisation of research, economic infrastructure on university campuses and providing risk capital to promising university spinouts".*
- The report also welcomed the commitment to 'join up' the Tax Strategy with the National Strategy for Economic Transformation (NSET), while noting concerns of Audit Scotland that NSET "currently lacks collective political leadership and clear targets" and sought an update on progress with addressing these concerns. *The Scottish Government's response highlights that a Cabinet Sub-Committee on Investment and the Economy has been created, chaired by the Deputy First Minister, to "help create a business environment that drives investment and growth", by identifying opportunities/critical blockers/threats to investment across portfolios, making progress in the Green Industrial Strategy, ensuring budget decisions are consistent with the MTFS, and demonstrating its commitment to prioritise growth and investment.*
- The Committee asked the Scottish Government to set out its ambitions for increasing labour market participation and productivity levels in the

workforce in Scotland, with a view to growing the tax base, including the steps it will take to meet those ambitions. *The Scottish Government's response states that it is committed to improving access to health services, introducing enhanced specialist employability support, and investing up to £90m in 2024-25 for the delivering of devolved employability services. In addition, it makes commitments in relation to improving careers support and skills planning, and funding for early learning and childcare, public transport, and affordable housing.*

- The Committee requested clarification on how the Scottish Government plans to use any increase in capital expenditure arising from the UK Autumn Budget 2024, including to maximise opportunities for investment in areas that stimulate economic growth in Scotland. *The Scottish Government responded that it "will focus future capital spend to meet our priorities of eradicating child poverty, growing the economy, tackling the climate emergency and improving public services".*
- The Committee continued to press for the IiP pipeline reset to be published as early as possible. *In its response, the Scottish Government indicates that "the reset pipeline is intended to give certainty to the construction sector and other stakeholders on the Government's infrastructure plans and it would not be helpful to publish something ahead of the UK Spending Review, based on only partial information".*
- On taxation, the Committee asked the Scottish Government to consider how it might learn from Estonia's 'simple and competitive tax system'. *The Scottish Government responded that it has begun research to explore international tax policy and that the Tax Strategy outlines its intention to broaden evidence on "how the tax environment impacts on the competitiveness and attractiveness of Scotland's economy".*

Evidence received

29. On 17 December 2024, the Committee heard evidence from representatives of emerging and growth sectors in Scotland, as well as universities, Skills Development Scotland, Scottish Development International and Colleges Scotland, in relation to growing the economy. Issues raised during this session included—

    - While there are good examples of colleges being responsive to match skills development with the needs of the local economy, the "pace and ambition of the college sector needs to be matched by the Scottish Government". The "talent pool in Scotland is attractive – this needs to be maintained and improved".
    - Colleges Scotland told the Committee that bureaucracy around reporting, fundamental review, and reform of the funding model "in order for it to work for industry", and involvement of colleges in regional economic partnerships, is needed.
    - The planning consent process also requires to be quicker to stimulate growth.

- More progress with public service reform is required, including a focus on prevention, eliminating inefficiencies, and increasing productivity.
- A debate is needed on how a public/private partnership type model might work best in the future.
- Some energy companies are playing a wider role in society, including building housing and regenerating local areas.
- Visibility of new and emerging sectors is important in attracting and promoting career opportunities to the workers of the future.
- More inward investment is required, along with a phased approach to supporting supply chains and spinouts to enable, for example, medicines discovered in Scotland to also be manufactured here. Ireland is seen as an exemplar in creating opportunities for growth.
- Tax policy is a significant factor in competitiveness. The tax base needs to be increased through the retention and creation of highly skilled jobs.
- The Scottish Government needs to be clearer on sectoral strategies.

