House of Commons

Scottish Affairs Committee

The financing of the Scottish Government

First Report of Session 2024–25

HC 456

Scottish Affairs Committee

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Contacts

All correspondence should be addressed to the Clerk of the Scottish Affairs Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 1810; the Committee's email address is scotaffcom@parliament.uk. You can follow the Committee on X (formerly Twitter) using @CommonsScotAffs.

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Summary

1. The Barnett formula was never intended to be a permanent method of determining the level of funding the Scottish Government receives. Yet, nearly 50 years on from its introduction, it endures. Whether the formula remains the most appropriate method of determining the Scottish Government's funding has been the subject of continued debate. A number of changes have been proposed over the years. Such changes include putting the Barnett formula on a statutory footing, introducing a dispute resolution element, and replacing the formula altogether with full fiscal autonomy for Scotland. Throughout our inquiry we have examined all of these reforms in detail.

2. Ultimately, we find that whilst the Barnett formula is imperfect, it is nonetheless fit for purpose. We heard no evidence of a workable alternative to the formula, and we are not convinced there is a clear need for significant reform. We are also not convinced that the Scottish Government's policy of full fiscal autonomy is a realistic prospect.

3. While we support the continued use of the Barnett formula, we make a number of recommendations to improve the way it operates in practice, particularly in respect of increasing the transparency of how HM Treasury applies it. We also recommend changes to the broader framework for how Scotland's financing, including removing the cap on the Scotland Reserve, reviewing how borrowing limits are calculated, as well as changes to the frequency, timing and intergovernmental communication related to UK Government fiscal events.

Introduction: The history of the Barnett formula

The Scottish Budget

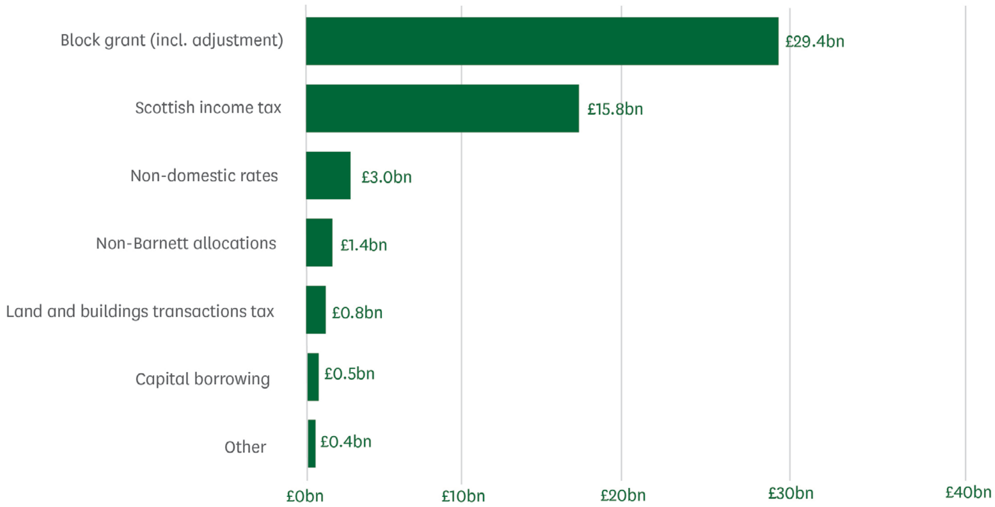
4. The Scottish Government is funded through a number of revenue sources, the largest and most fundamental of which is the block grant.[1] The block grant is the money transferred from the UK Government to the Scottish Government, to fund devolved public services in Scotland. The Scottish Government can spend the funds received through the block grant on devolved services as it wishes.[2] In 2023/24, the block grant was projected to be 54% of total Scottish Government revenue, at £29.4bn, and has increased to £34.7bn at the 2025–26 Main Estimates, a modest increase as a proportion of total revenue at 58% based on forecast tax receipts.[3] Other major components of the Scottish Budget include devolved taxes, such as Scottish income tax.

1 Scottish Fiscal Commission (FSG009) p3; Stuart McIntyre, Professor of Economics, University of Strathclyde; James Mitchell, Professor of Public Policy, University of Edinburgh; and Graeme Roy, Professor of Economics/Assistant Vice Principal, University of Glasgow, and Chair of the Scottish Fiscal Commission (FSG0008) p5

2 UK Government, Assessing the design and operation of the Scottish Government's block grant adjustments Background information and survey questions, 29 July 2022

3 IFS, The Scottish Budget 2025–26, Pg 90

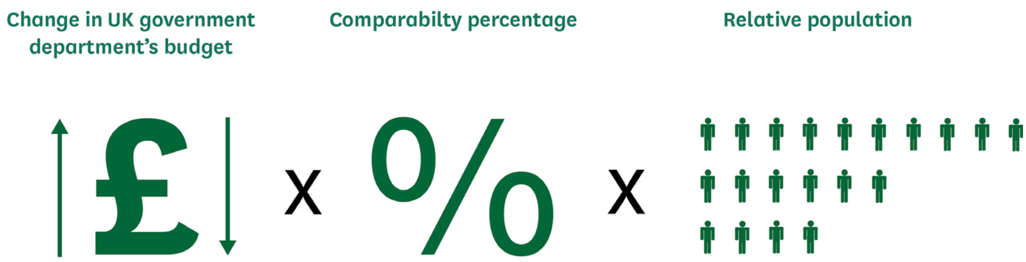
Scottish Government expected revenue, 2023/24



Source: Institute for Government analysis of the 2023/24 Scottish budget. Notes: includes both resources and capital block grants. The Scottish government collects non-domestic rates but transfers this to local authorities in full. Other includes Scottish landfill tax, non-tax income such as fine revenue, and other minor revenue sources.

5. The Barnett formula calculates the annual change in this block grant, in line with UK Government spending in England, or England and Wales, depending on the population served by the UK Government department. For example, HS2 is UK Government spending in England and Wales, for which Scotland receives consequentials. These annual changes or 'Barnett consequentials', are added to the previous year's block grant, then rolled forward to the next year.

The Barnett formula



6. Barnett consequentials are calculated on the basis of individual departmental spend, before being amalgamated to give a total figure. The first figure used in the formula is the change to each UK Government department's budget. This figure is multiplied by the relative population of the devolved nation, to try and ensure each devolved nation receives the same pounds-per-person change in funding.[4] This is calculated using the latest estimates from the Office for National Statistics (ONS). Finally, this figure is multiplied by the 'comparability percentage', which measures the extent to which a UK Government department's services are devolved.

7. The block grant is also adjusted to reflect devolution of taxes and social security spending through Block Grant Adjustments (BGAs). Tax BGAs are subtracted from the block grant to reflect the tax revenue the Scottish Government is now raising instead of the UK Government, when a tax is devolved.[5] Conversely, social security BGAs are additions to the block grant which account for the additional spending the Scottish Government is now responsible for when such responsibilities are devolved.[6] Forecasts on devolved taxes and social security spend from the Scottish Fiscal Commission (SFC) and Office for Budget Responsibility (OBR) feed into the calculations of these BGAs, and the wider Scottish Budget. Once the outturn data on this revenue and spend is available, reconciliation adjustments are made to correct the differences between the forecasts and actual figures.[7]

8. The final factors that feed into the Scottish Budget are the Scottish Government's borrowing powers and the Scotland Reserve. When there are forecast errors, the Scottish Government can undertake resource borrowing up to £600 million per year for day-to-day spending, with a cumulative limit of £1.75 billion.[8] For large-scale infrastructure and capital investments, the Scottish Government can undertake capital borrowing of up to £450 million per year, with a cumulative limit of £3 billion.[9] The Scotland Reserve is a mechanism that allows the Scottish Government to move funds from one financial year to the next and is capped at storing at just over £700 million in 2024–25. Chapter five of this report explores how these borrowing limits have been adjusted and proposed changes to these and the Scotland Reserve.

Our inquiry

9. Our inquiry spanned two public oral evidence sessions, in which we heard from expert commentators from the Institute for Fiscal Studies, the Scottish Fiscal Commission and the Fraser of Allander Institute, as well as the Secretary of State for Scotland. We also received written evidence submissions from a range of individual researchers, research bodies, public

4 House of Lords Library, The Barnett formula: How it operates and proposals for change, 6 March 2023
5 Scottish Fiscal Commission, Block Grant Adjustments
6 Scottish Fiscal Commission, Block Grant Adjustments
7 Audit Scotland, Administration of Scottish income tax 2023/24, January 2025; Fraser of Allander, Scottish Budget Guide
8 House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024
9 House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024

institutions, and others. We are disappointed that representatives from neither HM Treasury nor the Scottish Government accepted our invitation to give oral evidence, given the determinative impact the formula has on the level of funding for public services in Scotland, and therefore its tangible impact on the everyday lives of Scots. We would like to thank the Rt Hon Ian Murray MP, Secretary of State for Scotland for extending one of our regular Scotland Office sessions to contribute oral evidence to this inquiry.

Our report

10. This report begins by considering whether the Barnett formula is the most appropriate method of determining the level of funding for Scotland and exploring the calls for changes to its calculation, including suggestions of a needs-based element. In chapter two, we explore calls for greater transparency in the operation and application of the Barnett formula. Of particular interest to those giving evidence to this Committee has been the calculation of comparability percentages and calls for more timely publication of the Block Grant Transparency document, which sets out in detail how the block grants for the devolved administrations are calculated. In chapter three, we consider proposals for improved dispute resolution methods between the Scottish and UK Governments, as well as suggestions for a formalisation of the formula. In chapter four, we explore the challenges to the Scottish Government's financial stability stemming from the timing of UK fiscal events, the frequency of those events and the occurrences of in-year changes to funding. Finally, in chapter five we consider proposed changes to the Fiscal Framework which may offer the Scottish Government greater flexibility and help combat some of the challenges outlined in the preceding chapter.

1 Is the Barnett formula fit for purpose?

11. Whether the Barnett formula is the most appropriate method of determining the level of funding for Scotland has been the subject of continued debate. A number of changes have been proposed over the years, the most important of which are explored below.

History of the Barnett formula

12. Ahead of the planned 1978 devolution of powers to a Scottish Assembly, HM Treasury sought a formula to allocate public spending to the proposed Assembly that did not require annual negotiations.[10] Drawing upon the example of the Goschen formula - which was the first formula used to calculate funding for services in Scotland, Ireland and Wales in 1888, allocating funds based on population - the then-Labour Chief Secretary to the Treasury, Joel Barnett, created the Barnett formula.[11]

13. The Barnett formula was designed to function as a simple, automatic tool to calculate the funding allocations of the new assemblies that were expected to be created in Edinburgh and Cardiff.[12] Although Scottish devolution was not achieved in 1978, the Barnett formula was still put in place, being used instead to calculate the annual spending limits of the Scotland Office.[13] As stated in written evidence, the formula seeks to provide the "same cash per person change in funding for Scotland as it budgeted for comparable spending responsibilities in England".[14] The formula was intended to be temporary, with Barnett himself stating that he did not anticipate the formula lasting more than a year, and that he expected a "more sophisticated method that took account of needs" to be devised.[15]

10 These Islands, How does the Barnett Formula actually work?, 24 October 2017
11 Select Committee on the Barnett Formula, The Barnett Formula !! how to ref?
12 Institute for Government, Funding devolution: The Barnett formula in theory and practice, March 2021
13 As above
14 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
15 Barnett, J. Lord (2000) 'The Barnett formula: how a temporary expedient became permanent', New Economy, vol. 7 (2), pp. 69–71.

