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@TheIFS

The funding and spending outlook

IFS Scottish Budget Report



Economic
and Social
Research Council

- **The Budget for 2025-26**
 - Block Grant funding
 - Tax revenue outlook
 - Overall day-to-day funding
 - Spending plans
- **The medium-term outlook**
 - Day-to-day funding
 - Trade-offs between services
 - Schools and public sector pay
 - Capital funding outlook



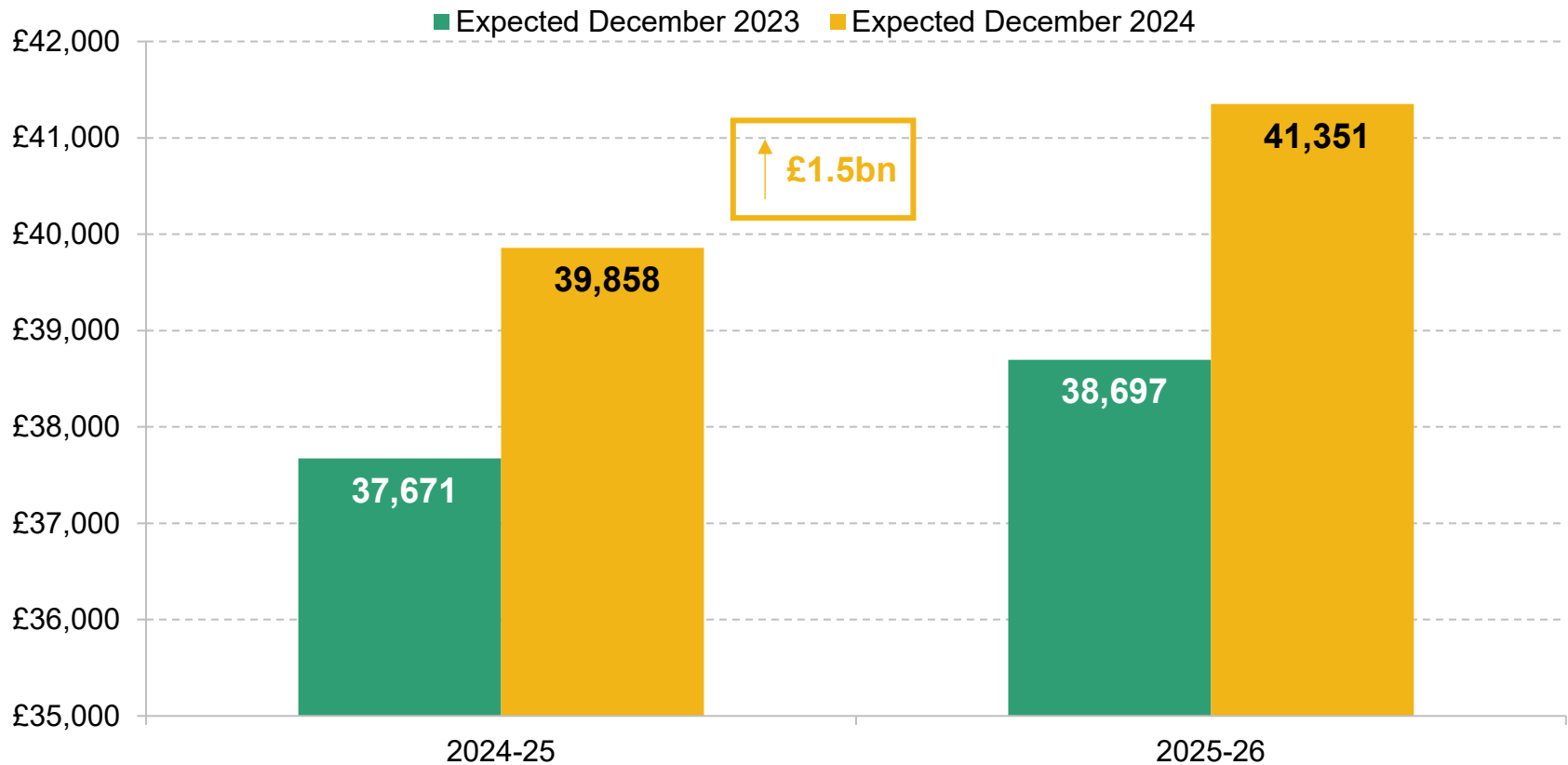
2025–26 Budget

How has funding changed this year and next?

- Top-ups to day-to-day funding from the UK government – partially offset next year by lower contributions from devolved tax revenues
- Day-to-day funding set to be flat between this year and next – although not all funding allocated in 2024–25
- Day-to-day spending growing slightly in real terms, varying considerably across portfolios
- Investment spending growing much faster – particularly for Justice and Net Zero portfolios

