



A critical juncture for change

Local government finance reform in Wales

Introduction

Local government in Wales is facing an increasingly constrained and complex financial environment (Audit Wales, 2024). The 22 local authorities responsible for delivering essential public services to 3.1 million residents are under mounting pressure, calling the financial sustainability of local government into question (Welsh Government, 2025a). With local government finance increasingly central to national debates about service sustainability, economic renewal, and constitutional reform, the forthcoming Senedd election is a key opportunity for political parties to set out clear reform options and commit to longer-term structural change.

This briefing presents a five-part analytical framework for assessing how well local government finance systems can withstand economic shocks, adapt to change, and continue delivering essential services. It examines governance structure, legislative oversight, revenue sources, spending discretion, and equalisation mechanisms through the lens of resilience and autonomy.

Applying the framework, Wales scores 10.5 out of a possible 25 points, placing it on the boundary between low and moderate financial resilience. While the system remains broadly functional, it faces significant constraints and presents clear opportunities for reform, which the paper seeks to address through its recommendations.

What a good local government finance system looks like

Rather than relying solely on current financial indicators, the framework examines the institutional features that allow systems to adapt and function effectively over time:

- 1. The structure of sub-national government** provides the foundation for how the system works. Factors such as the size of authorities, the clarity of their functions, and how they collaborate shape their ability to operate efficiently and adapt to change.
- 2. Legislative frameworks and oversight** determine the level of autonomy local authorities have and the regulatory constraints they operate under, influencing both their capability and scope for innovation.
- 3. Available income sources** provide the financial basis for service delivery. The diversity of councils' revenue sources, local control over tax rates, and the balance between locally generated income and Welsh Government funding all affect councils' autonomy and long-term sustainability. Systems that rely heavily on central grants are more exposed to policy changes, while those with a broader range of income sources tend to cope better with financial pressures.
- 4. Discretion over spending** determines how freely authorities can allocate resources to respond to local priorities. The degree to which funding is tied to specific uses, the level of flexibility authorities have in adjusting service levels, and how free they are from centrally

imposed requirements all influence local capacity to adapt. Without sufficient spending flexibility, even relatively well-funded authorities can struggle to meet local needs effectively.

5. Equalisation mechanisms based on regular assessments of relative need help reduce disparities in councils' ability to raise and spend money. Strong equalisation systems strike the right balance between ensuring councils receive appropriate support while maintaining incentives for responsible financial management and local revenue generation.

The framework uses a structured five-point scoring system to assess each dimension, with scores ranging from 1 (minimal resilience or autonomy) to 5 (optimal resilience or autonomy). The scoring is based on established theories of public finance and draws on international best practice in fiscal decentralisation, institutional design, and public service delivery.

Evaluation of local government finance in Wales

Using the scoring methodology, Wales achieves a score of 10.5 out of 25. This places the system at the threshold between **low resilience and autonomy**, characterised by systemic weaknesses that require reform, and **moderate resilience and autonomy**, where the system remains functional under significant constraints. This score reflects several issues, including:

1. Structural constraints. Wales's 22-council model provides institutional clarity and supports collaboration. However, variations in council size can result in fragmentation, higher costs for smaller councils, and uneven local income-raising capacity, particularly in rural areas. While structural reform has been debated repeatedly, evidence suggests that other parts of the system offer more meaningful and realistic opportunities for change.

2. Limited fiscal autonomy under current legislative arrangements. Despite increased

devolved powers and recent reforms¹, control over many of the key decisions about local government finance remains with the UK Government. Combined with extensive legal obligations and audit requirements, this limits how much freedom councils have in practice and creates a system that is shaped as much by central requirements as by local priorities.

3. Narrow and constrained revenue base.

Welsh councils rely heavily on the Revenue Support Grant (RSG) provided by Welsh Government and have only one major local tax, council tax. Business rates are distributed nationally, and councils have limited freedom to set or change fees and charges. Compared with OECD counterparts, Wales has a notably limited range of local revenue instruments.

4. Restricted practical spending discretion.

Although councils can spend the RSG at their discretion, statutory services must be funded first and rising demand in these services, particularly education and social care, is crowding out funding for non-statutory services. Despite efforts to reduce restrictions on how funding is spent, the scope for genuine local spending flexibility has continued to narrow each year.

5. Transparent but outdated equalisation mechanisms. The equalisation system is rules-based and collaborative, but the underlying formula has not undergone a comprehensive review for more than 20 years. Emerging needs, demographic change, and the challenges of delivering services in rural areas are not consistently reflected.

Despite these weaknesses, there are existing strengths within the Welsh system that can be built upon. For instance, strong partnership working between the Welsh Government and local authorities is comparable to international examples and stronger than arrangements in England. Another strength of the system is the flexibility provided by un-earmarked RSG, which

¹ Through the [Local Government Finance \(Wales\) Act 2024](#)

enables local priority-setting within statutory limits. While there is scope for improvement, the formula-based allocation of RSG also supports a transparent and broadly equitable distribution of resources that reflects local need. Finally, a growing use of collaborative delivery models is evident, including the emergence of federated models like Torfaen and Blaenau Gwent.

Opportunities for reform

International evidence demonstrates that resilient systems combine diversified revenue, modern equalisation, and meaningful local autonomy. Wales has several solid foundations but requires a phased and strategic programme of reform:

Tier 1: Short-term reforms (low friction, high feasibility)

1. Modernise the settlement process

Wales should review how need and cost are assessed within the RSG to ensure authorities facing rurality, entrenched poverty, or higher social care demand receive appropriate support. In Germany, the equalisation system is regularly recalibrated to reflect expenditure needs and tax capacity (German Federal Ministry of Finance, 2025). Adopting a more transparent and simpler methodology similar to Germany's could help ensure funding better reflects changing circumstances over time.

