Finance and Public Administration Committee
2nd Meeting, 2026 (Session 6)
Tuesday 13 January 2026

Scrutiny of the Scottish Budget 2026-27: UK context

Purpose

1. The Committee is invited to take evidence from the following witnesses from the Office for Budget Responsibility (OBR) in relation to the UK context to the forthcoming Scottish Budget 2026-27—

- Tom Joseph, Member of Budget Responsibility Committee,
- Laura Gardiner, Chief of staff, and
- Rosie Colthorpe, Deputy director – Economy

2. This paper includes a summary of key issues raised in the OBR's Economic and fiscal outlook and its Devolved tax and spending forecasts published on 26 November 2025. A summary of key announcements in the UK Budget 2025 is provided at Annexe A.

3. The Committee took evidence from David Phillips, Associate Director at the Institute for Fiscal Studies on the UK context to the Scottish Budget 2026-27 at its meeting on 16 December 2025.

OBR's Economic and fiscal outlook

Overview

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

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

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

7. The OBR further expects the unemployment rate "to remain close to its current rate of around 5% until 2027", before falling back to around 4% over the forecast. It explains that "the employment rate is expected to be broadly flat at around 61 per cent over the forecast, as a cyclical decline in the unemployment rate is offset by a structural fall in the participation rate from an ageing population and rising sickness-related inactivity".

8. According to the OBR, policies in the UK Autumn Budget "increase spending in every year and by £11 billion in 2029-30, primarily to pay for the summer reversals to welfare cuts and lift the two-child limit in universal credit".

9. The UK Budget also raises taxes "by amounts rising to £26 billion in 2029-30, through freezing personal tax thresholds and a host of smaller measures and brings the tax take to an all-time high of 38% of GDP in 2030-31". The OBR states that the tax increases which are expected to raise £0.7 billion next year and £26 billion in 2029-30 more than offset the increase in spending by the final years of the forecast.

10. Overall, the direct effect of these policy measures "increases borrowing by £3.7 billion in 2025-26, by £5.9 billion in 2026-27 and by £9.9 billion in 2027-28".

Productivity

11. The Committee has a long-standing interest in the actions being taken by Government to improve productivity growth in the UK and Scotland. Traditionally, the OBR has been more optimistic than the Scottish Fiscal Commission (SFC) with its forecasts for productivity growth.

12. In its November 2025 forecasts, the OBR has however reduced its central forecast for the underlying rate of productivity growth in the medium term to 1%, 0.3 percentage points slower than in its March forecasts. It explains that "the UK's productivity performance has undershot our forecasts, despite several substantial downgrades since 2010, as a significant rebound from recent negative shocks has not materialised".

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

14. The OBR's briefing paper (no.9) on forecasting productivity provides more detail on its decision. This explains that "[…] the productivity picture has become clearer and weaker more recently", highlighting "a more consistent picture of developments in hours worked, output, and productivity since 2020" due to improvements in the quality of labour force data produced by the Office for National

Statistics (ONS)[1]. The latest ONS data indicates that productivity fell by 0.5% in 2023 and a further 0.8% in 2024.

15. The OBR further highlights that "a number of underlying structural changes in the UK and global economy point to more persistent weakness in productivity growth relative to the period before the financial crisis". These include—

- UK and global trade intensity is expected to fall in the coming years, "as a result of the recent resurgence in global protectionism on top of the enduring effects of Brexit, and for this to weigh on productivity growth".

- The slowdown and falling contribution to productivity growth from the financial, manufacturing, and information and communications technologies (ICT) sectors since the mid-2000s "is unlikely to fully reverse or be offset by accelerating growth in other sectors".

- A set of underlying trends "whose combined effect should weigh on productivity growth". This includes "population ageing [which] is likely to increase employment in the health and social work sectors, which have relatively low levels of productivity". AI is expected "to make a smaller contribution to productivity growth over the next five years than the ICT revolution did before the financial crisis" and the OBR also suggests that climate change may have significant negative impacts on productivity growth.

Fiscal mandate and forecast cycle

16. In the OBR's central forecast, "the Government's fiscal mandate for the current budget to be in balance in 2029-30 is met by a margin of £22 billion (0.6% of GDP), which is £12 billion (0.3% of GDP) more than in March". This, the OBR suggests, "increases the Chancellor's probability of meeting her fiscal mandate from 54 per cent in March to 59 per cent in this event".