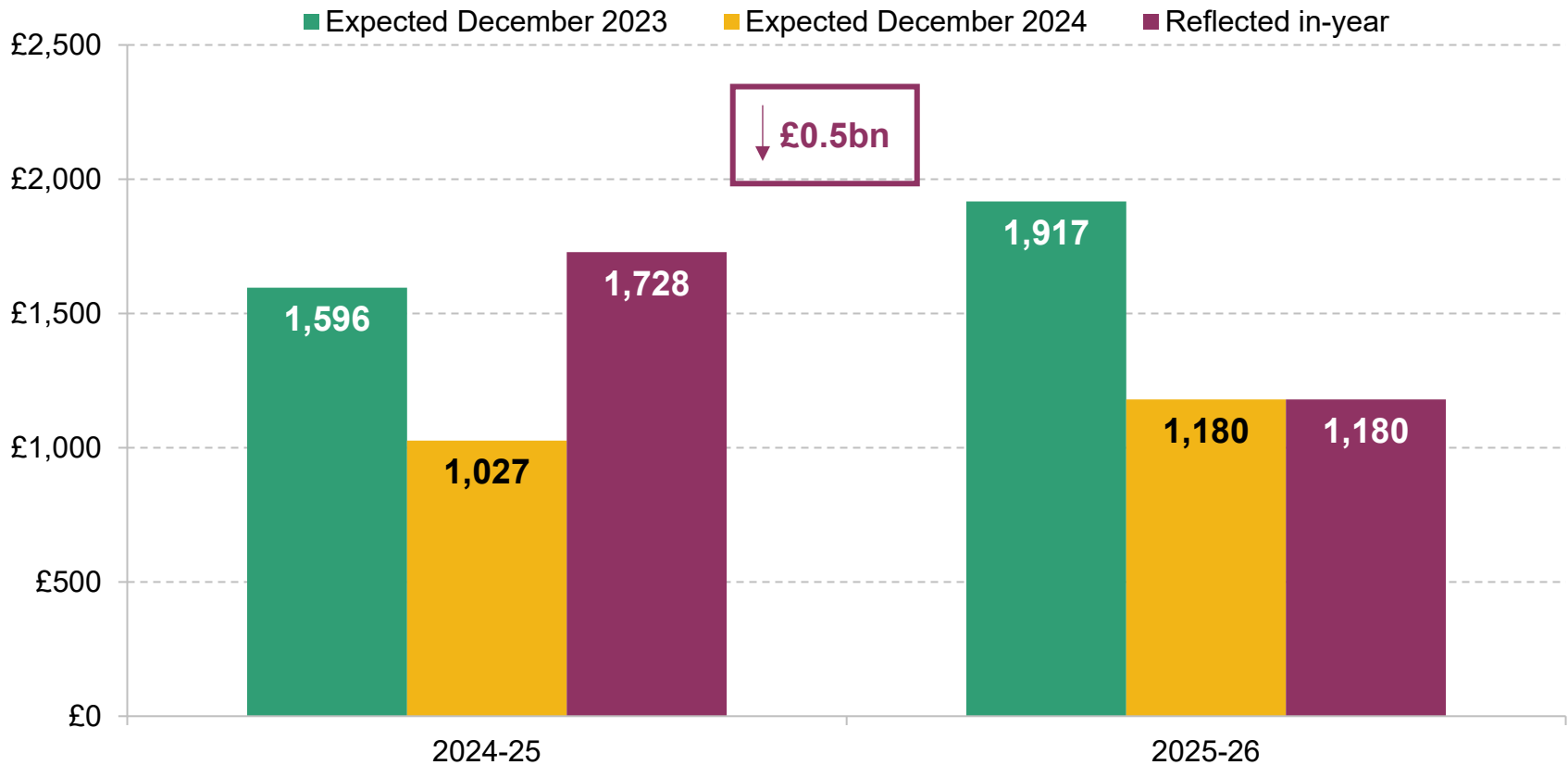
UK Block Grant funding has been topped up substantially...

UK general-purpose day-to-day funding (£ million), expected in December 2023 and December 2024



...but the contribution of devolved taxes is lower than expected

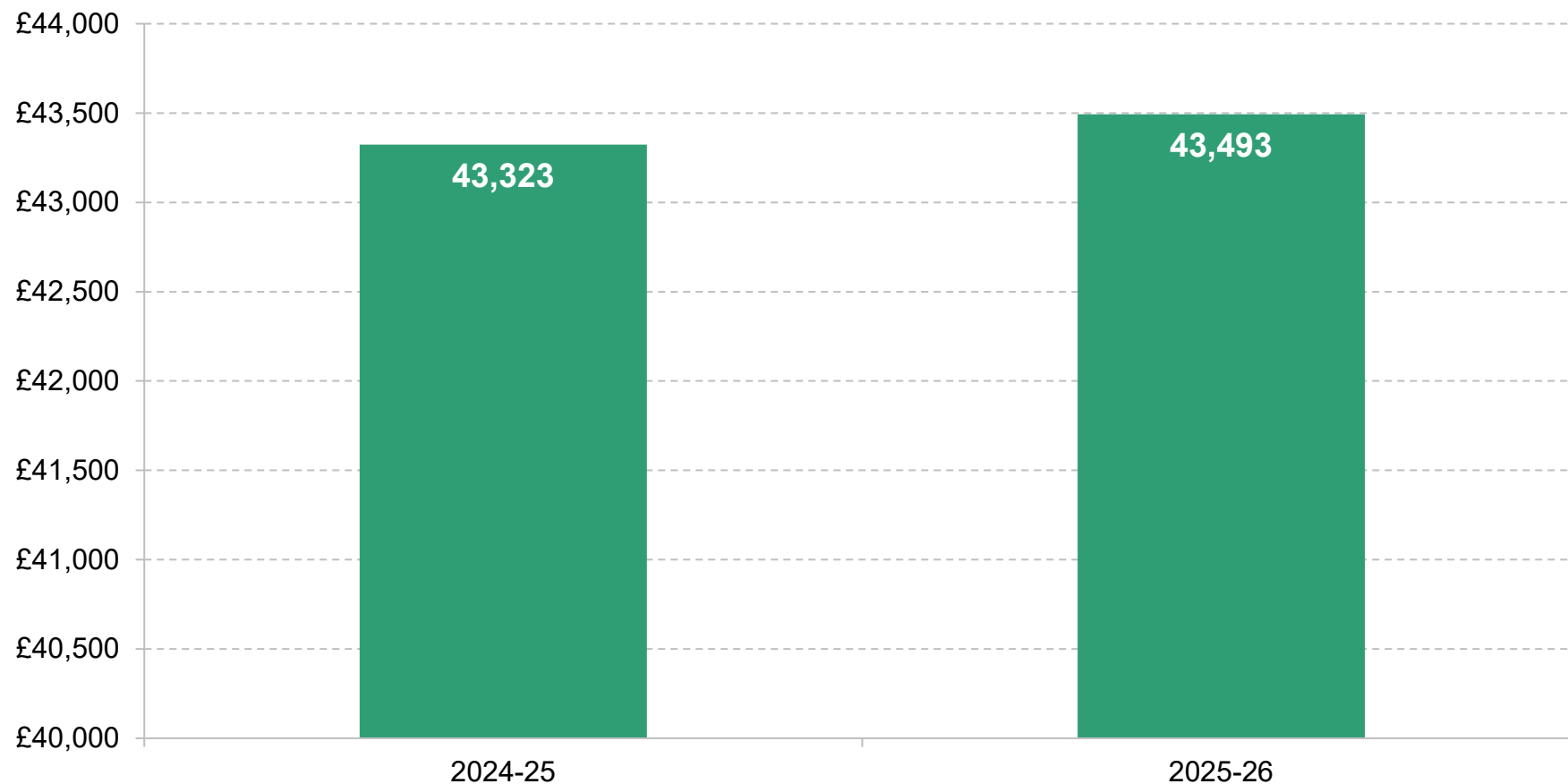
Net tax revenue position (£ million), expected in December 2023 and December 2024



