



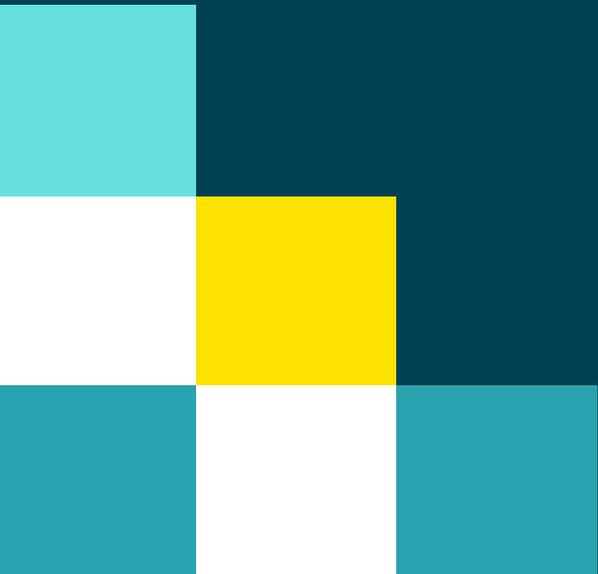
**Wales Centre for Public Policy**  
**Canolfan Polisi Cyhoeddus Cymru**

# A critical juncture for change

**Local government finance  
reform in Wales**

**Kevin Muldoon-Smith**

March 2026



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# Executive Summary

This evaluation of local government finance in Wales applies a five-part analytical framework focused on resilience and autonomy, covering governance structure, legislative oversight, revenue sources, spending discretion, and equalisation mechanisms. Out of a possible 25 points, Wales scores 10.5, placing it on the boundary between low and moderate financial resilience. While the system struggles on the margins of viability, it faces significant constraints and presents clear opportunities for reform.

## Key Findings

### 1. Structural constraints

In Wales, the 22 unitary authority model provides institutional clarity and supports collaboration. However, significant variation in authority size affects economies of scale and local income-raising capacity, particularly in rural areas. While structural reform has been debated repeatedly, available evidence suggests that other elements of the system offer greater potential for meaningful and deliverable change.

### 2. Limited fiscal autonomy under current legislative arrangements

Despite devolved powers under successive Government of Wales Acts and recent reforms through the Local Government Finance (Wales) Act 2024, key fiscal levers remain reserved to Westminster. Combined with extensive statutory service obligations and audit requirements, this limits genuine local discretion and produces a system 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) and have only one major local tax, council tax. Non-domestic rates are fully pooled, and councils operate within restrictive frameworks for fees and charges. Compared with OECD counterparts, Wales has a notably limited range of local revenue instruments.

### 4. Restricted practical spending discretion

Although the RSG is un-hypothecated, rising statutory demand, particularly in education and social care, continues to squeeze discretionary services. Despite efforts to reduce ring-fencing, local choice has continued to narrow year on 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 rurality pressures are not consistently reflected.

Wales exhibits the following systemic vulnerabilities:

- Heavy financial dependency on Welsh Government;
- Limited revenue diversification and narrow tax base;
- Relatively high levels of ring-fenced funding;
- Fragmented structure with uneven local income capacity;
- Minimal discretionary space outside statutory services; and
- Annual settlements that undermine long-term planning.

Wales also exhibits the following system strengths:

- Strong central and local partnership working and structured collaboration;
- Transparent, formula-based distribution of resources;
- Un-hypothecated block grants that enable local priority-setting; and
- Growing use of collaborative delivery models.

## A critical juncture for Wales: the Senedd elections

The forthcoming Senedd elections present Wales with a critical juncture, a rare point at which political attention, institutional reflection, and public debate converge. With local government finance increasingly central to national discussions on service sustainability, economic renewal, and constitutional reform, the electoral cycle offers an opportunity for political parties to articulate clear reform pathways and commit to longer-term restructuring.

International experience shows that major fiscal reforms often emerge during such political moments, when governments possess both the mandate and the momentum to modernise systems. Wales now stands at such a point.