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

18. The UK Government announced as part of its Autumn 2025 Budget that it is "reforming the OBR forecast cycle". The Budget document states that "the government is delivering on its commitment to hold one fiscal event a year, by legislating so that the OBR's assessment of the government's performance against the fiscal mandate will happen once a year – at the annual Budget in the autumn, when the government sets out its tax and spending policy". It further notes that "the

[1] The OBR explains that "LFS sample sizes have now partially recovered, and the survey's labour supply estimates have converged with those from other sources, such as payroll data".

OBR will continue to publish a second forecast in the spring to provide an interim update on the economy and public finances".

19. The Fraser of Allander Institute suggested in its reaction blog published on 26 November 2025 that this however "is unlikely to have any practical consequences". It explained that "the OBR will still publish the relevant figures, and the headroom will be very easy to calculate by everyone", adding "this will do nothing to change fiscal volatility – only a move towards one forecast a year would".

20. On 5 January 2026, the Chancellor confirmed she has asked the OBR to prepare an Economic and fiscal forecast for publication on 3 March 2026, noting this will "fulfil the obligation required by the Budget Responsibility and National Audit Act 2011 for the OBR to produce at least two forecasts in a financial year". She went on to say that—

"As set out at the Budget, the spring forecast will not make an assessment of the Government's performance against the fiscal mandate and will provide an interim update on the economy and public finances.

The Government intend to respond to this with a statement to Parliament. This is in line with my commitment to deliver one major fiscal event a year at the Budget. This approach gives families and businesses the stability and certainty they need and, in turn, will support the Government's growth mission."

Issues affecting Scotland

21. The UK Budget document states that, as a result of the UK Budget 2025, the Scottish Government will receive an additional £510 million in resource funding over the next four years and an extra £310 million in capital funding over five years (£820 million in total).[2] The FAI suggested that this funding for the Scottish Government "is quite lumpy: there is a boost in the short-term, eroding away quickly and a small cut in day-to-day spending in 2028-29".[3]

22. Alongside its Economic and fiscal outlook, the OBR also published Devolved tax and spending forecasts, November 2025. The OBR forecasts that the Scottish tax Block Grant Adjustment (the amount removed from the Scottish Budget to reflect tax devolution) will be £21,382 million in 2026-27. This is slightly lower than the £21,658 forecast by the SFC in May 2025. SPICe highlighted in its reaction blog published on 27 November 2025 that "if the next forecast from the SFC expects a lower BGA than in May, this will be a boost for the Scottish Government".

23. SPICe further observed that the UK Budget has been accompanied by new forecasts for the GDP deflator, which are used to uprate borrowing limits in the fiscal framework. This means that the Scottish Government is able to borrow up to £491 million in capital in 2026-27, while the cumulative capital borrowing limit rises to £3,275 million. The annual limit on resource borrowing increases to £655 million,

[2] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy
[3] FAI Budget 2025 reaction: meeting the (briefed) expectations.

with the cumulative cap rising to £1,910 million, and the limit on the Scotland Reserve increases to £764 million[4].

24. The Scottish Government and HM Treasury are currently in discussions regarding the scope of a future fiscal framework review. As requested, the Committee submitted views on what should be included within scope of the review on 19 December 2025, including borrowing and the Scotland Reserve, the timing of fiscal events and forecasts, and block grant adjustments and forecasting.

Interaction between the SFC and OBR forecasts

25. At its evidence session with the SFC on 2 September 2025, the Committee explored the differing approaches taken to forecasting by the SFC and the OBR, and the possible implications for the Scottish Budget. The SFC explained that due to data quality issues, they were using Real Time Information from HMRC in place of the ONS Labour Force survey. Professor David Ulph[5] noted that:

> "One implication of that point in relation to the quality of our employment forecasts and comparing those to the OBR forecast is that we are not comparing like with like. Our forecast is based on RTI data and the outturns that come from that, while the OBR forecast is based on the labour force survey data and the outturns that come from that. That creates a challenge in understanding how well we are performing in forecasting."

26. The SFC also discussed the correlation between forecast errors by the SFC and by the OBR, and how this impacts reconciliation. Professor Ulph noted that analysis in 2021 assumed a correlation of around 50% between the SFC and OBR forecast errors, but subsequent data suggests that the correlation is actually around 80%. The SFC went on to say that—

> "The correlation matters quite a lot. If we and the OBR made exactly the same mistakes, there would be no reconciliation. It is only because we make different mistakes that we have the problem of reconciliation. That is why the correlation between what we do and what the OBR does matters."

27. The SFC noted, on the general interaction between the OBR and SFC forecasts, that it does not make independent judgements on the overall performance of the UK economy, but rather "we largely take the outcomes and risks that emerge from the OBR forecasts as a given and then look at those in Scotland-specific terms".