14. The Barnett formula has been the subject of several previous inquiries by parliamentary committees. These include inquiries by the House of Lords Committee on the Barnett Formula in 2009, and the House of Lords Constitution Committee in 2015, 2016 and 2022.[16] Key proposals arising from the reports which followed these inquiries, principally the inclusion of a needs-based element to the Barnett formula, will be discussed in chapter one.

Full fiscal autonomy

15. In response to our inquiry, the Scottish Government reiterated its policy of advocating for "full fiscal autonomy" within the current constitutional settlement.[17] It says such autonomy would "create a fairer system that would protect public services and allow investment in [the] economy".[18] This proposal has been a long-standing policy of the Scottish Government. In response to the Smith Commission, which was established in 2014 to consider the devolution of further powers to Scotland, the Scottish Government proposed that:

> The Scottish Parliament should have policy responsibility for all taxes unless there is a specific reason for a continued reservation. In particular, the Scottish Parliament should have full autonomy for income tax, national insurance, corporation tax, capital gains tax, fuel duty, air passenger duty and inheritance tax.[19]

The Scottish Government has said that such autonomy would ensure "simplicity and transparency in tax arrangements […] and minimise administrative and compliance burden".[20] Should the Scottish Parliament's financial powers fall short of full fiscal responsibility, as defined above, then the Barnett formula is the Scottish Government's preferred method of determining Scotland's level of funding.[21]

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16 House of Lords Select Committee on the Barnett Formula, First Report of Session 2008–09, The Barnett Formula, HL 139; House of Lords Select Committee on the Constitution, 11th Report of Session 2014–15, Inter-governmental relations in the United Kingdom, HL 146; House of Lords Select Committee on the Constitution, 10th Report of Session 2015–16,The Union and devolution, HL 149; House of Lords Select Committee on the Constitution, 10th Report of Session 2021–22, Respect and Co-operation: Building a Stronger Union for the 21st century, HL 142;

17 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

18 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

19 The Scottish Government, More powers for the Scottish Parliament: Scottish Government Proposals, 2014

20 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

21 The Scottish Government, More powers for the Scottish Parliament: Scottish Government Proposals, 2014

16. We have heard varying views as to the practicality of these proposals. David Phillips, Head of Devolved and Local Government Finance at the Institute for Fiscal Studies, explained that if full fiscal autonomy was pursued, devolving "all taxes, as far as possible" to the Scottish Government, certain exceptions would nonetheless still be required.[22] Phillips noted examples of such exceptions, including tariffs on external trade, which would need to continue to be managed by the UK Government, as well as certain areas of spending, such as defence and foreign affairs.[23]

17. João Sousa, Deputy Director at the Fraser of Allander Institute, similarly argued that full fiscal autonomy could face several difficulties in practice. Sousa emphasised how complicated such a change would be to enact, explaining that "there are a lot of taxes organised on a UK-wide basis, and there is currently no way to split them without creating a whole new system".[24] Sousa highlighted the example of VAT revenues, which were due to be assigned to the Scottish Government in April 2021, having been set out in the Scotland Act 2016. This assignment "has never been taken forward".[25] Further discussion of VAT revenue assignment will be explored later in this report.

18. If these challenges regarding the division of tax revenues were resolved, the question remains of how much this would benefit the Scottish Parliament in practice.[26] David Phillips explained that Scotland's revenue, per person, is approximately the same as the average across the UK, yet public spending per head in Scotland is approximately 12% higher.[27] Discussions of the drivers of this public spending will be explored later in this report, but Phillips' point was that, without a growth in revenues or a reduction in spending, establishing full fiscal autonomy for the Scottish Parliament could risk a budget deficit.[28] We also note that governments use deficits to achieve their goals.

19. The Rt Hon Ian Murray MP, Secretary of State for Scotland, voiced a similar concern, noting that full fiscal autonomy would cost the Scottish Government £8 billion per year.[29] The Minister expressed his view that the best way to fund public services would require maintaining "the funding formulas that are currently there".[30]

22 Q8 [David Phillips]
23 Q8 [David Phillips]
24 Q8 [João Sousa]
25 Q8 [João Sousa]
26 Q8 [David Phillips]
27 Q8 [David Phillips]
28 Q8 [David Phillips]; A budget deficit occurs when a government spends more than it receives in revenues and so must borrow to cover the difference.
29 The work of the department, 25 March 2025, Q3
30 The work of the department, 25 March 2025, Q3

20. **CONCLUSION**

We note the Scottish Government's call for full fiscal autonomy, but do not consider that this currently appears to be a realistic prospect. Fundamental questions remain about how full fiscal autonomy would work in practice, and whether it would be operable within the constraints of the UK's current devolution settlement. Practicality aside, we do not believe that a compelling case has been made that such a change would automatically result in Scotland receiving a higher level of funding. Given that the Scottish Government did not accept the invitation to come before us to explain its proposal and respond to these fundamental questions, we do not see how we can consider this a serious proposition, and we remain to be convinced that this proposal is desirable in principle, let alone workable in practice.

21. The remainder of this report explores the effectiveness of the Barnett formula, as it currently applies, and other features of the financing of the Scottish Government in more detail.

Continued use of the Barnett formula

22. Throughout our inquiry we heard a clear consensus about some of the Barnett formula's key benefits. Most notably, we heard that the formula is simple, and so provides a straightforward method for allocating funding around the UK.[31] As emphasised by the UK Government in its submission to us, this "simple and efficient" formula has "stood the test of time".[32]

23. Building on this point, João Sousa similarly pointed out that, while no version of the Barnett formula will be perfect, its predictability and simplicity are "its greatest strengths".[33] In written evidence, the Fraser of Allander Institute also explained how independent stakeholders can follow the Barnett formula calculations and compare the figures presented by HM Treasury with their own results, enabling effective scrutiny of the UK Government.[34] This level of transparency regarding the Barnett formula has been praised, although areas for improvement - notably concerning comparability percentages - will be discussed later in this report.[35]

31 Mr Richard Parry (FSG0005)
32 UK Government (FSG0003)
33 Q33; Fraser of Allander Institute (FSG0007)
34 Fraser of Allander Institute (FSG0007)
35 Fraser of Allander Institute (FSG0007)

24. The UK Government also argued that the Barnett formula “allows a pooling and sharing of risks and resources across the UK”.[36] It explained that, in doing so, the formula “ensures all parts of the UK receive a secure and stable level of funding for public services” as the cost of any downturns or benefits of any windfalls can be shared across all parts of the UK.[37]

25. Responding to this view, David Phillips from the Institute of Fiscal Studies agreed that it could be argued “there is a degree of pooling and sharing”, in terms of the Scottish Government’s revenues.[38] He set out the hypothetical example of a fall in revenues in Scotland driven by a downturn in the oil and gas industry, the costs of which would be felt in tax receipts (such as national insurance, corporation tax and VAT).[39] In this scenario Scotland would be somewhat insulated from the full negative fiscal impact of the fall in tax receipts, as the Scottish Government is not solely dependent on those receipts for its revenue.[40] Of course, the same principle also applies in reverse, wherein Scotland’s economic gains are similarly “pooled at the UK level and then allocated” across the UK through the Barnett formula.[41]

26. On the other hand, we also heard that this pooling and sharing of risks is only “partial”, because the formula does not take account of spending needs, and therefore does not mitigate key long-term spending risks driven by demographic change.[42] As explained above, the Barnett formula considers a population share of the annual change of spending in England, but does not factor in any features of that population - for example, whether the population in Scotland is ageing more quickly than England and requires more spend on healthcare. That “risk”, as it were, is not accounted for in the Barnett formula and therefore it cannot effectively share those risks across all parts of the UK.[43] It is for this reason that some commentators have proposed the introduction of a ‘needs-based’ element into the formula.

Consideration of need

27. Scotland is currently the only devolved nation whose funding needs are determined purely on the basis of population and comparability percentages, irrespective of the other factors that could influence spending demands. Suggestions that other factors should be used in the Barnett formula are based on the premise that the cost of providing public services

36 UK Government (FSG0003)
37 UK Government (FSG0003)
38 Q2 [David Phillips]
39 Q2 [David Phillips]
40 Q2 [David Phillips]
41 Q2 [David Phillips]
42 Q2 [David Phillips]
43 Q2 [David Phillips]; UK Government (FSG0003)

"is influenced by a range of factors" beyond just relative population size.[44] This 'need' could encompass the characteristics of that population, levels of deprivation and population density, as there are higher costs associated with the delivery of public services for a more disparate population.[45]

28. Factors beyond purely population size are used in both the Wales and Northern Ireland Barnett formulas. Both have in-built 'funding floors' which prevent their respective block grants from "falling below a needs-related level".[46] These 'floors' place a threshold under current funding levels, preventing funding falling below 115% and 124% in Wales and Northern Ireland respectively, relative to England.[47] In practice, this is premised on the idea that for every £100 spent in England, the delivery of the same services would cost £115 in Wales and £124 in Northern Ireland.

A Scottish funding floor

29. The Calman Commission, set up in 2009 to review the Scotland Act 1998 and the experience of Scottish devolution, argued that the block grant "as the means of financing most associated with equity […] should be justified by need".[48] In response to this conclusion, the UK Government said at the time it had "no plans to review the Barnett formula".[49] However, there have been continued calls ever since to introduce a needs-based element into Scotland's formula. For example, in 2016, the House of Lords Constitution Committee recommended that the UK Government replaced the Barnett formula with "a mechanism that takes into account the relative needs of different nations and regions in allocating funds" in order to ensure a fair distribution of resources.[50]

30. Despite these arguments, we have heard that rather than increasing the amount of money available for Scotland, the introduction of a needs-based element into Scotland's Barnett formula would reduce Scotland's funding. The Institute for Fiscal Studies explained that, while need in Scotland is "estimated to be higher than in England, higher incomes and lower poverty than in Wales and Northern Ireland mean that [Scotland's] needs

44 House of Commons Library, The Barnett formula and fiscal devolution, 20 February 2025
45 House of Commons Library, The Barnett formula and fiscal devolution, 20 February 2025; Institute for Government, Devolved public services, 20 April 2021
46 House of Commons Library, The Barnett formula and fiscal devolution, 20 February 2025
47 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
48 House of Commons Library, The Commission on Scottish Devolution – the Calman Commission, 4 June 2010
49 House of Commons Library, The Commission on Scottish Devolution – the Calman Commission, 4 June 2010
50 House of Lords Constitution Committee, Tenth Report of Session 2015–16, The Union and devolution, HL paper 149, para 117

are estimated to be lower than in those nations”.[51] David Phillips similarly explained that a needs-based assessment would reduce the Scottish Government’s funding.[52] Although the Barnett formula does not take account of spending needs, David Phillips explained that most evidence suggests that Scotland’s funding is already “some way above that needs level”.[53]