## Reform priorities

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
2. Update equalisation indicators
3. Strengthen financial monitoring and transparency
4. Deepen partnership working

### **Tier 2: Short–medium-term reforms**

5. Introduce multi-year settlements
6. Further consolidate grants and reduce ring-fencing
7. Modernise fees and charges

### **Tier 3: Medium–long-term reforms**

8. Diversify local revenue options
9. Rebalance cost liability for health, social care, and education

### **Tier 4: Long-term structural reform**

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

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 elections therefore provide 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.

# Introduction

The fiscal pressures facing Welsh local authorities have intensified significantly over the past decade.<sup>1</sup> In 2024–25, Welsh councils received £5.7 billion in core revenue funding through the RSG and non-domestic rates, representing a 3.3% increase on a like-for-like basis (Welsh Government, 2024). Despite this increase, the Welsh Local Government Association reported that authorities still faced a £432 million funding gap (WLGA, 2024b). For 2025–26, core funding has risen to £6.14 billion, a 4.5% increase, and the provisional settlement for 2026–2027 indicates a further 2.7% increase, which although welcome would not address the underlying gap in local authority finance. Local authority revenue expenditure per head stands at £3,493, with education expenditure rising by 7.5% and social services by 8.1% (Statistics for Wales, 2024), reflecting sustained demand pressures. While councils have demonstrated resilience and innovation in maintaining service delivery (Welsh Government, 2025), the combination of constrained settlements, rising demand for statutory services, and inflationary pressures has created a financial environment that increasingly threatens the viability of current service models. In this context, the forthcoming Senedd election represents a potential turning point, when competing visions for fiscal devolution, public service reform, and intergovernmental funding arrangements will be tested before the electorate.

Understanding Welsh local government finance requires an appreciation of the devolved governance settlement. Since the establishment of the Senedd in 1999, responsibility for local government policy and funding has, in the main, rested with the Welsh Government. The Welsh block grant - from the UK Treasury determines the overall resources available, which the Welsh Government then allocates to councils primarily through the RSG<sup>2</sup> (see Sections 6 and 8 for further discussion of funding streams). This system creates both opportunities and constraints. While local government in Wales is accountable to both the Welsh and UK governments, Welsh ministers do exercise significant discretion over local government funding within the fiscal parameters set at Westminster. As a result, local councils remain indirectly tied to UK fiscal policy decisions. Periods of austerity, inflation, or spending growth in England therefore have direct implications for financial stability and predictability at the local level in Wales.

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<sup>1</sup> Like-for-like settlement comparisons over time are notoriously difficult, accurate assessments are reliant on compound adjustments and classifications of transfers compared to new responsibilities.

<sup>2</sup> Local authorities also receive funding directly or indirectly through redistributed business rates, elements of land tax, land transaction tax, and Welsh Rates of Income Tax WRIT).

The next Senedd electoral cycle may therefore act as a catalyst for reconsidering the balance between autonomy and accountability within this settlement, particularly as debates around fiscal powers, regional equity, and the adequacy of the block grant gain renewed prominence.

Local authorities in Wales have far fewer fiscal levers than their counterparts in many other countries.<sup>3</sup> The primary local tax is council tax, which accounts for approximately 21 to 40% of council revenue (Statistics for Wales, 2025).<sup>4</sup> However, council tax is widely criticised for being regressive and outdated, with property valuations still based on 2003 bandings.<sup>5</sup> While councils also benefit from redistributed non-domestic rates (business rates), which are fully pooled at the national level, local incentives for economic growth remain limited.<sup>6</sup> By contrast, business rate retention operates in England, although the link between retention and economic growth is not well established.

The current financial landscape has been fundamentally shaped by austerity policies introduced following the 2008 financial crisis (Downe & Taylor-Collins, 2019). The Welsh Government has described the 2024–25 budget period as the most challenging financial context Wales has faced since devolution, with the overall budget valued at £1.3 billion less in real terms than when it was set in 2021, due to inflation. Welsh local authorities have experienced sustained real-terms reductions in core funding, requiring difficult decisions about service priorities and delivery models (Taylor-Collins & Downe, 2021). Councils have responded through efficiency programmes, service reconfiguration, increased collaboration, and alternative delivery models. Against this backdrop, the 2026 Senedd election could mark a critical juncture, with the potential to support a more ambitious reform agenda that redefines the relationship between central and local government in Wales.