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

[5] Professor Ulph was one of the SFC Commissioners at the time of this evidence session. His tenure ran from October 2018 to October 2025.

Next steps

28. The Committee will take evidence on the Scottish Budget 2026-27 and accompanying SFC forecasts on 20 and 27 January 2026, before publishing a report of its scrutiny in early February.

Committee Clerking Team
January 2026

ANNEXE A

Key announcements in the UK Budget 2025

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

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

Removing the two-child limit in universal credit from April 2026. The UK Government estimates that this measure will lift 450,000 children out of poverty. The Fraser of Allander Institute (FAI) in its reaction blog on the UK Budget noted that this decision allows the Scottish Government to spend the £155 million it had set aside for mitigation on other priorities, although it also highlighted knock-on effects[6] that would reduce the net savings to around £121 million. [7]

Increasing the national living wage by 4.1% to £12.71 per hour for eligible workers aged 21 and over. For 18 to 20-year-olds, the increase will be 8.5% to £10.85 per hour and for 16 to 17-year-olds and apprentices 6.0% to £8.00 per hour.

Introducing a cash limit of £12,000 within the overall annual limit of £20,000 for individual savings accounts (ISAs).[8]

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

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

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

3. The Budget document states that, as a result of the UK Budget 2025, the Scottish Government will receive an additional £510 million in resource funding over the next four years and an extra £310 million in capital funding over five years (£820 million in total).[9] The FAI suggested that this funding for the Scottish Government "is

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[6] The FAI explained that scrapping of the two-child cap leads to additional costs to the Scottish Government "as it means more households are entitled to Universal Credit (and therefore for some Scottish benefits like the Scottish Child Payment) and moves more existing Universal Credit claimants onto the Benefit Cap (which is mitigated in Scotland through Discretionary Housing Payments)".
[7] FAI Budget 2025 reaction: meeting the (briefed) expectations.
[8] The limit will not apply to savers over the age of 65.
[9] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy

quite lumpy: there is a boost in the short-term, eroding away quickly and a small cut in day-to-day spending in 2028-29".[10]

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

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

Freezing personal tax thresholds for both income tax and national insurance contributions (NICs) for employees and self-employed individuals for a further three years—from April 2028 through until April 2031. Prior to the UK Budget there was speculation that income tax rates in the UK would be increased. The FAI had estimated that a two-percentage point increase in the basic rate of UK income tax would have led to a cut of around £1 billion in Scotland's block grant in each of the next three financial years.[11]

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

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

Increasing tax on property income and savings income by two percentage points at the basic, higher and additional rates from April 2027. The Budget states that the UK Government intends to "engage with the devolved governments of Scotland and Wales to provide them with the ability to set property income rates in line with their current income tax powers in their fiscal frameworks".[12] The Cabinet Secretary for Finance and Local Government wrote to the Committee on 9 December 2025 providing advance notice of a Legislative Consent Memorandum (LCM) relating to amendments to the UK Finance (No.2) Bill which would devolve this power to Scotland. The letter asks the Committee to consider and report on the LCM by the end of January 2026 to fit in with the UK Bill's timetable.

In its reaction blog on the UK Budget, SPICe noted that "once the Scottish Parliament has the powers to set income tax rates to property, it will presumably face a choice between at least matching the rates for England, or accepting a block grant adjustment which will reduce funding for the Scottish Budget".[13]

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

[10] FAI Budget 2025 reaction: meeting the (briefed) expectations.
[11] What would UK income tax changes mean for Scotland? | FAI
[12] Change to tax rates for property, savings and dividend income — technical note - GOV.UK
[13] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy

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

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

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

Implementing permanent lower business rates for retail, hospitality and leisure properties. SPICe commented in its blog that "it is certain that industry [in Scotland] will advocate for the Scottish Government to implement similar changes for retail, hospitality and leisure properties in Scotland".[14] The Scotsman newspaper reported on 11 December 2025 that 12 Scottish retail organisations have jointly written to the Cabinet Secretary for Finance and Local Government calling for a permanent business rate discount for all retailers at the Scottish Budget which is "at least as competitive" as the situation in England.[15] Five Business Improvement Districts have since, alongside the Scottish Retail Consortium, called on Scottish Government and MSPs to introduce a permanent business rate discount for all retail, hospitality, and leisure premises.[16]

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

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

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[14] SPICe UK Budget 2025: Key Changes and Impacts on Fiscal Policy
[15] Scotsman article, 11 December 2025
[16] Improvement districts back business rate discount for retail, hospitality and leisure | Scottish Financial News