2. Update equalisation indicators

Wales already has a relatively transparent framework for redistributing funding between councils through the RSG and redistributed business rates. However, it could benefit from drawing on OECD equalisation models to introduce better data, contemporary indicators, and improved process transparency. Finland updates demographic, geographic, and socio-economic metrics annually (Finnish Ministry of Finance, 2025); the Netherlands applies detailed cost-weighting factors (Government of the Netherlands, 2025); and Switzerland incorporates fiscal capacity and structural cost differences across cantons (Swiss Federal Finance Administration, 2025).

3. Strengthen financial monitoring and transparency

Many countries use simple and accessible indicators to monitor financial health. Japan's traffic-light system remains the most widely cited example (Kawato, 2010), while Germany's municipal supervisory authorities use early-warning triggers and defined intervention thresholds. Wales could develop a streamlined, publicly accessible financial health measure to support councillors, stakeholders, and citizens.

4. Deepen partnership working

While formal collaboration between different tiers of government is more established in Wales than in England, international models demonstrate further opportunities to strengthen partnerships between central and local government. For example, Italy's Unified Conference provides statutory co-decision forums across governmental tiers (Presidency of the Council of Ministers, 2025), and Germany's local government associations shape federal and Länder legislation. Building on Wales's existing strengths, including emerging federated models such as Torfaen and Blaenau Gwent, could enhance trust and enable shared services or joint delivery at scale.

Tier 2: Short–medium-term reforms

5. Introduce multi-year settlements

Wales should align with most OECD countries by giving local government greater budget certainty over multiple years. The Netherlands operates four-year settlement frameworks, Sweden relies on three-year budget cycles, and Germany uses medium-term financial planning to guide subnational budgeting. England's cautious shift towards multi-year settlements also provides a relevant UK precedent.

6. Further consolidate grants and reduce ring-fencing

Nordic countries like Denmark, Finland, and Norway, give councils more freedom over how grant funding is used, with grants delivered as flexible block payments and ringfencing generally below 10%. Reducing ring-fencing in

Wales to below 10%, and ideally closer to Nordic levels, would enhance local discretion, reduce administrative burden, and support more strategic financial planning. In the medium to long term the ambition should be to eradicate ring-fenced grants entirely to enable local discretion.

7. Modernise fees and charges

Internationally, fees and charges make up a meaningful share of local revenue, but councils in Wales have less freedom to use them. Austria and Germany allow municipalities broad discretion to set charges for services ranging from waste collection to planning, while New Zealand makes extensive use of user charging within local government, guided by clear cost-recovery principles (NZ Office of the Auditor-General, 2021). Reforming Wales's approach to fees and charges could support local innovation and reduce pressure on core taxation.

Tier 3: Medium–long-term reforms

8. Diversify local revenue options

Across Europe, subnational authorities benefit from a broader range of local tax instruments than those currently available in Wales. Sweden and Denmark rely heavily on local income taxation; France uses a mix of residence-based, property, and business taxes; and Italy and Spain assign regional surcharges on income or consumption taxes. Allowing Welsh local authorities controlled access to local income or sales taxes, selective levies, and new tourism or environmental taxes, would strengthen fiscal autonomy and better align revenue generation to local policy choices.

9. Rebalance cost liability for health, social care, and education

Welsh local authorities spend most of their budgets on statutory services like health, social care, and education, limiting their ability to focus on discretionary and place-shaping roles. International counterparts have tackled this by changing the tier of government responsible for bearing the costs of these services. For example, Finland transferred responsibility for health and social care to 21 new wellbeing

service counties, allowing municipalities to focus more on education and local development (Finnish Institute for Health and Welfare, 2025), while Denmark realigned responsibilities and financing to reduce duplication and clarify accountability (Kjaer et al., 2010). A similar realignment in Wales could sharpen local government's focus on community services, prevention, and local economic growth.

Tier 4: Long-term structural reform

10. Pursue meaningful fiscal subsidiarity to align revenue powers with service responsibilities

International evidence shows that systems are more resilient when responsibility for delivering services is aligned with control over funding. Countries such as Switzerland, Spain, and Italy give subnational governments access to significant tax bases. In Japan, the Trinity Reform exposed a mismatch between where money was spent, and where revenue was controlled, leading to a major devolution of revenue powers (Ikawa, 2008). A comparable diagnostic exercise in Wales could highlight structural imbalances and strengthen the case for reallocating taxing powers to better match local responsibilities.

Conclusion

The local government finance system in Wales is functional but heavily constrained, characterised by dependency, narrow revenue sources, rising statutory demand, and outdated equalisation arrangements (Audit Wales, 2024; WLGA, 2024a). At the same time, Wales benefits from strong partnership structures, transparent distribution mechanisms, and a history of collaborative reform.

The forthcoming Senedd election therefore provides a pivotal opportunity to set a new direction, one that modernises local government finance, strengthens resilience, and aligns Wales more closely with leading OECD practice. By advancing the phased reforms set out here, Wales can build a system that is more autonomous, equitable, and financially sustainable over the coming decades.

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Find out more

For the full report see Muldoon-Smith, K. (2026). **A critical juncture for change: Local government finance reform in Wales**. Wales Centre for Public Policy.

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