Demographic and social trends compound these funding challenges. Wales has an ageing population, requiring substantial investment in adult social care services (WLGA, 2025a). Children’s services face rising demand driven by increased identification of safeguarding concerns and special educational needs. Educational provision must also adapt to curriculum reform and changing pedagogical approaches. Environmental responsibilities continue to expand as Wales pursues ambitious decarbonisation targets (WLGA, 2025b). Each of these pressures carries significant financial implications that must be reconciled within constrained budgets. Even where recent settlements provide nominal increases, inflation and rising

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<sup>3</sup> Although England, Scotland and Northern Ireland face similar situations relative to other international locations.

<sup>4</sup> Monmouthshire has the highest reliance at 40% and Caerphilly least with 21%

<sup>5</sup> Revaluation will take place in 2028 under provisions set out in the Local Government Finance (Wales) Act 2024.

<sup>6</sup> There is an emerging agenda of city deals, investment zones and Freeports though.

demand often result in ongoing real-terms constraints. Political choices made in the next parliamentary term will therefore be decisive in shaping how these pressures are managed, whether through continued containment or a more fundamental reimagining of local service delivery and investment.

The COVID-19 pandemic introduced additional complexity to local government finance (Audit Wales, 2020). Welsh councils played a central role in the emergency response, from supporting vulnerable residents to administering business grants and managing public health interventions. While the Welsh Government provided substantial additional funding to cover pandemic-related costs, the long-term financial legacy includes depleted reserves<sup>7</sup>, deferred maintenance, and emerging service pressures that will influence financial planning for years to come.

One strength of the Welsh system is its emphasis on redistribution. The Welsh Government allocates the RSG using a formula designed to reflect local need, in contrast to the Barnett Formula, taking account of factors such as population, deprivation, rurality, and age profiles. This approach ensures that councils with lower tax bases and higher levels of demand receive greater relative support than wealthier areas. However, disputes remain. Rural authorities argue that sparsity and higher service delivery costs are not fully recognised for some services (Holzinger, 2024), while others note that hypothecated grants can restrict local flexibility. As a result, the redistributive system promotes broad equity but can place pressure on centre–local relationships when councils perceive funding levels or conditions as insufficiently responsive.

This report examines these challenges through systematic analysis of financial data, policy frameworks, and stakeholder perspectives. It assesses the adequacy of current funding levels in relation to statutory<sup>8</sup> responsibilities and community expectations, considering both the immediate pressures facing councils in setting balanced budgets and the longer-term sustainability of local public services in Wales. The analysis also draws on international comparisons, examining approaches to local government finance and service delivery in comparable jurisdictions to identify potential lessons and opportunities for reform. This includes work conducted in collaboration with the Local Government Information Unit, through Muldoon-Smith et al. (2024) and the Local Government Finance Observatory at LGIU. This international

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<sup>7</sup> This is not uniform; some local authorities have managed to maintain and occasionally increase their reserves.

<sup>8</sup> Statutory duties embody a degree of ambiguity in expression. Statutory can be “required” by statute” or “permitted”. And within those there can be levels of prescription of what is meant. For example, library provision is statutory in the sense that a council must provide a library service. And there are library standards which a council must meet but they are arguably not at the same level of prescription for a service such as education or social services. Whereas a council may provide other services such as swimming pools. Effort will be made throughout to unpack this situation in the relative context being discussed.

research, which explores how other countries structure local government funding systems, manage fiscal pressures, and deliver public services, has informed the development of an analytical tool used in this report to assess the effectiveness of the Welsh local government finance system and to identify potential innovations and alternative models. In this context, the 2026 election represents more than a routine democratic event. It marks a potential inflection point in Welsh governance, offering an opportunity to recalibrate fiscal relationships, reconsider the role of local authorities, and set a new strategic direction for the sustainability and equity of public services across Wales.