31. In written evidence, the UK Government noted that the “Scottish Government currently receives more than 20% per person than equivalent UK Government funding in the rest of the UK”.[54] In 2021, figures published by HM Treasury show estimates that comparable funding per person in Scotland is the highest of any UK nation, at 126% of English levels. The Institute for Government (IfG) has explained that one reason for this disparity in funding levels is because “historic differences in spending between the nations” have been preserved by the Barnett formula as it uses the “previous year’s devolved budget as a starting point”, as well as delays in updates to the population data used in the formula.[55]

Relative funding per head

Relative funding per head	Average over SR21 period (22–23 to 24–25)
UK Government	£100
Scottish Government	£126
Welsh Government	£120
Northern Ireland Executive	£121

Source: Block grant transparency spreadsheat and HM Treasury calculations in line with the methodology set out in the Welsh Government’s fiscal framework

In oral evidence, the Secretary of State emphasised this point, and said that the UK Government should use the formula “that gives the most funding for Scotland, because that is the way you deal with need”.[56]

32. Since our evidence sessions concluded for this inquiry, the Scottish Fiscal Commission (SFC) published its second Fiscal Sustainability Report, focusing on health. The SFC warned that the Scottish Government “will face significant challenges funding devolved public services” because of an ageing population, one aging earlier than the rest of the UK, and

51 Institute for Fiscal Studies (FSG0004)
52 Q13 [David Phillips]
53 Q11 [David Phillips]
54 UK Government (FSG0003)
55 IfG, The Barnett formula, 5 November 2020
56 The work of the department, 25 March 2025, Q2

rising health pressures in coming years, with the population aged over 85 projected to almost double in the next quarter century.[57] These growing pressures on public finance are concerning and may prompt further consideration of Scotland's spending needs in the future.

33. **CONCLUSION**
Whilst the Barnett formula is an imperfect method of calculating Scotland's funding, we have heard no convincing evidence of a workable alternative. We therefore consider the formula to be fit for purpose and are not convinced there is clear need to reform it significantly.

34. **CONCLUSION**
In particular, we are not convinced there is a need to introduce a needs-based factor into the Barnett formula at this time. Scotland currently may be receiving more than it would if a needs-based factor, like the floors introduced in Northern Ireland and Wales, were to be introduced. However, whilst such a factor is not appropriate at this time, the need of one should be kept under review.

35. Whilst we broadly accept the continued use of the Barnett formula, the changes set out later in the remainder of this report could improve its operation and effectiveness.

57 Scottish Fiscal Commission, Fiscal Sustainability Report – April 2025, April 2025, p6

2 Transparency

36. While our evidence generally shows that the Barnett formula works well, offering a stable and comprehensible funding mechanism, we have heard there is significant room for improvement in the transparency of the formula's application - particularly in respect of how comparability percentages are calculated, and the timeliness of publication of the Block Grant Transparency document. These points are discussed in turn below.

Calculation of comparability percentages

37. As outlined in the introduction to this report, Barnett consequentials are calculated by multiplying the annual change in UK Government department's budget by the relative population and the comparability percentage. The comparability percentage represents the level to which a UK Government department is responsible for delivering services in Scotland. These factors range from 0%, where none of a department's services are devolved, to 100%, where the entirety of its services are devolved.[58] For example, education is a policy area which is fully devolved, and so the Department for Education has a comparability percentage of 100%.[59]

38. Comparability percentages are decided by HM Treasury, in consultation with the Scottish Government, and are included in the Statement of Funding Policy, which sets out how UK Government funding for the devolved administrations is determined over the Spending Review period.[60] The Statement of Funding Policy lists each of the departmental comparability factors for Scotland, Wales and Northern Ireland respectively. However, the Statement does not set out how those factors have been calculated. The relevant change in each UK Government department's budget, and the figure for relative population (taken from population estimates from the Office for National Statistics), are both traceable and open to public scrutiny. Currently, comparability factors are therefore the only component of the Barnett formula which is opaque.

58 House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024
59 House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024
60 HM Treasury, Statement of Funding Policy addendum, October 2024

39. We have heard calls for greater transparency of the formula's application. For example, the Convention of Scottish Local Authorities (COSLA) called for consideration of how "timely transparency" of Barnett consequentials can be improved.[61] The Fraser of Allander Institute went on to describe the handling of comparability percentages as the "main issue [regarding a] lack of transparency and recourse".[62] Similarly, David Phillips called for "more information on the spending included and excluded from calculating comparability factors" to be published in the Statement of Funding Policy.[63]

40. The Secretary of State for Scotland, the Rt Hon Ian Murray MP, stated that comparability percentages are calculated through negotiation between the Scottish and UK Governments.[64] Although the details of those negotiations are not publicly available, the Minister noted that "the figures are there for people to see in terms of the quantum of resourcing".[65] The Minister described the comparability factors as being part of a "hugely complicated picture" and emphasised that these calculations are kept under review.[66]

41. **CONCLUSION**

The operation of the Barnett formula is not as transparent as it could or should be. In particular, there is a lack of transparency around how comparability percentages are calculated. Comparability percentages are a fundamental feature of the Barnett formula and the only multiplier which cannot be effectively scrutinised by the public. We have heard no good reason for this opacity, which limits the ability of the public and UK and Scottish Parliaments to hold their respective Governments to account.

42. **RECOMMENDATION**

In all future Statements of Funding Policy, the UK Government should include details of how the comparability percentage of each department has been calculated, including a programme-by-programme breakdown of what has and has not been included in the calculation.

61 The Convention of Scottish Local Authorities (COSLA) (FSG0001)
62 The Fraser of Allander Institute (FSG0007)
63 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
64 The work of the department, 25 March 2025, Q5
65 The work of the department, 25 March 2025, Q5
66 The work of the department, 25 March 2025, Q5

Timeliness of Block Grant Transparency document publication

43. The Block Grant Transparency document sets out how the Scottish Government's block grant has been calculated.[67] This document is updated by HM Treasury based on the Statement of Funding Policy, in consultation with the Scottish Government and other devolved administrations.[68] The UK Government championed the Block Grant Transparency publication as evidence of its operation of the block grant being "transparent and open to scrutiny".[69]

44. However, while we have heard praise for the publication offering important information on how funding changes have been calculated, the documents are often published with a significant time lag. Indeed, the latest version of the document was published in July 2023, since when there have been "quite a lot of significant changes".[70] This view was shared by both David Phillips and Claire Murdoch, Head of Social Security and Public Funding at the Scottish Fiscal Commission, both of whom criticised the late publication.[71] Murdoch suggested that it would be helpful for the Treasury to "clearly publish" what changes have been made in each new publication of the document, highlighting "which elements of additional funding are being baselined for future years, and which are non-recurring".[72] Murdoch explained that such changes would help devolved administrations and stakeholders better understand the Scottish Government's funding position and the basis of its year-to-year changes, thereby enabling greater scrutiny.[73]

45. In response to these concerns, the Secretary of State emphasised the importance of the Block Grant Transparency document and noted that a new version would be published after the spending review in June.[74]

67 HM Treasury, Block Grant Transparency: July 2023, 16 August 2023
68 Scottish Fiscal Commission (SFG0009)
69 UK Government (FSG0003)
70 Q17 [Claire Murdoch]
71 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004); Q17 [Claire Murdoch]
72 Q17 [Claire Murdoch]
73 Q17 [Claire Murdoch]
74 The work of the department, 25 March 2025, Q6

46. **CONCLUSION**

We recognise the importance of the Block Grant Transparency document, as well as the value in it being published in a timely manner. We welcome the Secretary of State's commitment to publishing an updated document after the 2025 Spending Review and hope the Government will continue this practice in future years. We see no reason why HM Treasury cannot provide an updated Block Grant Transparency document alongside each major fiscal event in the same way in which it provides a raft of other relevant documents to accompany such events.

47. **RECOMMENDATION**

The UK Government should publish an updated Block Grant Transparency document alongside each fiscal event which will result in changes to Scotland's funding.

3 Dispute resolution and formalisation

48. We have heard that the Treasury holds a great deal more power than the devolved administrations when it comes to the application of the Barnett formula, and its corresponding dispute resolution mechanisms.[75] This reflects the nature of the UK's devolution settlement. Potential resolutions to this imbalance, including the possibility of an independent dispute resolution body or some formalisation of the formula, are explored in this chapter.

Classification of Barnett spend

49. HM Treasury is the ultimate authority on the application of the Barnett formula and what UK Government spending it is applied to.[76] When making these decisions, HM Treasury considers which parts of the UK benefit from the government spending in question.[77] For example, if spending is considered beneficial for the whole of the UK, such as spending on a reserved policy area like defence, there will be no corresponding increase in funding to the Scottish Government through the Barnett formula. Conversely, when there is an increase in UK Government spending in a devolved policy area like healthcare, the Barnett formula would be applied to that spending, leading to a corresponding increase in the Scottish Government's budget. This classification can lead to disagreements between the devolved governments and the Treasury over whether or not additional consequentials should be paid.

HS2 Spending

50. A recent example of HM Treasury exercising this classification authority concerns spending for HS2. Rail infrastructure is reserved in Wales, unlike Scotland and Northern Ireland, prompting HM Treasury to class HS2 an

75 Fraser of Allander Institute (FSG0007)
76 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021
77 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021

'England and Wales' project which benefits both countries.[78] As a result, Wales did not receive Barnett consequentials for the spending on HS2, unlike Scotland and Northern Ireland.[79]

51. The UK Government has highlighted that although the Welsh Government does not receive direct Barnett consequential from HS2 spending, it has benefited from the increases in the Department for Transport's budget. Spending on HS2 has increased the Department's budget, which at the time had a comparability factor of 80.9% for Wales (though this figure has since decreased). As such, the UK Government argues that the HS2 project has still benefitted Wales through "indirect consequentials", which amounted to £755 million between 2015 and 2019.[80]

52. In 2021, the Welsh Affairs Committee recommended that HS2 should be reclassified as an England only project, "to ensure that Welsh rail passengers receive the same advantage from investment in HS2 as those in Scotland and Northern Ireland".[81] In 2023, the then First Minister Mark Drakeford, said legal action was being considered by the Welsh Government, although that Minister afterwards confirmed they would not take the issue to court after legal advice indicated such a legal challenge is "unlikely to succeed".[82]

The ultimate arbiters

53. It is also within the gift of UK Government ministers to bypass the formula altogether, with no formal requirement to account for such decisions.[83] This has been seen in the allocation of additional resource designed to boost regional economies through the City Region Deals.[84] A controversial example in 2017 saw the UK Government agree to allocate an extra £1bn to Northern Ireland following negotiations over the "confidence and supply agreement" with the Democratic Unionist Party at Westminster, with no resultant consequentials for Wales or Scotland.[85]