Scottish Budget 2025-26: public service reform

Overview

30. The Scottish Government states in the Scottish Budget 2025-26 that it will focus "on doubling down on reform and efficiencies across our public sector" and that the PSR programme "is vital to improving outcomes and achieving sustainable public finances in the longer term". It highlights that "to do that we will focus on early interventions and prevention, moving our system to working with people and communities, understanding their needs and giving them what they need to thrive". It goes on to state that—

> "We have set out a 10-year programme of PSR to Parliament, with a strong focus on the data, levers and workforce that will drive efficiency. To enable this work, we will deliver an Invest to Save fund in 2025-26, backed by up to £30m of funding recognising the need to catalyse efficiency, effectiveness and productivity projects as part of the PSR programme. We will integrate progress on PSR into the forthcoming Fiscal Sustainability Delivery Plan."

31. The Committee's pre-budget 2023-24 report published in November 2023 included recommendations arising from its inquiry into the Scottish Government's PSR Programme and agreed to continue to consider progress with the reform programme as part of its pre-budget scrutiny each year thereafter. In response, the Scottish Government committed to providing six-monthly updates on progress with its PSR programme in May/June and December. Its second full update was received on 23 September 2024.

32. In its pre-budget 2025-26 report, the Committee expressed disappointment that this delay had limited its ability to fully examine the update and therefore agreed to consider it in more detail as part of budget scrutiny 2025-26. The Scottish Government responded that this delay had been "due to various

reasons including the UK pre-election period" and that "the Minister is committed to submitting an update report in December 2024 to return to the original reporting pattern [and] beyond December 2024, our intention is to give a full update utilising the same approach". This update report was received on 21 December 2024. Both are summarised below.

Second full PSR update – September 2024

33. The Scottish Government's 23 September update states that—

> "There is a pressing requirement for reform to ensure fiscal sustainability. However, the route to achieving that fiscal sustainability is not about a focus on reduction in services, it is about reducing the demand for public services ('prevention') and changing the model of service delivery for better results. In short this is about focussing on improving outcomes, and ultimately improving people's lives."

34. The update also sets out the intended outcomes of the PSR programme as follows—

- "to ensure public services remain fiscally sustainable, by reducing the costs and reducing long-term demand through investment in prevention,
- to improve outcomes, which will improve lives and reduce demand, and
- to reduce inequalities of outcome among communities in Scotland, recognising the need not just for improved outcomes, but a focus in policy and delivery on those most disadvantaged."

35. Activity under this programme is grouped under three broad categories of: (1) driving efficiency and effectiveness, (2) service change and prevention, and (3) enabling structures. Progress has included cash savings of £5.5m in 2023-24 and £15m in 2024-25 through "specialist property negotiation around asset strategy for the Single Scottish Estate, liabilities for lease ends and rates combined with expert financial management". The Scottish Government estimates further savings of £8m in 2025-26 and 2026-27.

36. Through its Commercial Value for Money programme, £4m of cashable and £600,000 non-cashable savings have been delivered "with little or no impact on policy delivery", and a further £50m of savings are projected in 2026-27. Progress with individual projects is also included in the update, along with a copy of the draft Ministerial Control Framework (MCF): The Approvals Process for the Creation of New Public Bodies in Scotland: Guidance for SG Directorates (May 2023). The MCF restates the Scottish Government's policy that any new public body should only be set up as a last resort and sets out criteria to be met before any new public bodies are created.

37. The Scottish Government's update outlines that 143 automations have been delivered through the Intelligent Automation Centre of Excellence, with a

further 469 in the pipeline. It further notes that, over the next three years, "improving productivity using AI enabled automation has the potential to yield additional capacity equivalent to over 700 Full-Time Equivalents (FTE) across [the] Scottish Government". Also included in the update is information on how portfolios are driving service improvement, efficiency, effectiveness and improving the operation of public bodies, including commitments in relation to prevention.

PSR update report – December 2024

38. The Minister for Finance states in his covering letter to the PSR update report dated 21 December 2024 that "less than three months since the previous update, this update serves to reset the reporting rhythm and provide the Committee with a focussed update on progress". This, he notes, "should be an interim update, with future updates returning to the same format as the September update, tracking commitments to 2026".