# What a good local government finance system looks like

Assessing the resilience of local government finance systems requires a systematic approach that examines the structural features shaping fiscal capacity, autonomy, and adaptability. The Local Government Finance Assessment Framework used in this report evaluates how well local government finance arrangements can withstand economic shocks, respond to changing circumstances, and sustain essential service delivery. Rather than focusing solely on current financial indicators, it examines the underlying institutional characteristics that allow systems to adapt and function effectively over time (see Appendix 1 for a detailed explanation of the underlying method and approach to research deployed in this work). The framework is informed by comparative local government assessment tools and approaches developed by, among others, Ladner et al. (2021), Ladner et al. (2025a, 2025b), Wolman (2008), Geisler et al. (2021), Kuhlmann (2018), the World Bank's Local Governance Performance Index, the OECD and UCLG World Observatory on Sub-national Government Finance, and the OECD Fiscal Decentralisation Database.

The framework comprises five interrelated themes that together define the operating environment for local government finance. The structure of sub-national government (1) establishes the institutional foundation, with authority size, functional clarity, and collaborative arrangements shaping efficiency and adaptive capacity. Legislative frameworks and oversight (2) determine the level of autonomy available to local authorities and the regulatory constraints within which they operate, defining both capability and scope for innovation.

Available income sources (3) provide the financial basis for service delivery. Revenue diversity, local control over tax rates, and the balance between locally generated income and intergovernmental transfers directly influence fiscal autonomy and long-term sustainability. Systems that depend heavily on central grants are more exposed to policy change, while those with more diverse local revenue bases tend to withstand fiscal pressures more effectively.

Discretion over spending (4) determines how freely authorities can allocate resources in response to local priorities. The degree of ring-fencing, flexibility over service levels, and freedom from prescriptive mandates all shape adaptive capacity. Without sufficient spending discretion, even relatively well-funded authorities can struggle to respond effectively to local need.

Equalisation mechanisms (5), based on regular assessment of relative need, address disparities in fiscal capacity arising from differences in economic base, demographic profile, and service demand. Well-designed equalisation systems promote equity while preserving incentives for sound financial management and local revenue generation.

The framework applies a structured five-point scoring system for each thematic dimension, ranging from 1 (minimal resilience or autonomy) to 5 (optimal resilience or autonomy). The scoring is grounded in established public finance theory and informed by a systematic review of international best practice in fiscal decentralisation, institutional design, and public service delivery. This standardised approach enables robust cross-jurisdictional comparison, moving beyond descriptive analysis to produce quantified assessments of system performance, policy effectiveness, and institutional capacity.

# Structure of local government

Any examination of contemporary local government finance in Wales must begin with the devolved constitutional settlement established through the Wales Acts (1998, 2006, 2017). These Acts created the Senedd and the Welsh Government, devolving powers in areas including education, housing, planning, local government, and aspects of taxation. Within these policy areas, Welsh Ministers hold both legislative and executive authority. The unitary authorities, comprising the 22 principal councils, operate as corporate bodies with democratic mandates, but remain creatures of statute, with their powers, duties, and funding arrangements defined through legislation enacted by the Senedd or, historically, by Westminster. This settlement creates a vertical system of governance. Unitary authorities operate within frameworks set by Welsh legislation and, in many cases, retained UK legislation and subordinate regulation.

At the same time, the Welsh Government itself remains dependent on financial and legal frameworks determined by the UK Government and Parliament. As a result, intergovernmental relations in Wales operate both upwards, with UK institutions, and downwards, with councils and regional bodies. Since the establishment of the National Assembly for Wales, now Senedd Cymru, in 1999, Wales has developed a distinctive governance model based on shared responsibilities between the Senedd, the Welsh Government, and local authorities.