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78 House of Commons Library, Transport funding for Wales and HS2, 22 October 2021
79 House of Commons Library, High Speed Rail 2 – an overview, 12 December 2024
80 House of Commons Library, High Speed Rail 2 – an overview, 12 December 2024
81 Welsh Affairs Committee, First Report of Session 2021–22, Railway Infrastructure in Wales, July 2021 HC 438, para 106
82 BBC News, No court action to seek HS2 Wales cash, 18 April 2024
83 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021
84 House of Lords Library, The Barnett formula: How it operates and proposals for change, 06 March, 2023
85 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021

54. This decision-making power which the UK Government holds over how and when the formula is applied prompted the Fraser of Allander Institute to label HM Treasury "ultimate arbiters".[86] It described HM Treasury as acting as "both rule-maker and referee" and having what appears to be "complete discretion" regarding the application of the Barnett formula.[87]

55. However, the Institute for Government (IfG) suggested that, broadly speaking, "there is little controversy" as to whether UK Government spending should generate Barnett consequentials "because the lines between devolved and reserved policy areas are relatively clear".[88] Those cases where controversy arises is driven by a lack of clarity as to whether or not a policy area is fully devolved. A 2019 study conducted by the National Audit Office concluded that the application of the Barnett formula is only "more complex" when there is more subjectivity in HM Treasury's categorisation decisions, which arises when a service is not fully devolved – as demonstrated in the previous example concerning HS2.[89]

56. We heard from many stakeholders that HM Treasury's absolute discretion over spending classifications is unfair. João Sousa suggested that there is a "strong case" for other parties to be consulted in such decisions or, failing that, for an independent dispute mechanism to be introduced, a proposal which will be discussed later in this chapter.[90] Similarly, the Convention of Scottish Local Authorities has said that, should a review of Barnett be considered, HM Treasury's decision only to apply the Barnett formula to "certain departmental spending" and not others, particularly in respect of large UK infrastructure projects, should be examined.[91]

57. The Secretary of State accepted that the Treasury is the ultimate arbiter "on the basis that it holds the pen on the budgets" but pointed to the "whole host of infrastructure" which allows the Scottish Government to engage with the operation of the Barnett formula.[92] In particular, the Secretary of State highlighted the Finance Interministerial Standing Committee (F:ISC) and the Joint Exchequer Committee, both of which offer forums for engagement between UK and Scottish Government finance ministers.[93] The F:ISC is part of the new intergovernmental relations framework and works to "consider the impact of economic and finance matters affecting the UK", led by

86 Fraser of Allander Institute (FSG0007)
87 Fraser of Allander Institute, Bypassing Barnet, 27 June 2017
88 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021
89 Institute for Government, Funding devolution The Barnett formula in theory and practice, March 2021; Comptroller and Auditor General, Investigation into devolved funding, Session 2017–2019, HC 1990, National Audit Office, 2019
90 Q21 [João Sousa]
91 The Convention of Scottish Local Authorities (COSLA) (FSG0001)
92 The work of the department, 25 March 2025, Q7
93 The work of the department, 25 March 2025, Q7

finance ministers from the UK and devolved administrations.[94] Similarly, the Joint Exchequer Committee, which was established in 2011 by the UK and Scottish Governments, acts as the intergovernmental ministerial forum for discussions of "financial and fiscal matters relating to the Scotland Act 2016 and accompanying Fiscal Framework".[95]

Independent dispute resolution body

Current dispute resolution process

58. In the absence of broader consultation of stakeholders, João Sousa called for changes to be made to the dispute resolution process.[96] At present, when the Scottish Government is unhappy with the calculation of the block grant or operation of the Barnett formula, it can raise a dispute with HM Treasury.[97] This dispute may then be escalated through the F:ISC, as outlined in the Statement of Funding Policy.[98] If the disagreement cannot be resolved through normal channels at "portfolio-level" and has "significant implications for the relationship between two or more governments", then any government can also raise a dispute through the F:ISC Secretariat and Intergovernmental Relations Secretariat - the impartial body that supports effective intergovernmental relations between the UK, Welsh and Scottish Government and the Northern Ireland Executive.[99] However, the IFS highlighted that the F:ISC is a "consultative rather than decision-making body", meaning the final decision-making power nonetheless still rests with HM Treasury.[100]

59. Disputes relating to the Fiscal Framework, such as those regarding the calculation of Block Grant Adjustments, modifications made to the block grant to reflect the devolution of tax or social security responsibilities, are addressed through a separate process.[101] These disputes are escalated "from officials, to senior officials, to Treasury and Finance ministers".[102] As set out in the Fiscal Framework, "technical input" on a dispute may be sought from

94 UK Government, Review of intergovernmental relations, 13 January 2022; UK Government, Terms of Reference for the Finance Interministerial Standing Committee, 25 September 2023
95 Scottish Government, Fiscal Framework: agreement between the Scottish and UK Governments, 2 August 2023
96 Q21 [João Sousa]
97 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
98 HM Treasury, Statement of Funding Policy, November 2023
99 HM Treasury, Statement of Funding Policy, November 2023; UK Government, Intergovernmental relations, 25 March 225
100 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
101 Scottish Fiscal Commission, Block Grant Adjustments
102 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)

the OBR and Scottish Fiscal Commission, the bodies responsible for preparing independent forecasts of tax receipts and social security spend.[103] If no agreement can be reached on a dispute, the dispute "falls", meaning the default arrangements under the Fiscal Framework would prevail.[104]

Calls for an independent body

60. In written evidence, concerns were raised about these dispute resolution mechanisms, which were described by the Fraser of Allander Institute as neither "automatic nor independent", relying instead on "agreement between the parties".[105] If no agreement is reached, then no change occurs.[106] The Fraser of Allander Institute explained how drawn-out the dispute resolution process can be, even for straightforward cases, which can disincentivise the raising of disputes.[107] It highlighted the example of a dispute between the UK and Scottish Governments regarding the spillover effects of changes to the Personal Allowance for income tax in 2018–19 and 2019–20, whereby one government "makes a policy decision that affects the tax receipts or expenditure of another".[108] Although both Governments agreed there was a spillover effect resulting from the UK Government's decision to increase Personal Allowance thresholds, disagreement on "the counterfactual against which the spillover effect should be measured, and the amount owed" persisted.[109] In July 2022, several years after the issue was initially raised by the Scottish Government in 2019, the dispute was resolved, resulting in the UK Government transferring £375 million to the Scottish Government.[110]

61. To increase the likelihood of such disputes being resolved, the Fraser of Allander Institute suggested the establishment of a jointly nominated dispute resolution body.[111] This suggestion was been echoed by David Phillips of the Institute for Fiscal Studies, who suggested that, were the Barnett formula to be put on a statutory basis, it could then be subject to "either

103 Scottish Government, Fiscal Framework: agreement between the Scottish and UK Governments, 2 August 2023
104 Scottish Government, Fiscal Framework: agreement between the Scottish and UK Governments, 2 August 2023
105 The Fraser of Allander Institute (FSG0007)
106 The Fraser of Allander Institute (FSG0007)
107 The Fraser of Allander Institute (FSG0007)
108 The Fraser of Allander Institute (FSG0007) ; The Scottish Government, Fiscal Framework: agreement between the Scottish and UK Governments, 2 August 2023
109 Scottish Government, "Other Income" expected by the Scottish Government in relation to personal allowance calculations: FOI release, 5 October 2022
110 The Fraser of Allander Institute, Weekly update: inflation, earnings, and budget windfall, 22 July 2022; Scottish Government, Implementation of the Scotland Act 2016: third report, 24 April 2019
111 The Fraser of Allander Institute (FSG0007)

an independent voice or a legal voice”.[112] Phillips acknowledged that the “design of the allocation process is ultimately a political decision” and the rules for this process should therefore be decided by politicians, but that there could be a role for an independent body to determine whether or not those rules are being followed.[113]

62. When questioned on the possibility of introducing a third-party dispute mechanism, the Secretary of State highlighted that both Parliaments and the public can act as that third party.[114] The Minister again noted that both Governments already work closely on dispute issues and highlighted the existing frameworks for dispute resolution and cooperation.[115]

Formalising the Barnett formula

63. The Barnett formula is non-statutory, meaning it does not have a basis in legislation, and the UK Government is not therefore legally required to apply it. There is therefore no legal recourse for the Scottish Government to challenge the UK Government’s application of the formula, if a dispute arises.[116] Instead, the formula is Treasury policy, which can, in theory and practice, be used or changed by the UK Government as it wishes.[117] We heard a variety of views about whether this should be changed by putting the formula on a statutory footing.[118]

64. On the one hand, formalising the formula through legislation may offer the Scottish Government, and potentially other actors, a legal route to challenge the operation of funding arrangements. David Phillips explained that, if put on a legislative footing the bypassing and operation could “in principle” be challenged in court and could require primary legislation.[119] The Institute for Fiscal Studies noted that any legislation would require careful drafting, with the clear intention that “courts should be asked to determine whether a clear set of rules are being followed”, rather than to determine the appropriate level of funding, as this remains a political choice.[120] Conversely, the Fraser of Allander Institute said that the current lack of statutory footing “has no practical implication”.[121] It explained that

112 Q21 [David Phillips]
113 Q21 [David Phillips]
114 The work of the department, 25 March 2025, Q9
115 The work of the department, 25 March 2025, Q9
116 Full Fact, The Barnett Formula isn’t set out in law, 6 December 2019
117 House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024
118 The Fraser of Allander Institute (FSG0007)
119 Q17 [David Phillips]
120 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
121 The Fraser of Allander Institute (FSG0007)

the Barnett formula is “now a well-established part of the constitutional settlement” and is not unlike the other “tenets of the UK’s unwritten constitution”.[122]

65. Formalising may also enable better scrutiny. The Fraser of Allander Institute notes that legislating could create a forum for discussion and potential changes to the formula.[123] Similarly, David Phillips of the Institute for Fiscal Studies said such a footing could ensure changes to such funding policies come under greater Parliamentary scrutiny.[124]

66. During our oral evidence, all three witnesses - Claire Murdoch, David Phillips and João Sousa - agreed that there are more “pressing issues” regarding the Barnett formula, such as improving transparency, which should be the focus of reforming efforts.[125]

67. When questioned on the proposal, the Secretary of State emphasised that he did not see any good reason to formalise the Barnett formula.[126] The Minister emphasised that the Barnett formula “works incredibly well”, supported by an infrastructure of intergovernmental relations.[127] Laurence Rockey, Director of the Scotland Office, suggested that any formalisation of the formula may add unnecessary complexity, and restrict the flexibility enjoyed by both the UK and Scottish Governments in its operation.[128]

68. **CONCLUSION**

HM Treasury, and therefore the UK Government, is the “ultimate arbiter” of the Barnett formula. As the formula is non-statutory, there is no legal recourse for the Scottish Government to challenge the UK Government’s application of it. There is also currently no formal, objective dispute resolution process relating to the application of the formula, although there are existing intergovernmental structures through which such matters can be raised. An imbalance persists however, with HM Treasury’s position enduring when agreement between parties cannot be reached, as reflects the UK Government’s constitutional position within the UK’s devolution arrangement.