39. The Minister goes on to state that he "will be leading the development of a PSR Strategy and will engage with public sector leaders at a PSR summit by the end of February 2025". This, he suggests, "will galvanise action behind PSR as well as bringing clarity to what our vision for PSR means across Scotland".

40. The update notes that data gathered by the Scottish Government on public body spend on corporate functions over the summer 2024 "has been used by Cabinet Secretaries through the Budget process to consider opportunities for further efficiencies and this will be an ongoing process as we move into the new financial year". The Scottish Government also plans to—

    - work with groups of similar bodies to conduct 'deep dives' into the data to understand better where there are opportunities for greater value for money and identify duplication,
    - collect and embed operational data on public services into future Budget processes, and
    - develop actions to support public bodies to "workforce plan effectively", including providing guidance on redeployment, as part of the forthcoming Fiscal Sustainability Delivery Plan, to be published alongside the MTFS.

41. The update report further notes that the Invest to Save fund of up to £30m announced in the 2025-26 Budget will "enable public bodies to invest in projects they could not achieve within annual revenue budgets that have a clear path to recurring savings" and encourage projects involving a combination of portfolios and public bodies. It also notes that the Scottish Government will work closely with public organisations to develop its approach and invite proposals in the New Year.

Pre-budget recommendations and response

42. In its pre-budget 2025-26 report, the Committee recommended that the Scottish Government should—

- Provide more information in its six-monthly updates on the upfront costs allocated to reform and cumulative savings. *The Scottish Government's response to the report did not include any reference to this recommendation.*
- Consider adopting "a more structured model of enabling exchanges between staff in the public and private sector, including flexible career pathways" and set out progress to achieving this mode of working in its six-monthly updates. *The Scottish Government responded that it would continue to use inward secondments "within a broad range of actions to build capabilities" and that outward secondments "will continue through the existing schemes" and remain as a development opportunity. It is updating its workforce plan, which includes capability planning activity and ensuring inward secondments are "being used to best effect to bring in specific skills and experience in targeted areas".*
- Consider and report back to the Committee on the potential benefits, risks, and costs of introducing a new category of public expenditure on preventative spend. *The Scottish Government stated that it is "taking forward work on preventative spend as part of the PSR programme and will update the Committee in due course". This work includes developing case studies examining post devolution examples of prevention that have resulted in improved outcomes, cost savings and/or reduced demand".*
- The Committee welcomed the First Minister's intention to provide "more concrete actions and fewer strategy documents" and sought an update on progress with this exercise, including any reduction in numbers achieved, as at December 2024 compared with the year before. *The Scottish Government responded that the Programme for Government set outs its strategic priorities, with individual strategies providing more detail on how they will be delivered. It goes on to say that "there is no central information held on reporting of the number of strategy documents, as decisions of this nature are made by individual cabinet secretaries".*
- Drawing on the experience of Estonia, where 1% of GDP is earmarked as stable state funding for IT (since 1998), consider whether Scotland should create a permanent spending commitment on IT, which can endure beyond political cycles. *The Scottish Government responded that it is currently implementing a portfolio approach to how its manages and implements digital projects which "will ensure the delivery of a portfolio of projects that is right sized to available funds and capability".*
- Set a standard for the interoperability of any newly created digital public service systems. *The Scottish Government indicated that its Digital Directorate's approach "is exactly what is being requested" and that it is also "pursuing interoperability of data for legacy digital public service systems".*

Evidence received

43. On 7 January 2025, the Committee took evidence from a number of the same organisations[6] it heard from on 30 May 2023 as part of its PSR inquiry, to explore progress with reform in the public sector and the support and leadership being provided by the Scottish Government to help facilitate this reform. Separately at that meeting, it also took evidence from the Auditor General for Scotland (AGS) on his report on Fiscal sustainability and reform in Scotland to inform its budget scrutiny. One of the key messages in the report is that—

> "The Scottish Government has identified a growing gap between its medium-term funding and spending position, but it has not yet set out a clear vision of how it will change public service delivery models to better support sustainable public finances and services. It does not yet have a good enough understanding of its cost base or made progress against audit recommendations to improve its future responses to crisis events."