Beneath the 22 principal authorities are 731 community and town councils in Wales, which form the most localised level of government. These councils cover much, but not all, of Wales. Larger urban areas such as Cardiff and Swansea have community councils in some districts, while others do not. While their powers are limited compared to principal councils, community and town councils play an important role in ensuring grassroots representation and strengthening democratic engagement. They also raise income through the council tax precept. In addition to the principal and community councils, there is an increasing emphasis on regional collaboration in Wales. Councils are encouraged to work together through mechanisms such as Corporate Joint Committees (CJCs). Established under the Local Government and Elections (Wales) Act 2021, CJCs bring principal councils together at a regional level to address strategic issues such as transport planning, regional economic development, and land-use planning. This reflects a policy direction aimed at balancing local autonomy with regional scale, in order to improve efficiency and respond to challenges that extend beyond individual council boundaries. The interaction between these three levels of government creates both stability and tension, which is reflected in a number of intergovernmental challenges:

Dependence on the block grant: as noted earlier, because the Welsh Government relies on transfers from the UK Treasury, local authorities are indirectly exposed to UK fiscal policy decisions. Periods of austerity in England have, to some extent, been reflected in Welsh settlements, placing pressure on councils despite local need.<sup>9</sup>

Redistribution and equity: the Welsh Government's formula-based allocation is intended to reflect relative need and reduce inequalities between councils. However, disputes persist over whether the settlement adequately captures local pressures, particularly in rural and highly deprived areas.

Autonomy versus accountability: councils often report limited flexibility, as hypothecated grants and national service standards constrain local discretion. The Welsh Government, in turn, argues that accountability to the Senedd requires consistent delivery of devolved priorities, such as reducing inequalities and promoting wellbeing, across Wales. Although many responsibilities are devolved, the UK Government continues to play a central role in shaping Welsh local government finance. This occurs primarily through the Barnett Formula, which determines the size of the block grant transferred from the UK Treasury to the Welsh Government. The Barnett mechanism provides a degree of stability and simplicity but remains a key structural determinant of the resources available to Welsh councils and is the subject of ongoing debate about fairness and adequacy.

When spending on devolved services in England changes, Wales receives a proportional adjustment, modified since 2016 by a needs-based factor. This block grant is the principal source through which the Welsh Government funds both its own programmes and transfers to local authorities. In addition, the UK Government retains control over macroeconomic policy, overall public spending levels, and certain tax levers. Since 2018, the Welsh Government has had the power to raise a portion of income tax and to set devolved taxes such as Land Transaction Tax and Landfill Disposals Tax. However, the scale of devolved taxation remains small in comparison with the block grant. As a result, the fiscal space available to local government in Wales continues to be heavily shaped by decisions taken at Westminster.

## The case for reforming the Barnett Formula

Devised by the Chief Secretary to the Treasury, Joel Barnett, in 1978, the formula calculates changes to devolved budgets as a population-based proportion of

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<sup>9</sup> Comparing levels of funding between English and Welsh local government systems is difficult given the different structure and different funding streams (and the significant reduction of the role of LAs in England in schools education provision). There is evidence that Local Government in Wales has not suffered the same level of austerity as England. However, that does not mean that Wales is not in a precarious financial position, only that England has been an extreme outlier in recent years.

spending changes in comparable services in England. For Wales, which accounts for approximately 4.6% of the UK population according to 2024 mid-year population estimates, this results in proportional increases when UK Government spending rises in England.<sup>10</sup> While the formula has endured for over four decades, it continues to attract persistent criticism in Wales, where governments, commissions, and academic studies consistently argue that it fails to reflect Welsh needs adequately (Welsh Government, 2021). Despite reforms, particularly through the 2016 fiscal framework agreement, the case for further reform remains compelling.

Two features are particularly problematic for Wales. First, the formula does not account for differences in socioeconomic need between nations. Second, it applies only to changes at the margin rather than to baseline funding levels, which were historically set higher for Scotland and Northern Ireland than for Wales. This effect, often referred to as the ‘Barnett squeeze’, has reduced Wales’s relative per-capita funding advantage over England, despite higher levels of need.

The Holtham Commission (2009–2010) provided empirical evidence that Wales required approximately 115% of English spending per head to deliver comparable public services. This was attributed to higher levels of ill health, greater rurality, and lower population density, all of which increase costs in areas such as healthcare, education, and transport. Although the 2016 fiscal framework introduced a needs-based factor set at 115%, this adjustment applies only to future funding increases, not to the baseline. Critics therefore argue that cumulative underfunding remains embedded in the system in the absence of fundamental rebalancing.