122 The Fraser of Allander Institute (FSG0007)
123 As above
124 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
125 Q18–19
126 The work of the department, 25 March 2025, Q8
127 The work of the department, 25 March 2025, Q8
128 The work of the department, 25 March 2025, Q8

69. **RECOMMENDATION**

We are not convinced that putting the Barnett formula on a statutory footing, or otherwise formalising it, would significantly improve its effectiveness. The use of the Barnett formula is already a well-established practice, not unlike other features of the UK's uncodified constitution. Although new routes to legal challenge may be opened though legislation, such a change would restrict the flexibility of the operation of the formula, with little evidence there would be practical benefits for either Government. We also cannot see how a new dispute resolution process specifically for the Barnett formula would not unduly overlap with or duplicate the existing intergovernmental dispute resolution process.

4 Budget stability

70. The finances of the Scottish Government are intrinsically linked to decisions in Westminster. The timing of UK Government fiscal events, as well as unexpected in-year changes to UK spending all impact the stability of devolved finances, as explored below.

Timing difficulties

71. The Fiscal Framework allows the Scottish Government a relative degree of financial certainty, as the Barnett formula is only used to calculate the year-on-year changes to the block grant, rather than calculating it from scratch every year.[129] However, the overall fiscal stance of the UK Government inherently impacts the Scottish Government's fiscal policy, as any changes to UK Government in-year spending can result in consequential changes to the next grant. These impacts are particularly apparent in respect of supplementary estimates, the Budget, and in-year spending changes.

Supplementary Estimates

72. The timing of UK Government fiscal events was highlighted as a challenge for the Scottish Government in terms of budgetary stability by the Scottish Government which told us that the current timetable for UK fiscal events "exacerbates funding volatility and uncertainty, making financial planning difficult for Devolved Governments".[130] In particular, both the Scottish Government and Scottish Fiscal Commission highlighted the challenges raised by the timing of the Supplementary Estimates process.[131]

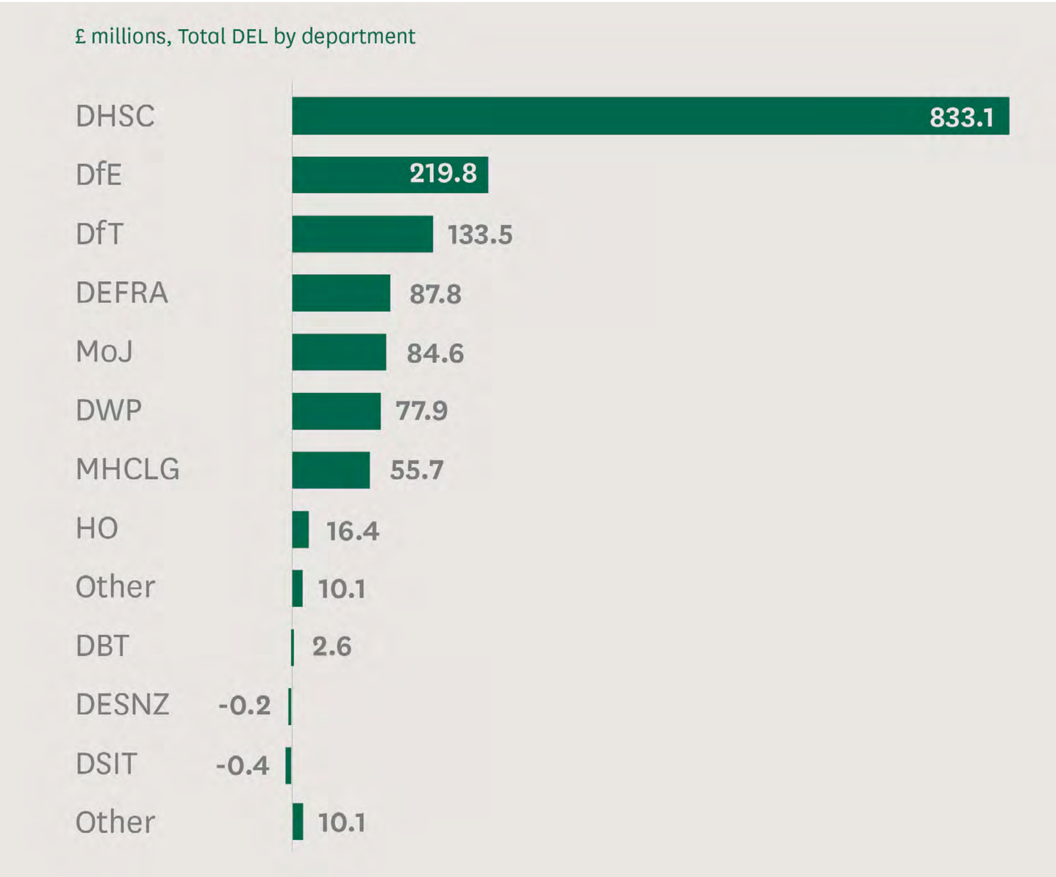
129 Stuart McIntyre, Professor of Economics, University of Strathclyde; James Mitchell, Professor of Public Policy, University of Edinburgh; and Graeme Roy, Professor of Economics/Assistant Vice Principal, University of Glasgow, and Chair of the Scottish Fiscal Commission (FSG0008); The Fiscal Framework is an agreement between the UK and Scottish Governments that sets the rules for the management and implementation of devolved tax and social security powers.

130 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

131 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025; Scottish Fiscal Commission (SFG0009)

73. Estimates are the process by which the UK Government seeks authority from the UK Parliament to action its spending plans each year.[132] The Main Estimates, announced between May and June, set out the initial departmental spending plans, whilst the Supplementary Estimates set out the revised and final departmental spending plans.[133] These spending plans include the finalised Barnett consequentials, as well as funding for the Scottish Government allocated outside of the Barnett formula. For example, the 2024/25 Barnett consequentials for Scotland, broken down by the Departmental Expenditure Limit (DEL) per UK Government department, are set out below:[134]

Barnett consequentials for Scotland



Source: House of Commons Library

Details of other expenditure, such as the funding for City Region Deals and Regional Growth Deals, which for this year totalled £119.2 million, are also set out in the Supplementary Estimates.[135]

132 HM Treasury, Supplementary Estimates 2024–25, 11 February 2025
133 House of Commons Library, Revised Government spending plans for 2024/25, 18 February 2025
134 House of Commons Library, Revised Government spending plans for 2024/25, 18 February 2025
135 House of Commons Library, Revised Government spending plans for 2024/25, 18 February 2025

74. The Supplementary Estimates are usually presented in February each year and approved by the House of Commons in March.[136] This means that the final departmental spending, and therefore the final Barnett consequentials are not agreed until just before April, "only weeks before the end of the financial year".[137] We have heard that such late confirmation of the final funding position is challenging for the Scottish Government, because it is forced to make funding decisions without a full understanding of its final budget for that year. The Scottish Government highlighted the example of the budget year 2023–24, where it was notified of additional consequentials "five weeks before the end of the budget year", at which point it had "already taken difficult in-year decisions to constrain spending plans".[138] It emphasised that those difficult decisions would not have been needed "had funding been confirmed earlier".[139]

75. The Scottish Fiscal Commission highlighted a case where the UK Government intervened to prevent such disruption.[140] In recognition of the unusual circumstances arising because of the COVID-19 pandemic, the UK Government set a guarantee that the Scottish Government's funding "would not be reduced in-year" to ensure certainty about the level of funding it would receive.[141] The Scottish Fiscal Commission explained how that guarantee was extended several times "as public health restrictions were changed in England".[142] The Scottish Fiscal Commission pointed to this allowance, and its "ad hoc nature", as evidence of an implicit recognition from the UK Government that the current system and timeline of fiscal events "creates challenges for the Scottish Government in managing its Budget".[143] It also pointed out that it is within the gift of HM Treasury to address those challenges, should it so choose, by allowing additional flexibilities, as it did during the pandemic.[144]

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136 House of Commons Library, Revised Government spending plans for 2024/25, 18 February 2025
137 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025; Scottish Fiscal Commission (SFG0009)
138 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
139 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
140 Scottish Fiscal Commission (SFG0009)
141 Scottish Fiscal Commission (SFG0009)
142 Scottish Fiscal Commission (SFG0009)
143 Scottish Fiscal Commission (SFG0009)
144 Scottish Fiscal Commission (SFG0009)

Autumn Budget

76. The Scottish Government also highlighted concerns relating to the timing of the Autumn Budget.[145] It noted that there are often "substantial changes to funding and tax policy" announced at the Autumn Budget, which have implication on its "in-year funding position as well as that of the subsequent financial year".[146] The UK Budget often includes significant tax and spend announcements, which can feed through to the Scottish Government's fiscal position.

77. The Budget usually takes place only "a handful of weeks before the draft Scottish Budget is due to be shared with the Scottish Parliament".[147] This means that the Scottish Government has limited time to adjust its spending and taxation plans to accommodate those potentially significant changes announced by the UK Government.[148] We heard that adjusting to such changes is not always straightforward. For example, in the 2024 Autumn Budget, the UK Government announced changes to employer National Insurance Contributions (NICs).[149] However, it took several months for the UK Government to confirm what impact this change would have on the Scottish Governments funding, which meant the Scottish Government had to set its budget without accounting for the change in NICs.[150] Consequently, Shona Robison MSP, Cabinet Secretary for Finance and Local Government in the Scottish Government warned that funding may have to be diverted from frontline services to accommodate the resultant £500 million "financial hole" in the Scottish Budget.[151] In January 2025, the UK Government confirmed that the Scottish Government "will receive funding through the Barnett formula in the usual way […] including for any support provided to UK Government departments for employer National Insurance

145 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

146 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

147 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

148 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025

149 House of Commons Library, Impact of planned changes to employer National Insurance contributions on police forces, 6 February 2025

150 Q22 [Claire Murdoch]

151 The Independent, Treasury must fully fund public sector tax increase, insists Robison, 3 November 2024

contributions”.[152] Despite this confirmation, the “actual figures” were not made clear until some months later in the Main Estimates published in Spring 2025 .[153]

78. Claire Murdoch suggested that such cases of uncertainty had “more significant” implications for the Scottish Budget “than the exact operation of the Barnett formula” itself:

> It is more the general certainty around how the fiscal landscape is looking, what changes are being made, and what impact they have on the funding. It is about confirming that early and publicly, and then allowing the devolved administrations, not just in Scotland but in Wales and Northern Ireland as well, time and certainty to plan their budgets.[154]

Moving forward, Claire Murdoch expressed hope that changes could be made to the timing of fiscal events, to “allow devolved administrations to plan their budgets”.[155]

79. When these challenges were put to the Secretary of State, the Rt Hon Ian Murray MP acknowledged that the financing of the Scottish Government “is a hugely complicated equation”, but that the uncertainty caused by the supplementary estimates is “just the way in which processes work”.[156] The Minister highlighted the “stabilising mechanisms” set out in the Fiscal Framework, such as the Scotland Reserve, which he said enabled Governments “to look at the overall figures at the end of the year” and balance them out.[157] The Minister also pointed to the self-financing sources of revenue the Scottish Government has, as well as the money the UK Government spends in Scotland outside of the Barnett formula, which “essentially dwarfs the rest of the budgets”.[158]

80. **CONCLUSION**

The Committee notes that the Block Grant is the single largest source of Scottish Government funding, and that tight rules on borrowing and fiscal reserves mean that significant changes to the block grant will almost always require significant, urgent changes to the Scottish Government’s spending plans.