Day-to-day funding set to be flat between this year and next



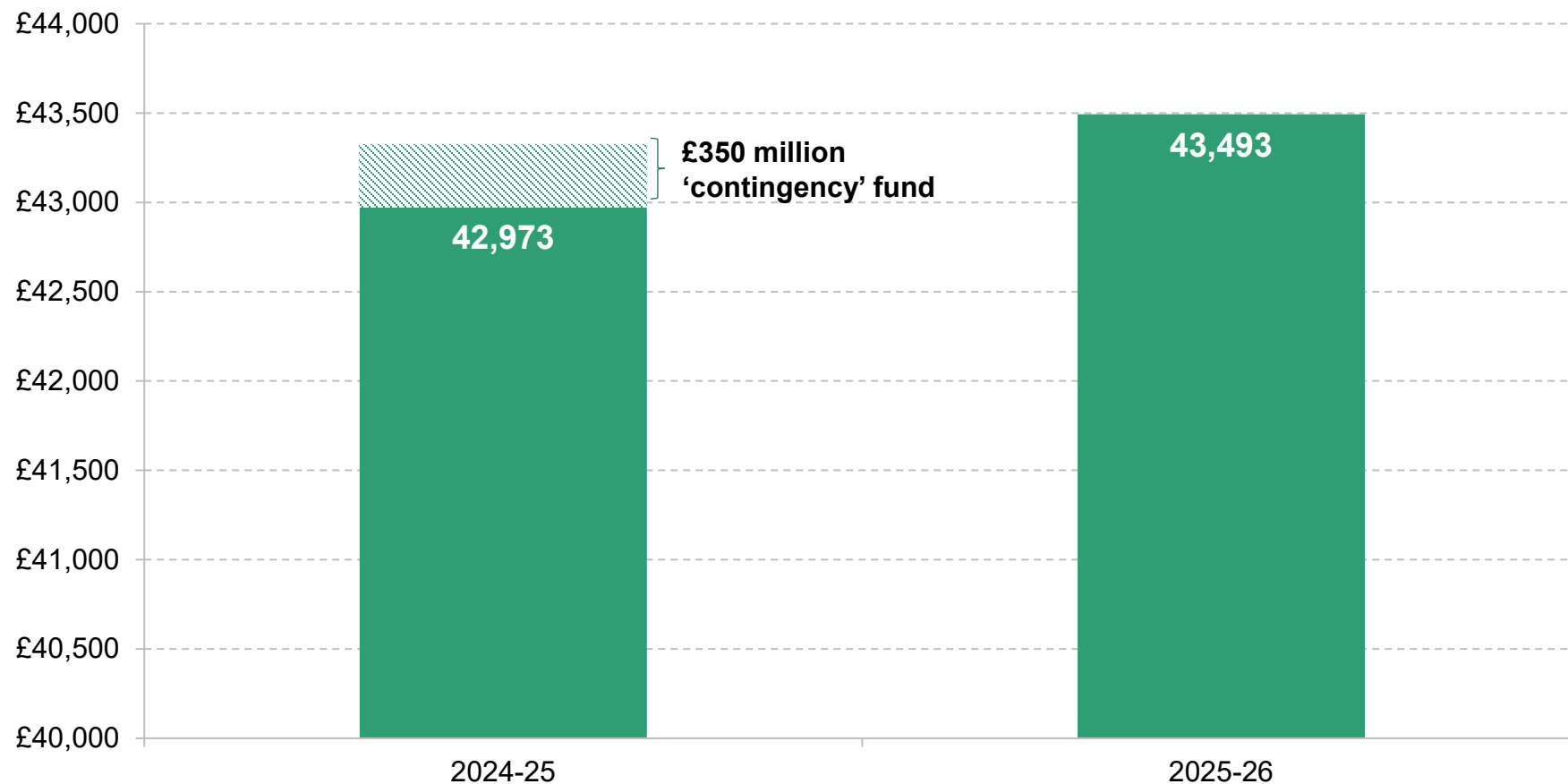
Day-to-day funding available for public services (£ million), 2024–25 prices



