House of Commons

Scottish Affairs Committee

The Financing of the Scottish Government: Government response

Third Special Report of Session 2024–26

HC 1357

Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)) and its associated public bodies.

Current membership

Patricia Ferguson (Labour; Glasgow West) (Chair)

Maureen Burke (Labour; Glasgow North East)

Harriet Cross (Conservative; Gordon and Buchan)

Dave Doogan (Scottish National Party; Angus and Perthshire Glens)

Lillian Jones (Labour; Kilmarnock and Loudoun)

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Douglas McAllister (Labour; West Dunbartonshire)

Susan Murray (Liberal Democrat; Mid Dunbartonshire)

Jack Rankin (Conservative; Windsor)

Elaine Stewart (Labour; Ayr, Carrick and Cumnock)

Kirsteen Sullivan (Labour; Bathgate and Linlithgow)

The following Members were members of the Committee during the inquiry:

Stephen Flynn (Scottish National Party; Aberdeen South)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No. 152. These are available on the internet via www.parliament.uk.

Publication

This Report was Ordered by the House of Commons, on 15 October 2025, to be printed. It was published on 17 October 2025, by authority of the House of Commons.

Committee reports are published on the Committee's website at www.parliament.uk/scotaffcom and in print by Order of the House.

Contacts

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Third Special Report

The Scottish Affairs Committee published its First Report of Session 2024–25, The financing of the Scottish Government (HC 456), on 16 July 2025. The Government Response was received on 23 September 2025 and is appended below.

Appendix 1: Government Response: Letter from the Secretary of State for Scotland the Rt Hon Douglas Alexander MP, dated 23 September 2025

Dear Patricia,

The Financing of the Scottish Government

I am grateful for the work of the Scottish Affairs Committee in examining this important issue and producing its report and associated conclusions and recommendations.

Since you took evidence on this subject earlier this year, Phase 2 of the Spending Review has delivered the largest real terms settlement for the Scottish Government since devolution began, with an average £50.9 billion per year between 2026–27 and 2028–29. This includes an additional £2.9 billion per year on average through the operation of the Barnett formula, and follows the £4.9 billion increase to the Scottish Government's funding for 2024/25 and 2025/26 that the Chancellor set out in the Autumn Budget last year. This means that the UK Government's Plan for Change has delivered an end to austerity and more money than ever before for the Scottish Government to invest in Scottish public services like our NHS, police, housing and schools.

The financial certainty and stability provided by the UK Government stands in contrast to the Scottish Government's position to scrap the Barnett Formula, which would be a recipe for economic chaos and permanent austerity for Scotland. The most recent Government Expenditure and Revenue Scotland statistics for 2024/25, published in August, showed a net fiscal transfer of £2,578 per person in Scotland compared to UK average. This points to a £14 billion funding gap that the Scottish Government would need to manage under Full Fiscal Autonomy.

Along with this letter, I have included the Government's response to your recommendations pertaining to the transparency of the Barnett Formula and the operation and flexibility of the Fiscal Framework.

I would be grateful if you could share this letter with members of the Scottish Affairs Committee. I look forward to my first appearance before the committee later this year.

Yours sincerely,

The Rt Hon Douglas Alexander MP

Appendix 2: Government response

Recommendation 1: ***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***

The statement of funding policy does include details of how the comparability percentage of each department has been calculated, including a programme-by-programme breakdown. This can be found in Annex B of the Statement of Funding Policy document published in June 2025: https://assets.publishing.service.gov.uk/media/684859e3d0ca5d7801e4e6f6/Statement_of_Funding_Policy.pdf

Recommendation 2: ***The UK Government should publish an updated Block Grant Transparency document alongside each fiscal event which will result in changes to Scotland's funding.***

The Block Grant Transparency breaks down all changes in the devolved governments' block grant funding from the 2015 Spending Review. As set out in the accompanying Explanatory Note of the last publication, the breakdown has generally been updated and published on an annual basis. It would not be appropriate to publish the breakdown alongside a fiscal event. The process for publishing the breakdown includes a review by each of the devolved governments, which can only happen once the devolved governments receive their block grant totals at a fiscal event. An annual publication therefore remains the most appropriate response.

HM Treasury sets out the impact on Scotland of policy changes at fiscal events in the publicly available fiscal event documents.

Recommendation 4: ***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.***

There is regular engagement between the UK Government and Scottish Government around changes to UK Government department spending, forecasting of tax receipts and devolved benefit expenditure including in-year UK policy decisions that may affect Scottish Government funding. The Scottish Government is given notice of changes at the earliest possible opportunity, given the market sensitive nature of information about some policy changes.

Given the mechanical nature of the Barnett formula no formal impact assessment is carried out, however impacts on devolved government funding from UK Government policy decisions are considered as a matter of routine, with potential devolved government funding changes resulting from UK Government policy decisions included in advice to Ministers. The intention to publish the block grant transparency report on an annual basis will mean that more up to date data on changes to devolved government block grant funding will be regularly set out.

Recommendation 5: ***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.***

The Scotland Reserve limit was agreed with the Scottish Government who are responsible for managing annual expenditure within agreed budgets. There are no annual payment or draw down limits on the Scotland Reserve and the limit is uprated annually in line with the latest GDP deflator at the time of the Scottish Government's draft Budget.

We expect the next Fiscal Framework review point to be in 2028. The scope of the next Fiscal Framework review will be determined by the Joint Exchequer Committee (Scotland) at least 3 months before the review is to start. Any future reviews would require mutual agreement between the Scottish and UK Governments.

As set out in the 2023 Scottish Fiscal Framework, The Smith Commission recommended that the Fiscal Framework should be reviewed periodically, with subsequent reviews to take place on a 5 yearly basis but not more than once in any UK or Scottish electoral cycle.

Following discussion with the Chief Secretary to the Treasury and Cabinet Secretary for Finance and Local Government, HM Treasury and Scottish Government officials have agreed to begin preliminary work on the scope for the next review of the Fiscal Framework in the coming months.

Recommendation 6: ***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.***

Resource and capital borrowing powers and limits have been jointly agreed by both the UK and Scottish Governments in the updated 2023 Fiscal Framework – these are fixed in 2023–24 prices and uprated annually using the GDP deflator at the time of the Scottish Government's draft Budget to maintain their real value. The limits are linked to inflation as that maintains the real value of the borrowing arrangements over time.

The scope of the next Fiscal Framework review will be determined by the Joint Exchequer Committee (Scotland) at least 3 months before the review is to start. Any future reviews would require mutual agreement between the Scottish and UK Governments.

We will consider the Scottish Government's borrowing arrangements at the Fiscal Framework review. Currently, the borrowing limits are uprated using the GDP deflator, with a methodology agreed with the Scottish Government.

Recommendation 7: ***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.***

The Scottish Government has prioritised the devolution of powers to introduce a Building Safety Levy and the devolution of Aggregates Levy.

HM Treasury will continue work with the Scottish Government to deliver the Smith Commission recommendations, including VAT Assignment.