152 PQ 36531 [on Public Sector: Employers’ Contributions], 7 March 2025; PQ 25722 [on Aberdeenshire Council: Employers’ Contributions], 22 January 2025
153 Scottish Government, Employer National Insurance Contributions costs: FOI release, 22 January 2025
154 Q22 [Claire Murdoch]
155 Q38 [Claire Murdoch]
156 The work of the department, 25 March 2025, Q16
157 The work of the department, 25 March 2025, Q16, Q23
158 The work of the department, 25 March 2025, Q23

In-year changes

81. As explained above, the Scottish Government's budget is heavily influenced by UK financial events. This entwined nature can cause challenges across the year. Financial decisions made outside major fiscal events offer an additional layer of uncertainty for the Scottish Government. The Scottish Government emphasised this point, describing the "considerable financial uncertainty and volatility" from "late and material in-year changes to funding".[159]

82. The impact of such in-year changes has recently been demonstrated by the changes made to Winter Fuel Payments. In July 2024 the Chancellor of the Exchequer, the Rt Hon Rachel Reeves MP, announced that the UK Government would withdraw the Winter Fuel Payment from pensioner households not in receipt of Pension Credit or certain other means-tested benefits.[160] The Scottish Government said it was notified "on the day of the announcement" with "no prior consultation" on the matter, despite the changes having considerable impact on the Scottish Government's financial position.[161]

83. The Scottish Government said that such cases of volatility resulting from in-year changes are caused by devolved administrations not being "properly factored into Whitehall decision making as a matter of routine".[162] The Scottish Government criticised a "lack of meaningful engagement ahead of UK fiscal events", with the Scottish Government "usually only made aware of changes to funding and tax policy on the morning of the UK's fiscal event".[163]

84. Claire Murdoch echoed these concerns, explaining how challenging it is for the Scottish Government to provide "multi-year planning to give certainty to local authorities and public bodies", without a clear "outlook from the UK Government in terms of the funding position", as this is "ultimately the most significant component of the Scottish Government's budget".[164] Murdoch noted that there are "signs that the whole system could become a little bit more suitable" for the Scottish Government, particularly "in terms of clarity around when fiscal events are taking place".[165] The Fraser of Allander Institute said that the current level of coordination regarding in-year fiscal

159 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
160 House of Commons Library, Changes to Winter Fuel Payment eligibility rules, 7 March 2025
161 Scottish Government, Consultation and changes to the Winter Fuel Payment for pensioners: FOI release, 3 October 2024
162 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
163 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
164 Q23 [Claire Murdoch]
165 Q23 [Claire Murdoch]

challenges is insufficient but agreed that since the current UK Government took office, this has improved.[166] The Scottish Government also recognised the "willingness" of the current UK Government to "address some of this uncertainty and volatility" but called for a "more fundamental and structured response".[167]

85. The Secretary of State assured us directly that the Scottish Government was informed of any relevant financial changes as early as possible, given the need for due process and Cabinet approval of such decisions.[168] Director of the Scotland Office Laurence Rockey also emphasised the regular communication and collaboration that takes place between officials of both Governments.[169]

Multi-year planning

86. We heard from Claire Murdoch that the Scottish Government "should be doing more multi-year planning" to offer greater certainty to local authorities and bodies. Murdoch explained that, without a clear outlook from the UK Government on its spending position, "which is ultimately the most significant component of the Scottish Government's budget", such multi-year planning is both "practically and politically" difficult to do.[170] Similarly, the Fraser of Allander Institute suggested a shift towards multi-year spending reviews would "naturally provide greater certainty for devolved budget policy making".[171]

87. This difficulty could be eased by the announcement in the 2024 Budget that the UK Government committed to having "one major fiscal event" every year, which may offer the Scottish Government more certainty and a greater ability to plan and take fully informed decisions.[172] The UK Government also committed to holding a Spending Review every two years, with departmental budgets being set for a minimum of three years.[173]

88. The Scottish Fiscal Commission noted that a regular cycle of spending reviews should put the Scottish Government in a "better position" to provide multi-year spending allocations, as block grant funding will be more certain.[174]

166 The Fraser of Allander Institute (FSG0007)
167 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
168 The work of the department, 25 March 2025, Q14
169 The work of the department, 25 March 2025, Q16
170 Q23 [Claire Murdoch]
171 The Fraser of Allander Institute (FSG0007)
172 HM Treasury, Autumn Budget 2024, 30 October 2024
173 HM Treasury, Autumn Budget 2024, 30 October 2024
174 Scottish Fiscal Commission, Fiscal Update – August 2024, 27 August 2024

One fiscal event per year

89. The Fraser of Allander Institute welcomed the Chancellor's announcement that a Budget will be held once per year, explaining that the change would "stop tinkering impulses".[175] The Institute said this would be welcomed by devolved administrations, as their budgets depend on decisions taken at the UK Budget, saying one Budget a year would offer "more certainty and the ability to plan and take meaningful decisions".[176] Claire Murdoch similarly welcomed the announcement but warned that commitments to moving to one fiscal event have been made before and "have not happened".[177]

90. The Scottish Government also welcomed the UK Government's intended approach but said that a "more fundamental and structured response" is needed to ensure the "timely sharing of funding information and engagement on policy decisions that affect devolved funding".[178] The Scottish Government described devolved administrations as sitting "at the very tail end of UK decision-making process", citing the "extremely late notification of substantial changes in levels of funding" and other changes to UK policy that affect devolved finances.[179]

91. The Secretary of State acknowledged that the timetable of fiscal events does pose a challenge and explained that the UK Government is seeking to offer greater certainty through multi-year spending allocations.[180] The Minister also emphasised the UK Government's broader commitment to economic stability.[181]

175 Fraser of Allander Institute, 2024 UK Autumn Budget: FAI reaction, 30 October 2024
176 Fraser of Allander Institute, 2024 UK Autumn Budget: FAI reaction, 30 October 2024
177 Q23 [Claire Murdoch]
178 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
179 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
180 The work of the department, 25 March 2025, Q13
181 The work of the department, 25 March 2025, Q13

92. **CONCLUSION**

The timing of supplementary estimates and UK Government fiscal events can cause clear challenges for the Scottish Government in terms of financial planning, with the Scottish Government's final funding position not confirmed until close to the end of the financial year. This uncertainty is compounded by in-year changes to UK Government spending plans, and the possibility of multiple fiscal events per year. We welcome the UK Government's commitment to "one major fiscal event" every year and the stated commitment to informing the Scottish Government of relevant funding changes as early as possible. While noting the regular official-level communication regarding spending, we remain concerned about the significant impact UK Government spending decisions can have on the Scottish Government's budget, often at very short notice and without warning.

93. **RECOMMENDATION**

The importance of regular communication between the UK and Scottish Governments, in respect of UK spending decisions which could impact Scotland's budget, cannot be overstated. The UK Government must ensure that the impact of UK budgetary changes on the block grant is assessed and considered while decisions are being made. The details of such impact assessments must be released alongside or very quickly following any spending decisions. While we recognise the need for due process, the Scottish Government should be informed of major changes which impact its funding as early as possible.

5 Flexibility

94. During our inquiry we considered the tools available to the Scottish Government and changes which could be made to the Scotland Reserve and Scottish Government borrowing powers to enable greater fiscal flexibility, in light of the challenges explored in the previous chapter.

Scotland Reserve

95. The first of these is the Scotland Reserve, which is a mechanism that allows the Scottish Government to trade off funds from one financial year to the next.[182] There is currently a hard limit on the amount that can be stored in the Scotland Reserve, set at just over £700 million in 2024–25. The Scottish Government described this as representing just over 1% of its total budget.[183]

96. Previous limits placed on the amount of money the Scottish Government could draw down from the Scotland Reserve were abolished as part of the Fiscal Framework Review in 2023.[184] This decision was praised by the Scottish Government, as it improved the "usability" of the Reserve and reduced the risk of the Scotland Reserve limits being breached.[185] If such a breach occurred, it could result in the Scottish Government having to "surrender" excess funds, as the Welsh Government had to in 2021.[186] On 1 April 2021, the Wales Reserve balance was £505.5 million, well over the Reserve limit of £350 million.[187] The Welsh Government explained that the Chief Secretary to the Treasury had rejected its request to carry forward funds in excess of this limit, resulting in £115.5 million being "lost to Wales due to poor account management".[188] While the Scotland Reserve limit has never been breached - the closing balance for 2023–24 being £293 million, less than half of the just over £700 million cap - an unexpected windfall could risk a similar

182 Scottish Fiscal Commission, Scotland Reserve
183 The Scottish Government, The Scotland Reserve: FOI release, 15 August 2023
184 Scottish Government, Scottish Budget 2024 to 2025: implementing the renegotiated Fiscal Framework, 19 December 2023
185 Scottish Government, Scottish Budget 2024 to 2025: implementing the renegotiated Fiscal Framework, 19 December 2023
186 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
187 Welsh Parliament, Mismanagement of public accounts has cost the people of Wales, 16 December 2024
188 Welsh Parliament, Mismanagement of public accounts has cost the people of Wales, 16 December 2024

outcome.[189] The Scottish Government has therefore called for the Reserve limit to be abolished, echoing concerns of one day having to surrender funds stemming from unexpected consequentials.[190]

97. In principle, the transfer of funds from one year to the next enabled by the Scotland Reserve has been described by the Fraser of Allander Institute as "a perfectly legitimate and understandable behaviour" which "should be available to the Scottish Government without limits".[191] A similar point was raised by Claire Murdoch of the Scottish Fiscal Commission, who said that the Scottish Government are not able to significantly underspend as "they cannot put terribly much in the reserve in relation to the size of the budget".[192]

98. When asked about reviewing the cap on the Scotland Reserve, the Secretary of State noted the role the Reserve plays in enabling the Scottish Government to manage its expenditure, highlighting the "substantial amount of money" that can be held in the Reserve.[193] The Minister emphasised that the cap on the Scotland Reserve was confirmed "in agreement with the Scottish Government".[194] Director of the Scotland Office Laurence Rockey explained that the forum for discussing further changes to the Scotland Reserve, such as the removal of the cap, would be at the next Fiscal Framework review, which is due to take place in 2027.[195]

99. **CONCLUSION**

Given the challenges the Scottish Government faces, we recognise its need for fiscal flexibility. The Scotland Reserve is a key tool that enables the Scottish Government to carry funds from one year to another, and there seems little benefit in capping the amount of money that can be stored in it. The danger of the Scottish Government having to surrender funds, due to a late addition which pushes the Reserve over the limit, whilst hypothetical, remains of concern to us.