44. In relation to public service reform, the report finds that "the Scottish Government has not provided the necessary leadership to public sector bodies to help deliver a programme of reform [and] it has not yet fully established effective governance arrangements for reform, and it is unclear what additional funding is required". Concerns were also raised regarding challenges in the collection of good quality data about the public sector workforce and estates.

45. Issues raised at the evidence session on 7 January 2025 include—

- Audit Scotland's recommendations remain relevant even after the Scottish Budget being published. It is hard to audit or scrutinise the PSR programme when it is a "moving target".
- Scottish Government has not made clear the extent to which the 'Invest to Save' fund will change delivery of public services.
- Excellent examples of PSR but it is unclear what the difference will be overall and whether prevention is embedded in the programme.
- It is hoped that the new PSR Strategy will allow proper monitoring of whether the Government is on track to deliver its aims.
- The Scottish Government uses the term 'right-sizing the public sector workforce', but it is unclear what the optimum size is.
- Government needs to set the right tone in terms of leadership and buy-in from public bodies for the PSR programme. This may not be

[6] Food Standards Scotland, NatureScot, Registers Scotland, South of Scotland Enterprise, Transport Scotland, and the Scottish Funding Council. It has also this time invited NHS National Services Scotland given that a significant proportion of the Scottish Budget goes on health, and the Fair Work Convention to discuss the extent to which fair work is being considered as part of the PSR programme.

apparent in evidence that the Scottish Government having to ask public bodies three times for PSR data.
- Some public bodies spoke of their experience of reducing the working week, with South of Scotland Enterprise noting that there had been no reduction in productivity when it introduced a four-day week.
- Others, such as Registers of Scotland (RoS), are aiming to reduce their headcount by 10% by 2027, through digitalisation and the demography of its workforce, while Food Standards Scotland (FSS) has seen a budget reduction of 25% over last 10 years.
- Transport Scotland argued that there is no 'one size fits all' in relation to reform across the public sector. Learning lessons and sharing best practice needs to be enhanced.
- Multi-year funding would help drive efficiencies, as would greater collaboration. FSS provided an example of co-funding a digital/data officer and offering co-location at no cost in an office with spare capacity that is leased until 2029. Ringfenced funding to support the sharing of services would be helpful.
- Many public bodies said they try to be as open and proactive as possible with the data they hold, however, improvements can be made to make public data more accessible and intuitive. Forums involving the Scottish Government relating to data/digital reform and guidance are in place, but public bodies are not mandated to make progress in this area. Interoperability of systems is an area where some progress is being made, though this remains challenging particularly with limited funds.

Scottish Government's Tax Strategy

Overview

46. As noted above, the Scottish Government published, alongside the Scottish Budget 2025-26 on 4 December, Scotland's Tax Strategy: Building on our Tax Principles. The Strategy is intended to expand on the Scottish Government's Framework for Tax 2021[7] and sets out the Scottish Government's approach to tax over the medium term across the devolved and local tax system.

47. The Committee expressed disappointment in its pre-budget report that the Scottish Government had not, as originally intended, first published a draft Tax Strategy for consultation. The Scottish Government explains that the Strategy was informed by engagement with stakeholders, including businesses, think tanks, academics, civic society groups and tax professionals. It also undertook a pre-budget engagement event with stakeholders, the outcomes of which are summarised in Scottish Budget 2025 to 2026: Public Attitudes to Tax, which was also published alongside the Budget document on 4 December 2024.

48. The Cabinet Secretary for Finance and Local Government explains in the Ministerial Foreword that the Strategy is intended to set out "the steps that will

[7] Framework for Tax 2021 - gov.scot

underpin this government's approach to developing tax policy; ensure the tax system raises the revenue needed to achieve our priorities; and support our growing economy". It explains that the Strategy sets out the Scottish Government's medium-term ambitions for how the tax system will develop to support the delivery of its four priorities: eradicating child poverty, growing the economy, tackling the climate emergency, and ensuring high quality and sustainable public services.