When Barnett-derived funding increases fail to keep pace with rising service costs arising from inflation, demographic pressures, or increasing levels of social need, local councils face acute financial strain and difficult choices. These often involve raising council tax, cutting services, or pursuing further efficiency and productivity measures. This mismatch arguably has a disproportionate impact on vulnerable populations in more deprived Welsh communities. Reforming the formula to place relative need at its core would help reduce the risk of local government becoming locked into repeated cycles of retrenchment.

From a constitutional perspective, allocating funding to devolved administrations without sufficient regard to relative need risks undermining principles of fairness and solidarity across the Union. Reform could therefore support a more sustainable and balanced devolution settlement. The strongest case for reform lies in a move towards fully needs-based allocations, under which each nation’s demographic, health, geographic, and socioeconomic characteristics are assessed and reflected in block

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<sup>10</sup> And reductions when it falls, within the process set out in the 2016 fiscal framework.

grant allocations. Such an approach was advocated by the Holtham Commission, and international examples, such as Australia's Commonwealth Grants Commission, demonstrate that needs-based equalisation systems can operate effectively within federal structures.

# Regulatory framework

The budgetary process for local government finance in Wales is the structured annual cycle through which the Welsh Government determines, allocates, and distributes funding to the 22 local authorities. It operates within the devolved fiscal framework outlined above and incorporates Welsh-specific tax revenues. The process links three interconnected levels of budgeting: the UK Government's funding allocation to Wales, the Welsh Government's own budget, and the individual budgets of local authorities. The annual cycle typically begins with the UK Autumn Statement and the Welsh Government Draft Budget, which together establish the overall financial envelope for devolved services. The Welsh Government then determines the level of Aggregate External Finance (AEF) available to local government. AEF comprises the RSG and the redistributed non-domestic rates (NDR) pool. Together, these constitute the core funding for councils, alongside specific grants and revenue from council tax.

The Local Government Finance Policy and Sustainability Division within the Welsh Government models funding scenarios and consults with the Welsh Local Government Association (WLGA) and council finance officers through technical working groups. Each year, usually in December, a Provisional Local Government Settlement is published. This sets out the total un-hypothecated funding available to the sector and its distribution between authorities based on a complex formula reflecting population, deprivation, and need indicators. This stage includes statutory consultation with councils and scrutiny by the Senedd.<sup>11</sup> Provisional information on specific grants is also published at this point. Following consultation, the Final Settlement is announced, typically in February, confirming each authority's allocation for the financial year beginning in April. Councils then finalise their own annual budgets and council tax levels, ensuring that revenue and expenditure are balanced in line with statutory requirements under the Local Government Finance Act 1992 and the Local Government and Elections (Wales) Act 2021. Authorities are required to set balanced budgets by 11 March each year, with formal approval by full council.

This annual process attracts considerable criticism. Concerns focus on the timing of the provisional settlement shortly before Christmas, the short period between provisional and final settlements, the requirement to set balanced budgets by March, and the continued reliance on single-year settlements. Together, these factors make medium- and long-term financial planning difficult and encourage a focus on annual

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<sup>11</sup> Distributional effects of changes to the data or methodology of the formula are discussed and assessed through the officer sub-group and political finance group prior to the provisional settlement.

budget management<sup>12</sup> rather than longer-term assessment of local need and service sustainability.<sup>13</sup>

Alongside revenue funding, the Welsh Government also issues a Local Government Capital Settlement, covering investment in infrastructure and assets, as well as targeted or ring-fenced grants for services such as education and social care. Councils must integrate these various funding streams into their medium-term financial strategies, ensuring financial sustainability and alignment with national priorities.

Scrutiny of local government finance in Wales operates through four interconnected pillars: internal council oversight, external audit, devolved parliamentary accountability, and public transparency. While historically closely related to arrangements in England<sup>14</sup>, the Welsh system has developed distinct characteristics that reflect devolution, statutory duties, and a collaborative culture between local authorities and the Welsh Government. Wales does not operate a single formal early-warning system, such as Japan's Financial Soundness framework. Instead, it relies on a preventive and collaborative approach that continuously monitors the financial health of local authorities through audit, oversight, and partnership working between councils, Audit Wales, and the Welsh Government. Each of Wales's 22 local authorities must operate sound systems of financial management and scrutiny under the Local Government Act 2000, the Local Government Finance Act 1992, and the Local Government and Elections (Wales) Act 2021. Internally, executive or cabinet members propose the council's annual budget and Medium-Term Financial Strategy (MTFS), while overview and scrutiny committees, composed of non-executive councillors, examine financial decisions and spending priorities. Their role is to ensure that budgets align with the council's wellbeing objectives, statutory service requirements, and community needs. Councils in Wales are also required to maintain an audit committee, referred to as a governance and audit committee under the 2021 Act. These committees review internal audit reports, risk management arrangements, performance data, and external audit findings.