Day-to-day funding set to be flat between this year and next

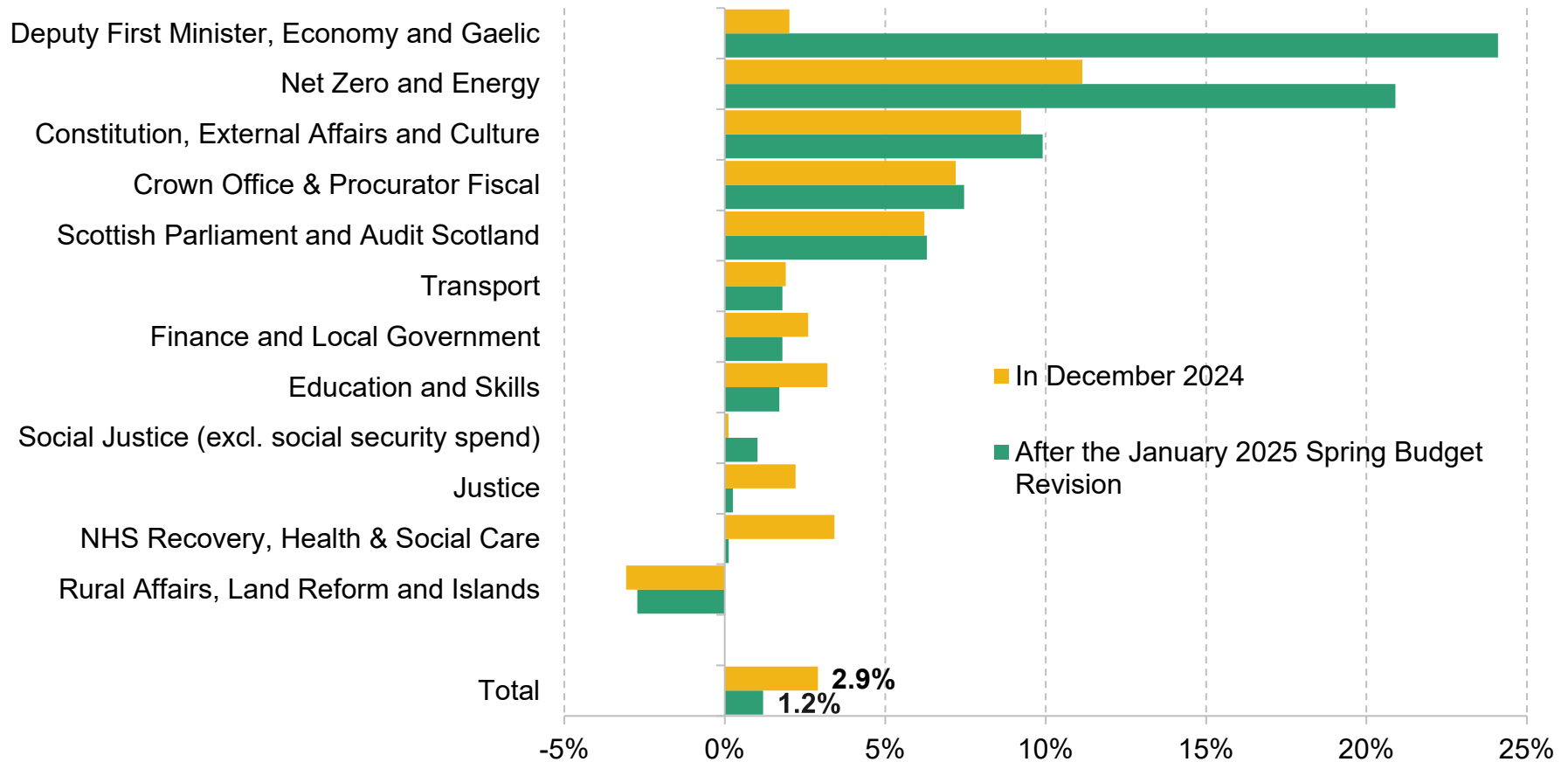


Day-to-day funding available for public services (£ million), 2024–25 prices



Implications for day-to-day spending

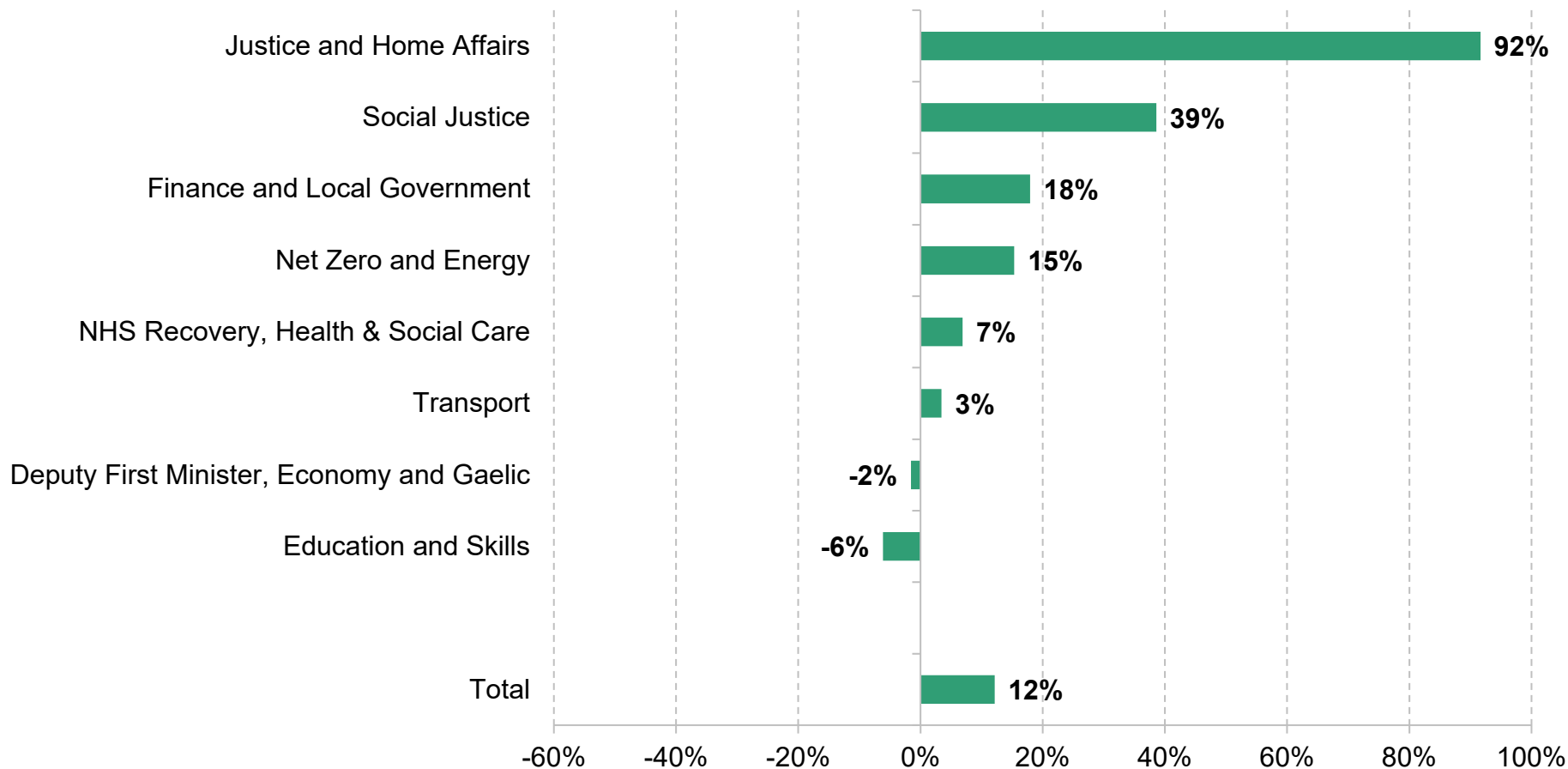
Change in day-to-day spending, real terms, 2024–25 to 2025–26



Capital spending boosted next year



Change in capital spending, selected portfolios, real terms, 2024–25 to 2025–26





Medium-term outlook

Funding uncertain after next year

- Block Grant funding in 2026–27 and beyond depends on plans for UK government spending set out in the June Spending Review
- Overall day-to-day funding in the UK set to grow 1.3% a year in real terms after 2025–26
 - Scottish Government projections assume the UK block grant grows by this amount annually
 - Dependent on the amount allocated to different areas of spending at the UK Spending Review
 - We think **funding from the UK government might grow more slowly** – around 0.9% a year – largely resulting from the ‘Barnett squeeze’