49. The Strategy outlines the Scottish Government's priorities for Scotland's existing tax system, setting out its intention not to introduce any new bands or increase the rates of Scottish Income Tax for the remainder of the Parliamentary session (as highlighted above). It suggests that this signals "a period of stability for our largest source of tax revenue [which] will allow us to assess the impacts of recent policy changes, and support the conditions needed for a growing economy".

50. The Scottish Government commits to increase public understanding of tax, strengthen its approach to compliance in collaboration with HMRC and Revenue Scotland, and work with administrators to ensure mechanisms for efficient tax collection, including increasing digitalisation of the Scottish tax system. It further states it will "renew considerations concerning changes to legislative processes for the fully devolved taxes", which may be of interest to Committee Members given their ongoing questions around the merits of a Finance Bill.

51. The Strategy further sets out commitments in relation to local taxes, including working in partnership with Local Government "to ensure that local taxes are fair and sustainable and to explore the creation of more revenue generating powers for local authorities". Concerns have continued to be raised by this Committee and others regarding lack of progress in relation to council tax reform. The Joint Working Group on Sources of Local Government Funding and Council Tax Reform begin a process of engagement in 2025 "to build consensus on the way forward for council tax reform", with the outcome of this work to be published by the end of the Parliamentary term.

Economy and the tax system

52. The Tax Strategy states that the Scottish Government will "drive forward a renewed focus on expanding the tax base and tax revenues by progressing specific economic activities with the potential to grow the economy and get more people into work". Specific actions include measures to maximise the potential of Scotland's workforce, provision of employability support, and continuing to deliver Scotland's Migration Service. The Scottish Government intends to broaden its understanding on how the competitiveness and attractiveness of Scotland's economy is impacted by the tax environment.

Evidence and evaluation

53. The Scottish Government commits to enhancing its evidence base to "inform tax policymaking and support evaluation of tax changes", including through

publishing its Areas of Research Interests on tax with available exploratory funding to support their development, and develop a regular programme of appraisal and evaluation across the Scottish tax system. Specific actions include formally evaluating the behavioural impact of changes to income tax in 2023-24 and 2024-25 once outturn data is available and conducting its first five-year LBTT review by the end of the Parliamentary session.

54. The Scottish Government plans to set out a detailed programme of work on future priorities alongside the next MTFS in 2025 and publish an update on progress against the Strategy in early 2026.

Pre-budget recommendations and responses

55. In its pre-budget 2025-26 report, the Committee recommended that the Strategy should provide a framework within which tax policies are designed to contribute to the longer-term sustainability of Scotland's public finances. The report also recommended that the Strategy should specify that, when developing future tax policy, the Scottish Government should assess how individual rates and bands in Scotland would interact with the UK-wide tax system, to avoid issues associated with anomalies relating to marginal tax rates in Scotland arising. It further asked the Scottish Government to reflect the issues raised in evidence to the Committee in the final Tax Strategy.

56. A number of witnesses, including the Auditor General, agreed that the introduction of a Tax Strategy is a welcome first step to greater certainty regarding future plans and approach.

57. In its briefing, SNP's tax strategy is a missed opportunity | Institute for Fiscal Studies, the Institute for Fiscal Studies (IFS) welcomed the Scottish Government's intention not to introduce any new tax bands for the remainder of the Parliamentary session. However, it noted that, while the Strategy's plan for income tax rates and thresholds for the remainder of the Parliamentary session provides helpful guidance to taxpayers, it will severely limit the Scottish Government's options should additional revenue need to be raised. The IFS also suggested that—

> "The Tax Strategy provides little sense of direction on tax policy beyond income tax. On council tax and business rates, for example, there is merely an intention to continue dialogue and engagement. It does not inspire confidence that much-needed reform will actually happen. There is welcome recognition of the value of more systematic evaluation of the effects of tax policy and plans to improve the administration of the tax system and taxpayers' understanding of it. It remains to be seen what will be achieved in practice."