External scrutiny in Wales is led by Audit Wales, the independent public body responsible for auditing local government and other devolved public bodies. Established under the Public Audit (Wales) Act 2004, Audit Wales, operating under the statutory authority of the Auditor General for Wales, delivers both financial and performance audit functions. Financial audits assess whether councils' accounts

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<sup>12</sup> In previous years, Welsh Government has provided indicative three-year projections/indications.

<sup>13</sup> In addition, households only receive a matter of weeks' notice of changes in council tax bills ahead of beginning of the financial year.

<sup>14</sup> Although the systems diverged significantly in recent years with the suspension of relative needs assessment in England.

present a true and fair view, while performance audit work examines whether proper arrangements are in place to secure value for money. This system ensures consistency and independence. Unlike in England, where local audits are undertaken by private firms, all local authority audits in Wales are overseen by Audit Wales, maintaining a unified and publicly accountable audit model.

At the national level, local government finance is scrutinised through the Welsh Government, the Senedd, and associated committees. The Welsh Government's Local Government Finance Policy and Sustainability Division calculates the Local Government Settlement in line with the formula agreed with local government in Wales, setting out the total annual funding allocation to councils. The Minister for Housing and Local Government presents both the draft and final settlements to the Senedd, where they are subject to committee scrutiny and consultation with the WLGA and individual authorities. Within the Senedd, the Local Government and Housing Committee and the Finance Committee scrutinise the settlement, budget transparency, and broader fiscal policy. They may call ministers, Audit Wales officials, and WLGA representatives to give evidence. Reports from Audit Wales also feed into this parliamentary scrutiny, enabling the Senedd to monitor trends in financial sustainability, governance, and service outcomes across local authorities.

The Welsh system places strong emphasis on public engagement and openness. Councils are required to publish financial statements, audit reports, and performance summaries on their websites. The Local Government and Elections (Wales) Act 2021 introduced new duties relating to self-assessment and panel performance reviews, requiring councils to demonstrate continuous improvement and financial resilience. This approach complements formal audit by embedding internal reflection and public reporting. Residents have statutory rights to inspect accounts, question auditors, and object to unlawful expenditure under the Public Audit (Wales) Act 2004.

Several recent statutes and strategic agreements also have significant implications for local government finance in Wales. The Local Government Finance (Wales) Act 2024 reforms two key local taxation regimes: non-domestic rates (business rates) and council tax. Its provisions on non-domestic rates change valuation frequency to better reflect economic conditions and strengthen the Welsh Government's powers to amend reliefs, set differential multipliers, and address avoidance practices. In relation to council tax, the Act enables the consolidation and reform of discounts, disregards, and exemptions, and introduces updated regulatory powers to modernise the system. It also fixes the next revaluation date at 2028, with subsequent revaluations on a five-year cycle, and provides powers to amend rates within each valuation band. The Act therefore serves as the main legislative mechanism for Wales-specific reform of local taxation structure and administration.

The Local Government and Elections (Wales) Act 2021 is primarily concerned with governance, electoral arrangements, and performance, but it also includes provisions that intersect with finance. These include duties affecting budgeting, transparency, and citizen engagement, as well as enabling powers that influence service delivery and, in turn, cost and funding structures. The Act sets expectations for stronger financial scrutiny, performance reporting, and democratic accountability, all of which councils must reflect within their financial planning processes. Earlier Wales Acts, particularly those enacted in 2014 and 2017, are also significant because they devolved key fiscal powers to Wales, most notably the ability to set Welsh Rates of Income Tax (WRIT) and control over certain environmental and property taxes, including Land Transaction Tax and Landfill Disposals Tax. These Acts underpin the fiscal tools available to the Welsh Government and therefore indirectly shape the resources and flexibilities available to local government.