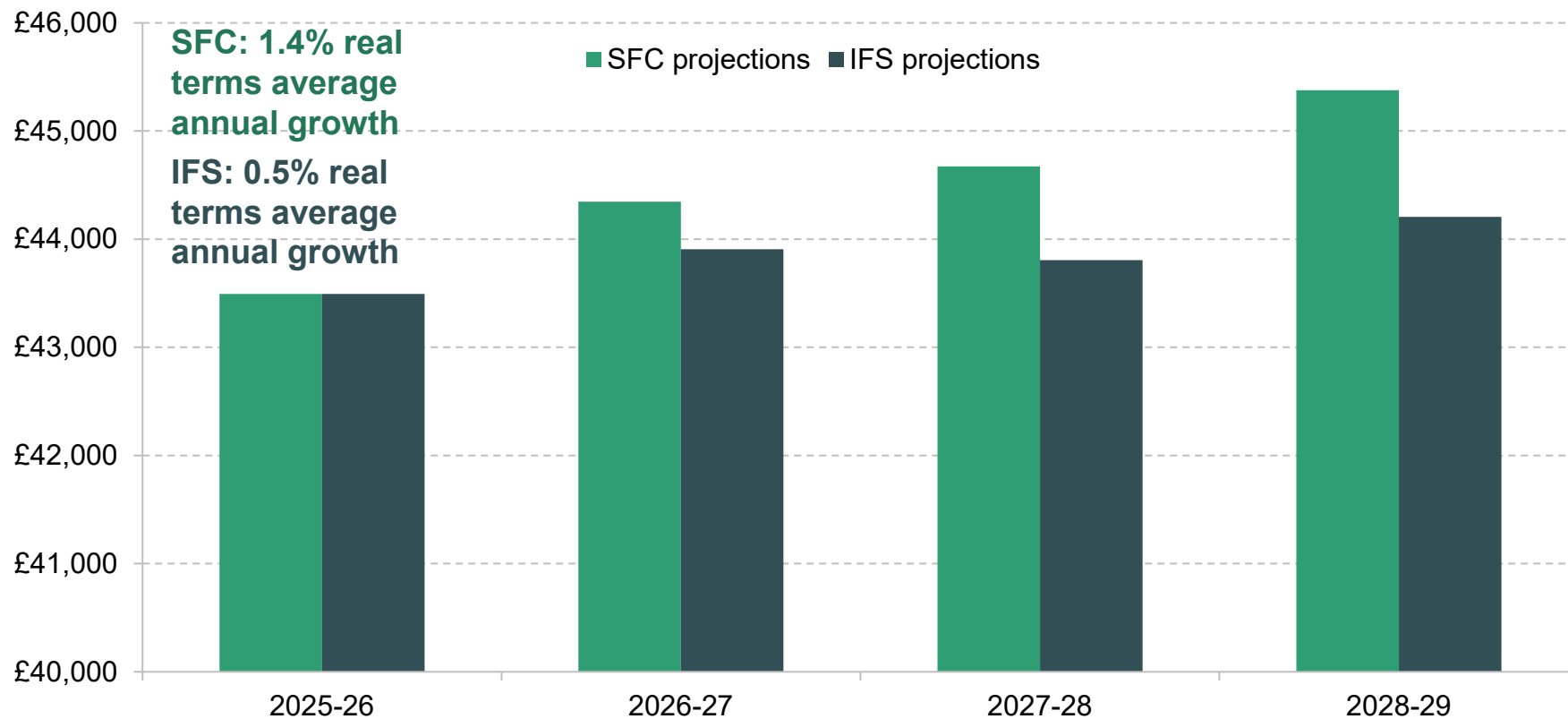
Funding uncertain after next year



- Net income tax position forecast to improve significantly from 2026–27 onwards
 - To some extent, differences in SFC and OBR forecasts represent differences in UK-wide factors – whichever is right, the net position is revised downwards
 - We think **risks are weighted to the downside here**
- A lot of uncertainty!

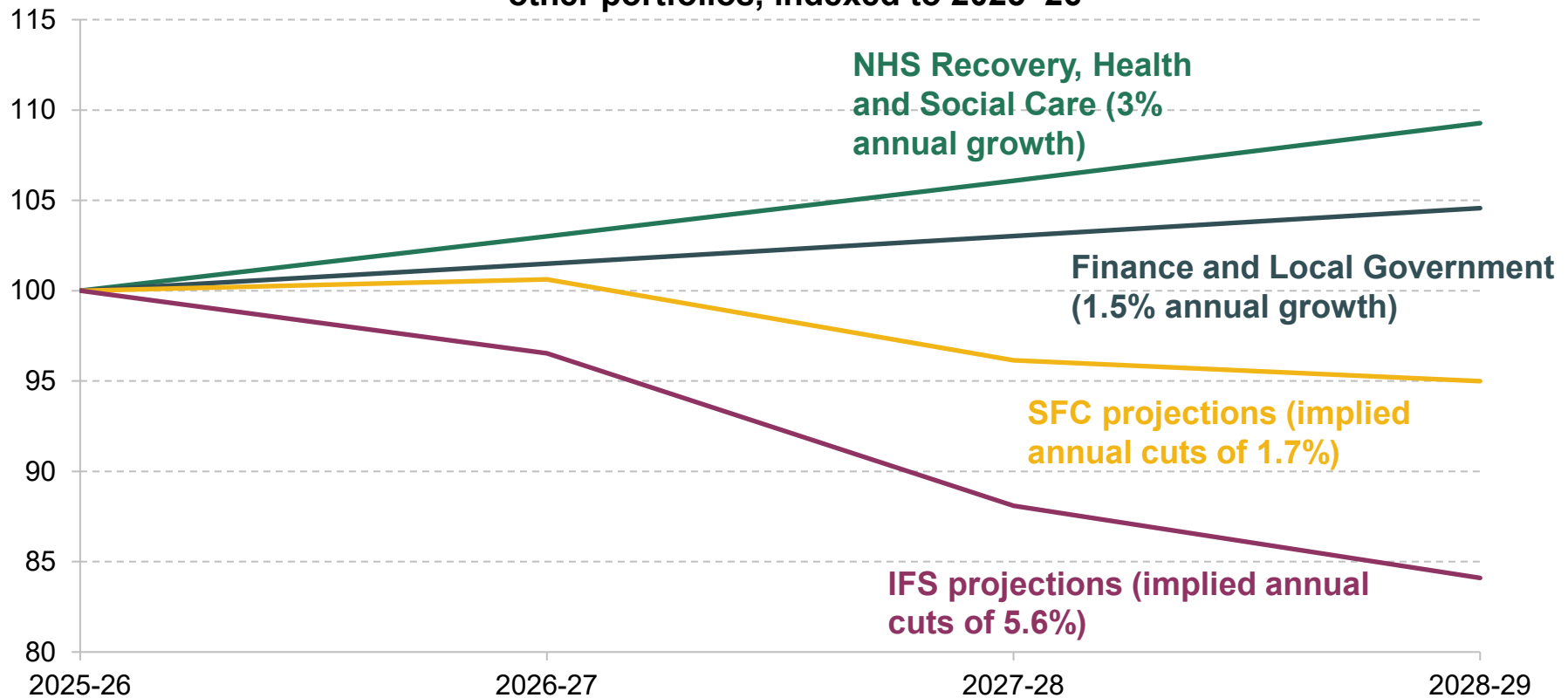
Funding uncertain after next year

Day-to-day funding (£ million), 2024–25 prices



Trade-offs for day-to-day spending after 2025-26

Real-terms spending on health and social care, local government, and all other portfolios, indexed to 2025–26