Next steps

58. The Committee will consider a draft report in relation to its scrutiny of the Scottish Budget 2025-26 on 28 January 2025.

Committee Clerking Team
January 2025

ANNEXE A

Background to the Scottish Budget 2025-26

UK Government's public spending audit 2024-25

1. The UK Government published the outcomes of HM Treasury's Fixing the foundations: public spending audit 2024-25 on 29 July 2024, which "shows that the forecast overspend on departmental spending is expected to be £21.9 billion above the resource departmental expenditure limit totals set by HM Treasury in the Spring Budget 2024". The document set out "savings that have been identified [which …] together … will deliver £5.5 billion savings in 2024-25 rising to £8.1 billion in 2025-26", including departments absorbing public sector pay pressures and reducing consultancy and marketing spend. In addition, winter fuel payments would be targeted from this year.

2. The Chancellor of the Exchequer further announced that a multi-year Spending Review will conclude in Spring 2025[8] which will set spending plans for a minimum of three years of the five-year forecast period and "departmental expenditure limits for 2025-26 will be set out alongside the Budget in October, which will also confirm control totals for 2024-25". The Guardian reported on 28 November that the Spending Review would be delayed due to "drawn out and complex negotiations" and will now be published in June 2025. However, the same report states that Government officials have indicated there is no delay and the Review was always intended to be published between May and July.

3. The Cabinet Secretary for Finance and Local Government, Shona Robison MSP, confirmed in a letter to the Committee on 23 August 2024 that "… additional measures are now necessary following the UK Treasury's recent audit of public spending and lack of clarity over whether their decision to deliver Pay Review Body recommendations will be fully funded".[9] She advised that the Scottish Government has "introduced a set of spending controls with the intention of further reducing spend in 2024-25" and that it will replicate in Scotland the UK Government's decision to target winter fuel payments. In her fiscal statement to the Scottish Parliament on 3 September, the Cabinet Secretary outlined up to £500m of further savings measures including resuming peak train fares and not progressing the concessionary fares extension to the asylum seekers' pilot. At that time, she was also planning on using up to £460m of ScotWind money to plug funding gaps.

4. The Committee took evidence from the Minister for Public Finance on 12 November 2024 in relation to the Autumn Budget Revision which includes some of these changes to spending plans for 2024-25.

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[8] The UK Autumn Budget 2024 confirmed that the UK Government would be carrying out a Spending Review to conclude in **late** Spring 2025.

UK Autumn Budget 2024

5. In the UK Autumn Budget 2024 published on 30 October 2024, the Chancellor announced significant increases in public spending, financed by a combination of tax rises and higher borrowing. Public spending is set to increase by £70 billion per year over the next five years, with two-thirds going to day-to-day resource spending, and one-third to capital spend, such as transport, housing and research and development. The Chancellor suggested that this rise in capital spending will "keep public investment broadly flat at around 2.5% of GDP over the next five years, rather than dropping to the 1.7% assumed in the previous Government's plans"[9]. The national minimum wage will increase to £12.24 an hour from April 2025 (an increase of 6.7%); the rate for 18–20-year-olds will increase from £8.60 to £10 per hour and the minimum wage for apprentices will rise from £6.40 to £7.55 per hour. In addition, extra funds have been allocated for the infected blood and Post Office horizon compensation schemes.