189 Q29; Scottish Government, Fiscal Framework outturn report: 2024, 26 September 2024
190 As above
191 The Fraser of Allander Institute (FSG0007)
192 Q28 [Claire Murdoch]
193 The work of the department, 25 March 2025, Q24
194 The work of the department, 25 March 2025, Q24
195 The work of the department, 25 March 2025, Q25

100. **CONCLUSION**

We note also that the jeopardy for returning funds to the UK Treasury at the end of the financial year incentivises poor behaviour in departmental spending, relative to value for money to the taxpayer. The removal of the Reserve, which is simply a treasury rule, would allow the Scottish Government to plan more strategically both within and across financial years. A political decision could remove the Scotland Reserve in advance of the next Fiscal Framework event in 2027 to the immediate benefit of the Scottish Government's budget setting.

101. **RECOMMENDATION**

At the next Fiscal Framework review, the UK Government should consider removing the cap on the Scotland Reserve, to ensure the Scottish Government's fiscal flexibility is not unduly limited and to avoid the undesirable possibility of it having to return funds.

Borrowing powers

102. As well as abolishing limits to drawdowns on the Scotland Reserve, the Fiscal Framework Review 2023 also made small changes to the Scottish Government's borrowing powers.[196] The borrowing powers set out:

- The annual limit that can be used to address devolved tax and social security forecast errors. The annual resource borrowing limit for day-to-day spending was increased from £300 million to £600 million for 2023–4, with a cumulative limit of £1.75 billion. Both these figures will be adjusted for inflation moving forward.
- For large-scale infrastructure and capital investments, the annual capital borrowing limit was maintained at £450 million, with a cumulative limit of £3 billion, with both to be adjusted annually in line with inflation.[197]

103. The Institute for Fiscal Studies produced an immediate response to the agreement, describing the changes as an "important step in the right direction" in improving fiscal flexibility.[198] It noted that inflation has "already eroded around 20%" of real-term values of the existing borrowing limits since they were first put in place.[199] However, the Royal Society of Edinburgh

196 Scottish Government, Fiscal Framework: factsheet, 7 April 2025
197 The Royal Society of Edinburgh (FSG0010); House of Commons Library, The Barnett formula and fiscal devolution, 29 May 2024
198 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
199 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)

argued that the increased borrowing limits are “still relatively small”, which it attributes to HM Treasury’s opposition to “significant extension of Scotland’s borrowing powers”.[200]

Increasing borrowing powers

104. During our inquiry we heard proposals to further increase the Scottish Government’s borrowing powers. There are currently limitations on the circumstances in which the Scottish Government can borrow money, notably that resource borrowing may only be used to mitigate the adverse funding impact of negative forecast errors in tax income and social security spend.[201] The Institute for Fiscal Studies said there is a case to widen this scope, as the Scottish Government “cannot borrow to smooth the resulting financial pressures” from “unexpected shocks to public service spending or shortfalls in revenue”.[202] The Fraser of Allander Institute similarly noted that these constraints could “induce the Scottish Government to raise taxes to meet short-term budget constraints, even if that further weakened the economy”.[203]

105. Even within the “narrowly defined scope” of covering negative forecast errors, the Scottish Government highlighted that the £600 million borrowing cap would not cover the latest forecast for income tax reconciliations for 2023–24, which is negative £701 million.[204] Income tax reconciliations used to “correct the difference between forecast tax receipts”, which are used in the Scottish Budget and “actual outturn data” which is published over two years later.[205] João Sousa, Deputy Director of the Fraser of Allander Institute, described this gap between the reconciliation and the borrowing cap as a reasonable cause for concern.[206] Sousa explained that if the Scottish Government had to settle a reconciliation which was larger than the borrowing cap at a time of fiscal shock, the funding of public services could suffer.[207] Such concerns illustrate the point that “these limits probably should not exist”, as “there is a very good argument” that a Parliament should be allowed to make its own decisions about how spending should be smoothed over time.[208]

200 The Royal Society of Edinburgh (FSG0010)
201 Scottish Fiscal Commission (FSG0009)
202 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
203 The Fraser of Allander Institute (FSG0007)
204 The transfer of risk to the Scottish Parliament following fiscal devolution must be matched by the policy and budgetary levers required to mitigate and manage such risk.
205 Audit Scotland, Administration of Scottish income tax 2023/24, January 2025; Scottish Fiscal Commission, Income Tax Reconciliations
206 Q30 [João Sousa]
207 Q30 [João Sousa]
208 Q30 [João Sousa]

106. This view is shared by the Scottish Government, which described its "limited" resource borrowing powers as "insufficient".[209] It called for "the policy and budgetary levers required to mitigate and manage" the in-year volatility the Scottish Budget faces, highlighting the differences in borrowing powers it has compared to the UK Government.[210] Calling for greater borrowing powers, the Scottish Government emphasised:

> The transfer of risk to the Scottish Parliament following fiscal devolution must be matched by the policy and budgetary levers required to mitigate and manage such risk.[211]

107. When these proposals were put to the Secretary of State, the Minister said that proposals for extending the Scottish Government's borrowing powers were "tested at length during the Fiscal Framework renegotiation" in 2023, and would "no doubt continue to be tested".[212] Nonetheless, the Minister emphasised that the current borrowing mechanisms available to the Scottish Government "work relatively well" and highlighted calls stakeholders such as the IFS and Fraser of Allander Institute have made for the Scottish Government's own budgeting to improve, "in order for this to be part of the process".[213]

Linking borrowing limits to inflation

108. A further proposed change to the Scottish Government's borrowing powers which could allow it greater fiscal flexibility relates to what those borrowing limits are linked to. The Institute for Fiscal Studies suggested that rather than being linked to inflation, as they are at present, borrowing limits should be linked to the amount of revenue and social security spending at risk.[214]

109. David Phillips, Associate Director of the IFS, explained that this change could be beneficial to the Scottish Government as, typically, "the revenue and spending under risk will go up by more than inflation", especially as social security spending has been increasing "with the rising disability benefits bill".[215] This could be better accounted for by linking borrowing limits to GDP growth or "forecast growth in the rest of the UK revenues and spending on these benefits", as is the case for Block Grant Adjustments.[216] When

209 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
210 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
211 The transfer of risk to the Scottish Parliament following fiscal devolution must be matched by the policy and budgetary levers required to mitigate and manage such risk.
212 The work of the department, 25 March 2025, Q10
213 The work of the department, 25 March 2025, Q10
214 David Phillips (Associate Director, Institute for Fiscal Studies) (FSG0004)
215 Q28 [David Phillips]
216 Q28 [David Phillips]

considering the difference between forecast negative reconciliations and the Scottish Government's resource borrowing cap, João Sousa also voiced support for linking borrowing limits to nominal GDP, which he described as a "very reasonable proposal".[217]

110. When discussed with the Secretary of State, the Minister noted that his view on what the Scottish Government's borrowing limits are linked to would depend on which option provides the highest level of funding for the Scottish Government.[218] The Minister said that he thought linking limits to inflation would ensure they maintain their value, which he expected "would have a real cash implication for public services in the Scottish context".[219]

Interest-free borrowing

111. As explained in the sections above, resource borrowing is a tool used by the Scottish Government to cover for forecast errors. Within the existing framework, the Scottish Government suggested that it should "incur no interest cost" when borrowing in such cases and questioned why the Scottish Budget "should be penalised" for costs associated with "the operation of the Fiscal Framework, and not a result of any action by the Scottish Government".[220]

112. David Phillips of the Institute for Fiscal Studies opposed this suggestion, emphasising that resource borrowing done by the Scottish Government "like any borrowing, […] needs to come with interest".[221] João Sousa similarly made this point, expressing his view that it is "very reasonable" for the Scottish Government to be charged interest.[222] Sousa explained that "someone has to pay the interest" and, "if it is not the Scottish Government, it will be the UK Government".[223]

113. **CONCLUSION**

At present, the Scottish Government's limited borrowing powers constrain its ability to manage fiscal shocks, as it is only able to borrow for resource purposes to cover forecast errors. Capital borrowing limits are currently linked to and grow in line with inflation, which may not necessarily be the highest metric of growth.

217 Q30 [João Sousa]
218 The work of the department, 25 March 2025, Q11
219 The work of the department, 25 March 2025, Q11
220 Letter from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, 16 January 2025
221 Q32 [David Phillips]
222 Q32 [João Sousa]
223 Q32 [João Sousa]

114. **RECOMMENDATION**
We recognise the arguments presented calling for reform to the Scottish Government's current borrowing arrangements. We maintain that such borrowing should continue to be subject to interest payments, the same as it is for any other government when it borrows to cover for its own forecast errors. However, we agree with the Secretary of State that borrowing limits should be linked to the measure which offers the Scottish Government the highest level of flexibility but, crucially, we note that which metric delivers this remains undetermined. The UK Government should therefore publish a transparent analysis of what borrowing limits would look like based on the different metrics advised in the evidence for this inquiry. At the next Fiscal Framework review, we encourage the UK Government to consider reforming the Scottish Government's capital borrowing powers, by automatically coupling borrowing to the metric which offers the highest limit.

VAT assignment

115. Assignment of some VAT revenues to the Scottish Government has been due to be implemented for several years, following changes made in the Scotland Act 2016. During our inquiry we heard concerns that the difficulties in implementation mean that this assignment may never actually be made.

116. Value Added Tax (VAT) is levied on the purchase of many goods and services and can be charged at three different tiers: a Standard Rate (20%), Reduced Rate (5%) or Zero Rated (0%). The Scotland Act 2016 set out that the first 10 pence of the Standard Rate of VAT, and the first 2.5 pence of the Reduced Rate raised in Scotland, would be assigned to the Scottish Government.[224]

117. The Scottish Fiscal Commission set out that this assignment would result in "the second largest source of tax revenue for the Scottish Government, after income tax".[225] In practice, VAT would "continue to be collected by HMRC at the UK level", with Scotland's assigned share being estimated "using a model developed by HMRC, HM Treasury and the Scottish Government".[226] The implementation of this assignment was due to begin in April 2021, but was delayed due to the Fiscal Framework Review, which was published in 2023.[227]

118. The Fraser of Allander Institute raised concerns that "after almost ten years, it has become clear that there is no reliable way of estimating Scottish VAT revenues in a precise enough manner to link it to a budget". As a result, the

224 The Scottish Government, Scotland Act 2016 implementation: seventh annual report, 22 May 2023
225 Scottish Fiscal Commission, Value Added Tax
226 Scottish Fiscal Commission, Value Added Tax
227 Scottish Fiscal Commission, Value Added Tax

research institute called for “an admission on all parts that this cannot work and therefore should be dropped” with João Sousa arguing that the planned assignment “is not sensible”.[228] Similarly, David Phillips of the Institute for Fiscal Studies described the suggestion that “VAT assignment is coming down the line” as a “farce” which needs to end. Phillips explained:

> It was repeated again in the Scottish Government’s tax strategy that, “we will continue to work with the Treasury on a basis for this.” The only way that you can really solve this is by making companies divide their accounts into what is Scotland and what is the UK. If that is the plan, say it. If it is not, can it.[229]

119. When challenged on the continually delayed assignment, the Secretary of State emphasised that both Governments were working closely to implement the policy.[230] The Minister highlighted how complicated the process will be and noted that priority had been given to other changes set out in the Scotland Act 2016.[231] No date was given for its completion.