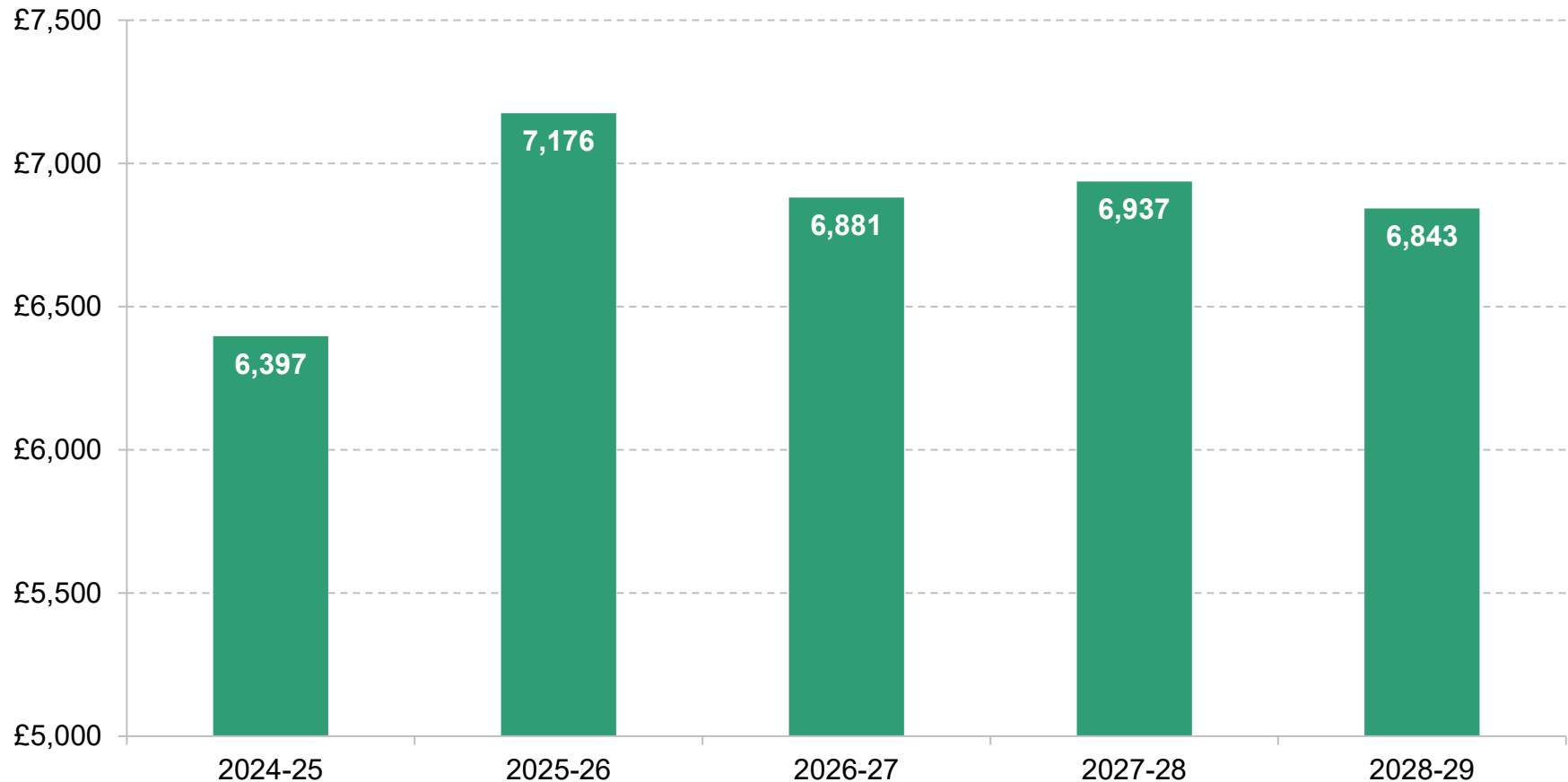


Opportunities and challenges in the medium run

- Mitigation of the two-child limit might be made redundant if UK government scraps the two-child limit
 - Could reduce scale of cuts to unprotected areas by an average of 0.6 percentage points
- Slower increases for health and local government are possible
 - Would limit required cuts elsewhere (or mean they could be avoided entirely)
- Boost to investment spending might help public-sector productivity and ease trade-offs
 - Will be important this is spent well