6. Key tax measures announced by the Chancellor include—

    - Employer **National Insurance Contributions** (NICs) will rise by 1.2% to 15% from 6 April 2025. The level at which employers will start paying NICs for each employee is to fall from £9,100 to £5,000. This measure is forecast to raise £25.7 billion per year by 2029-30.
    - **Capital gains tax** will rise on disposals made on or after 30 October 2024 (the lower rate from 10% to 18%, and the higher rate from 20% to 24%).
    - The freezing of **inheritance tax thresholds** will be extended to 2030[10]. From April 2026, inheritance tax relief for business and agricultural assets will be capped at £1m, with a new reduced rate of 20% being charged on assets above that.
    - **Value-added Tax (VAT)** will be charged on private school fees across the UK.
    - The temporary 5p cut in **fuel duty** announced by the previous Government will be extended for one year to 2025-26.
    - The freeze in **income tax thresholds** will end in 2028-29, at which point thresholds will increase in line with inflation (England only).

7. The Chancellor also announced increases in borrowing, averaging around £32 billion per annum higher than the previous Government's plans over the forecast period. To allow space for this extra borrowing, the Chancellor changed the definition of debt in her fiscal rules. The Office for Budget Responsibility (OBR) has explained that the UK Government intends "to target Public Sector Net Financial Liabilities (PSNFL) as the main balance sheet aggregate in its fiscal rules". PSNFL is a wider measure of debt which includes financial assets and

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[9] Autumn budget 2024: Key announcements and analysis - House of Lords Library

[10] The previous UK Government had announced that this freeze would continue until 2028.

liabilities (such as the Student Loan Book and funded public sector pension schemes), meaning interest rates may take longer to fall[11].

8. Decisions in the UK Autumn Budget have led to additional consequential funding for the Scottish Budget, with £1.5 billion added to this year's budget[12] (2024-25), rising to £3.4 billion for 2025-26[13]. During evidence to the Committee on the Autumn Budget Revision on 12 November 2024, the Minister for Public Finance said that "we welcome the additional funding, but that funding is necessary to correct for persistent underinvestment in public services and to address the cost pressures that we face". He went on to explain that "the amounts provided by way of consequentials arising from the UK autumn budget are broadly consistent with what has been factored into our planning and we are therefore not in a position to reverse the savings that were previously announced".[14]

9. While public sector employers are expected to be compensated by HM Treasury for higher costs resulting from the NICs increase, it has yet to be confirmed what level of compensation will apply to Scotland, which has a larger proportion of its working population employed in the public sector than in England. In October 2024, the Scottish Government estimated that the UK Government's increase in NICs would add £500m to Scottish public sector costs.[15]

10. On 20 November 2024, the Scottish Government published the indicative costs of the policy to the Scottish public sector based on newly collected data, gathered by the Scottish Government between 8 November and 15 November 2024 from estimates provided by portfolios and organisations. Key findings include that "the static increase in employer NICs might cost between £520 million and £580 million in financial year 2025 to 2026 for directly employed public sector employees in Scotland's devolved public sector, with a central estimate of £550 million". The Scottish Government also notes the latest estimates on potential Barnett consequentials of up to £380m, suggesting a potential shortfall of around £140m to £200 million. However, it adds that this estimate of up to £380m is subject to a high degree of uncertainty and could be much lower if, for example, some of the additional funding does not generate consequentials, or higher if HM Treasury chooses to increase the overall sum available outside the normal operation of the Barnett formula.

11. The OBR observes in its October 2024 Economic and Fiscal Outlook that "the cancellation of the SFC's May forecast due to the announcement of the General Election means that its most recent forecast was published in December last year". It goes on to suggest that "the gap between this previous SFC forecast

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[11] Report on Pre-Budget Scrutiny 2025-26 - Managing Scotland's Public Finances: A Strategic Approach
[12] The Scottish Budget 2024-25 approved by Parliament earlier this year amounted to approximately £60 billion.
[13] £1.5 billion baselined into the 2024-25 Budget, and an additional £1.9 billion added for 2025-26, totals £3.4 billion.
[14] Official Report
[15] What's in the UK Budget? Ask Reeves. – SPICe Spotlight | Solas air SPICe

and ours means that making a detailed comparison and analysing differences between the forecasts is less informative than usual at this stage”.