120. **CONCLUSION**

It seems highly unlikely to us that the assignment of VAT revenues will ever come into force. It is clear that implementing the assignment poses a significant challenge, and given the amount of time that has passed since the change was due to come into force, it is far from clear whether it is realistic or possible.

121. **RECOMMENDATION**

We call on the UK Government, in its response to this report, to explain why it thinks the assignment of VAT revenues is still possible, despite robust views to the contrary, and whether the Scottish Government shares this position. We also call on the UK Government, by the summer of 2026, to write to us with an update on the progress made to date on implementing VAT assignment.

228 The Fraser of Allander Institute (FSG0007); Q38 [João Sousa]
229 Q38 [David Phillips]
230 The work of the department, 25 March 2025, Q4
231 The work of the department, 25 March 2025, Q4

Conclusions and recommendations

Is the Barnett formula fit for purpose?

1. We note the Scottish Government's call for full fiscal autonomy, but do not consider that this currently appears to be a realistic prospect. Fundamental questions remain about how full fiscal autonomy would work in practice, and whether it would be operable within the constraints of the UK's current devolution settlement. Practicality aside, we do not believe that a compelling case has been made that such a change would automatically result in Scotland receiving a higher level of funding. Given that the Scottish Government did not accept the invitation to come before us to explain its proposal and respond to these fundamental questions, we do not see how we can consider this a serious proposition, and we remain to be convinced that this proposal is desirable in principle, let alone workable in practice. (Conclusion, Paragraph 20)

2. Whilst the Barnett formula is an imperfect method of calculating Scotland's funding, we have heard no convincing evidence of a workable alternative. We therefore consider the formula to be fit for purpose and are not convinced there is clear need to reform it significantly. (Conclusion, Paragraph 33)

3. In particular, we are not convinced there is a need to introduce a needs-based factor into the Barnett formula at this time. Scotland currently may be receiving more than it would if a needs-based factor, like the floors introduced in Northern Ireland and Wales, were to be introduced. However, whilst such a factor is not appropriate at this time, the need of one should be kept under review. (Conclusion, Paragraph 34)

Transparency

4. The operation of the Barnett formula is not as transparent as it could or should be. In particular, there is a lack of transparency around how comparability percentages are calculated. Comparability percentages are a fundamental feature of the Barnett formula and the only multiplier which cannot be effectively scrutinised by the public. We have heard no

good reason for this opacity, which limits the ability of the public and UK and Scottish Parliaments to hold their respective Governments to account. (Conclusion, Paragraph 41)

5. In all future Statements of Funding Policy, the UK Government should include details of how the comparability percentage of each department has been calculated, including a programme-by-programme breakdown of what has and has not been included in the calculation. (Recommendation, Paragraph 42)

6. We recognise the importance of the Block Grant Transparency document, as well as the value in it being published in a timely manner. We welcome the Secretary of State's commitment to publishing an updated document after the 2025 Spending Review and hope the Government will continue this practice in future years. We see no reason why HM Treasury cannot provide an updated Block Grant Transparency document alongside each major fiscal event in the same way in which it provides a raft of other relevant documents to accompany such events. (Conclusion, Paragraph 46)

7. The UK Government should publish an updated Block Grant Transparency document alongside each fiscal event which will result in changes to Scotland's funding. (Recommendation, Paragraph 47)

Dispute resolution and formalisation

8. HM Treasury, and therefore the UK Government, is the "ultimate arbiter" of the Barnett formula. As the formula is non-statutory, there is no legal recourse for the Scottish Government to challenge the UK Government's application of it. There is also currently no formal, objective dispute resolution process relating to the application of the formula, although there are existing intergovernmental structures through which such matters can be raised. An imbalance persists however, with HM Treasury's position enduring when agreement between parties cannot be reached, as reflects the UK Government's constitutional position within the UK's devolution arrangement. (Conclusion, Paragraph 68)

9. We are not convinced that putting the Barnett formula on a statutory footing, or otherwise formalising it, would significantly improve its effectiveness. The use of the Barnett formula is already a well-established practice, not unlike other features of the UK's uncodified constitution. Although new routes to legal challenge may be opened though legislation, such a change would restrict the flexibility of the operation of the formula, with little evidence there would be practical benefits for either Government. We also cannot see how a new dispute resolution process

specifically for the Barnett formula would not unduly overlap with or duplicate the existing intergovernmental dispute resolution process. (Recommendation, Paragraph 69)

Budget stability

10. The Committee notes that the Block Grant is the single largest source of Scottish Government funding, and that tight rules on borrowing and fiscal reserves mean that significant changes to the block grant will almost always require significant, urgent changes to the Scottish Government's spending plans. (Conclusion, Paragraph 80)

11. The timing of supplementary estimates and UK Government fiscal events can cause clear challenges for the Scottish Government in terms of financial planning, with the Scottish Government's final funding position not confirmed until close to the end of the financial year. This uncertainty is compounded by in-year changes to UK Government spending plans, and the possibility of multiple fiscal events per year. We welcome the UK Government's commitment to "one major fiscal event" every year and the stated commitment to informing the Scottish Government of relevant funding changes as early as possible. While noting the regular official-level communication regarding spending, we remain concerned about the significant impact UK Government spending decisions can have on the Scottish Government's budget, often at very short notice and without warning. (Conclusion, Paragraph 92)

12. The importance of regular communication between the UK and Scottish Governments, in respect of UK spending decisions which could impact Scotland's budget, cannot be overstated. The UK Government must ensure that the impact of UK budgetary changes on the block grant is assessed and considered while decisions are being made. The details of such impact assessments must be released alongside or very quickly following any spending decisions. While we recognise the need for due process, the Scottish Government should be informed of major changes which impact its funding as early as possible. (Recommendation, Paragraph 93)

Flexibility

13. Given the challenges the Scottish Government faces, we recognise its need for fiscal flexibility. The Scotland Reserve is a key tool that enables the Scottish Government to carry funds from one year to another, and there seems little benefit in capping the amount of money that can be stored in it.

The danger of the Scottish Government having to surrender funds, due to a late addition which pushes the Reserve over the limit, whilst hypothetical, remains of concern to us. (Conclusion, Paragraph 99)

14. We note also that the jeopardy for returning funds to the UK Treasury at the end of the financial year incentivises poor behaviour in departmental spending, relative to value for money to the taxpayer. The removal of the Reserve, which is simply a treasury rule, would allow the Scottish Government to plan more strategically both within and across financial years. A political decision could remove the Scotland Reserve in advance of the next Fiscal Framework event in 2027 to the immediate benefit of the Scottish Government's budget setting. (Conclusion, Paragraph 100)

15. At the next Fiscal Framework review, the UK Government should consider removing the cap on the Scotland Reserve, to ensure the Scottish Government's fiscal flexibility is not unduly limited and to avoid the undesirable possibility of it having to return funds. (Recommendation, Paragraph 101)

16. At present, the Scottish Government's limited borrowing powers constrain its ability to manage fiscal shocks, as it is only able to borrow for resource purposes to cover forecast errors. Capital borrowing limits are currently linked to and grow in line with inflation, which may not necessarily be the highest metric of growth. (Conclusion, Paragraph 113)

17. We recognise the arguments presented calling for reform to the Scottish Government's current borrowing arrangements. We maintain that such borrowing should continue to be subject to interest payments, the same as it is for any other government when it borrows to cover for its own forecast errors. However, we agree with the Secretary of State that borrowing limits should be linked to the measure which offers the Scottish Government the highest level of flexibility but, crucially, we note that which metric delivers this remains undetermined. The UK Government should therefore publish a transparent analysis of what borrowing limits would look like based on the different metrics advised in the evidence for this inquiry. At the next Fiscal Framework review, we encourage the UK Government to consider reforming the Scottish Government's capital borrowing powers, by automatically coupling borrowing to the metric which offers the highest limit. (Recommendation, Paragraph 114)

18. It seems highly unlikely to us that the assignment of VAT revenues will ever come into force. It is clear that implementing the assignment poses a significant challenge, and given the amount of time that has passed since the change was due to come into force, it is far from clear whether it is realistic or possible. (Conclusion, Paragraph 120)

19. We call on the UK Government, in its response to this report, to explain why it thinks the assignment of VAT revenues is still possible, despite robust views to the contrary, and whether the Scottish Government shares this position. We also call on the UK Government, by the summer of 2026, to write to us with an update on the progress made to date on implementing VAT assignment. (Recommendation, Paragraph 121)

Formal Minutes

Wednesday 9 July 2025

Members present

Patricia Ferguson, in the Chair

Maureen Burke

Dave Doogan

Lillian Jones

Mr Angus MacDonald

Douglas McAllister

Jack Rankin

Elaine Stewart

Kirsteen Sullivan

The financing of the Scottish Government

Draft Report (*The financing of the Scottish Government*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 121 read and agreed to.

Summary agreed to.

Motion made, and Question put, That the Report be the First Report of the Committee to the House.

The Committee divided:

Ayes, 6	Noes, 1
Maureen Burke	Dave Doogan
Lillian Jones	
Mr Angus MacDonald	
Jack Rankin	
Elaine Stewart	
Kirsteen Sullivan	

Question accordingly agreed to.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available (Standing Order No. 134).

Adjournment

Adjourned till Wednesday 16 July at 9.00 am.

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee’s website.

Wednesday 29 January 2025

Dr João Sousa, Senior Knowledge Exchange Fellow and Deputy Director, Fraser of Allander Institute; **David Phillips**, Associate Director, Institute for Fiscal Studies (IFS); **Claire Murdoch**, Head of Fiscal Sustainability and Public Funding, Scottish Fiscal Commission Q1–38

Tuesday 25 March 2025

Rt Hon Ian Murray MP, Secretary of State for Scotland; **Kirsty McNeill MP**, Parliamentary Under-Secretary of State at Scotland Office; **Laurence Rockey**, Director at Scotland Office Q1–37

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

FSG numbers are generated by the evidence processing system and so may not be complete.

1	Convention of Scottish Local Authorities	FSG0001
2	Fraser of Allander Institute, University of Strathclyde	FSG0007
3	NFU Scotland	FSG0011
4	Parry, Mr Richard (Honorary Fellow, University of Edinburgh)	FSG0005
5	Phillips, Mr David (Associate Director, Institute for Fiscal Studies)	FSG0004
6	Quality Meat Scotland	FSG0002
7	Roy, Professor Graeme (Professor of Economics & Assistant Vice Principal, University of Glasgow); Profesor James Mitchell (Professor of Public Policy, University of Edinburgh); and Professor Stuart McIntyre (Professor of Economics, University of Strathclyde)	FSG0008
8	Royal Society of Edinburgh	FSG0010
9	Scottish Fiscal Commission	FSG0009
10	UK Government	FSG0003
11	Correspondence from Shona Robison MSP, Scottish Government, regarding the financing of the Scottish Government inquiry, dated 16 January 2025	

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

Session 2024–25

Number	Title	Reference
2nd Special	Scotland's space sector: Government response	HC 801
1st Special	Science and Scotland: Government response	HC 800