Capital funding set to be boosted next year – although then fall

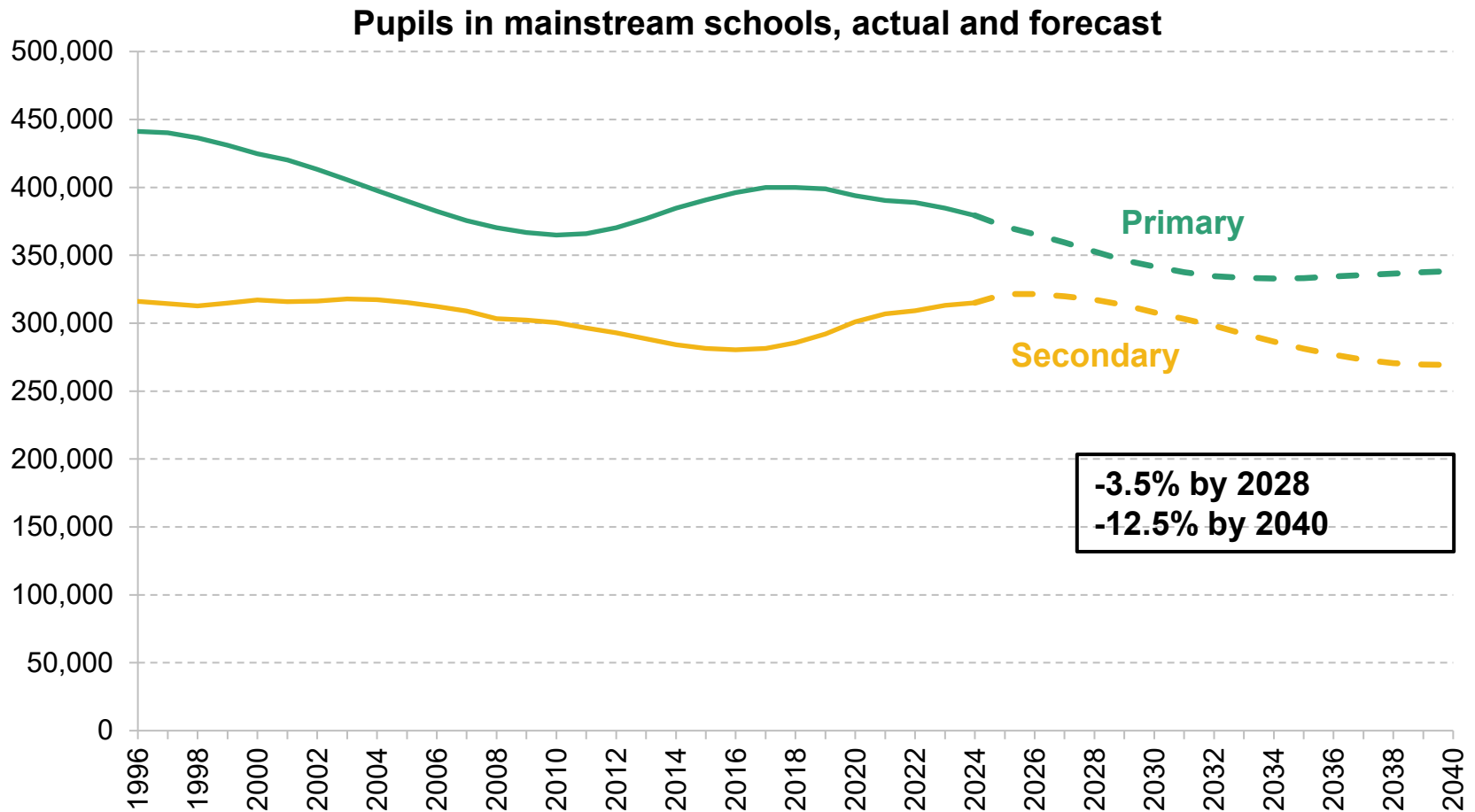
Capital funding (£ million), 2024–25 prices



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- School pupil decline is forecast between 2024 and 2040

Pupil decline could free up money – but practical challenges

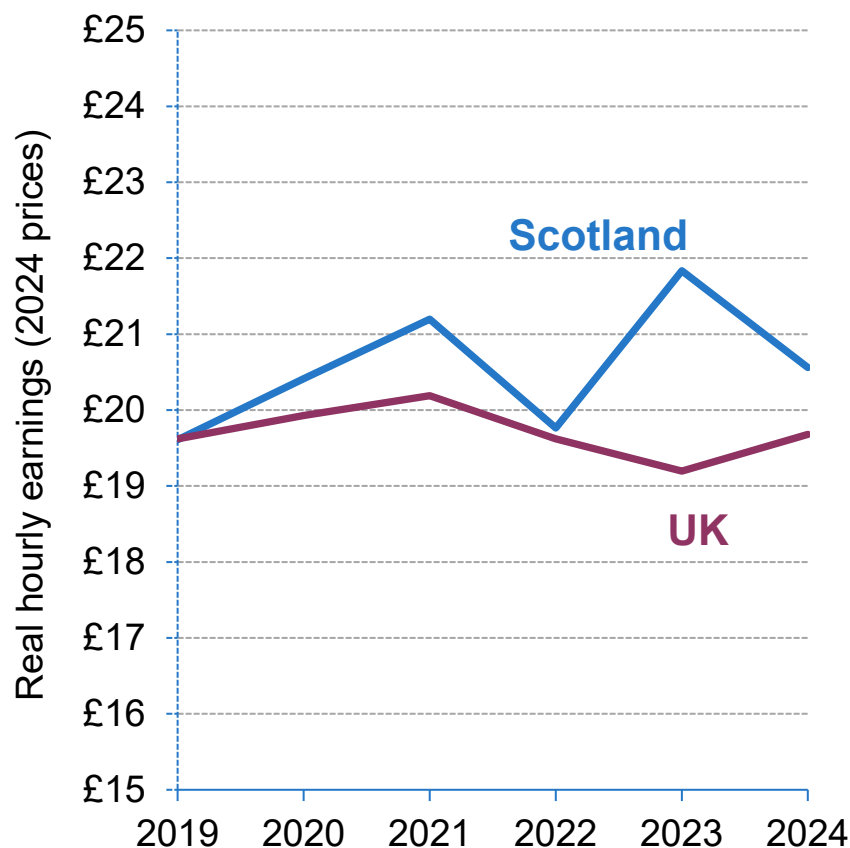


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- Slower increases for health and local government are possible
- Boost to investment spending might help public-sector productivity and ease trade-offs
- School pupil decline is forecast between 2024 and 2040
- Public sector is larger and paid more on average in Scotland

Pressure from public sector pay

Median public sector hourly pay,
Scotland and the UK



- Scotland has prioritized public sector pay: median was **5% higher** in Scotland than UK average in 2024
- 22% of workforce in public sector (vs 17% in England)
- Challenge for Scotland: funding from the UK government rises in line with spending per person in England, where public sector pay has increased less quickly.



Conclusions

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- Funding higher this year & next than was expected, as a result of big boost to UK government funding
 - Partially offset by downgrade in forecast net tax revenue position
- Outlook for 2026–27 onwards will be much clearer after the UK government's Spending Review in June
 - Scottish Govt should then carry out its own Spending Review
 - But likely to be tight spending plans, implying cuts to a range of services
- Particularly important to use higher spending this year and next effectively, or smooth it out over more years
 - Higher investment spending an opportunity to boost productivity