A number of institutional mechanisms support intergovernmental relations in Wales. The Partnership Council for Wales is the principal forum linking local and devolved government and is established under sections 72 and 73 of the Government of Wales Act 2006. It brings together Welsh Ministers, local government leaders, the Welsh Local Government Association, and other relevant bodies. Its purpose is to promote cooperative working, discuss strategic issues, and advise the Welsh Government on local government policy and finance. The Partnership Council meets several times each year and functions as a consultative rather than decision-making body. Its work is supported by sub-groups and working groups focused on areas such as finance, governance reform, and service collaboration. While its statutory basis ensures regular engagement, some critics have argued that it operates more as a forum for consultation than for joint decision-making. Although the Partnership Council is more substantive than comparable arrangements in England, there remains scope for reform in relation to formal decision-making powers. The WLGA plays a central role as the collective voice of local government in Wales and acts as a key intermediary within intergovernmental relations. It represents councils in negotiations on funding settlements, legislative change, and service standards. The WLGA's close working relationship with the Welsh Government, often characterised by consensus-building rather than confrontation, reflects the smaller scale and more networked political culture of Wales. The association participates actively in the Partnership Council and a wide range of Welsh Government advisory boards, shaping policy design and financial frameworks.

In addition, a Strategic Partnership Agreement between local and central government was signed in June 2025 by the First Minister, the WLGA Leader, the WLGA Presiding Officer, and the Cabinet Secretary for Housing and Local Government. This 23-page agreement formalises the long-standing relationship between the Welsh

Government and Wales's 22 local authorities. Although not statutory, it is endorsed by all principal council leaders. The agreement underpins the statutory Partnership Council for Wales and associated partnership arrangements, setting out the respective roles of national, local, and regional governance. It also acknowledges the need for the Welsh Government to balance funding for local government within the overall financial envelope available to support its wider responsibilities and priorities. Importantly, the agreement prioritises the use of multi-year financial settlements wherever possible. A protocol on hypothecated grants, co-developed as part of this process, further reaffirms the Welsh Government's commitment to providing as much financial certainty as possible in relation to ring-fenced funding and to setting out clear, agreed longer-term strategies for such grants.

# Sources of income for local government

The RSG, distributed by the Welsh Government, constitutes the largest single income source for most Welsh local authorities, typically accounting for around 60–70% of total revenue. This un-hypothecated grant can be spent at each council's discretion, allowing flexibility in prioritising services according to local community needs. The distribution of the RSG is determined through a complex relative needs-based formula that considers factors including population size, demographic profile, levels of social deprivation, sparsity and dispersion, the cost of providing specific services, and the availability of local income. The formula aims to ensure that authorities with greater needs or higher service delivery costs receive proportionately more funding. The distribution formula is the mechanism through which the Welsh Government determines how the RSG is shared across Wales's 22 local authorities. It seeks to divide the un-hypothecated local government funding pot in a way that reflects relative needs and resources. Central to the formula is the calculation of each council's Standard Spending Assessment (SSA), which represents an estimate of the funding required to deliver a standard level of services. The SSA is a notional measure. It does not prescribe how much a council must spend, but it underpins the level of grant it receives. Councils with higher needs and a lower capacity to raise income locally receive greater support through the RSG.<sup>15</sup> The SSA calculation is structured around service blocks that reflect councils' main responsibilities. The principal blocks include:

- Education, driven by pupil numbers and weighted by age profile, deprivation, Welsh language needs, and rurality.
- Social services, based on population age structure, including the number of older people and children, alongside deprivation indicators, disability rates, and rurality or sparsity.
- Highways, transport, and environmental services, reflecting factors such as road length, traffic volume, population density, and sparsity.

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<sup>15</sup> Indicators of relative need were derived through regression techniques and are factors which drive the need to spend. Methodologically, they are intended to be things which cannot be directly manipulated by local choice.

- Other services, including culture, housing, planning, and environmental health, using proxy indicators such as population size, caseload, deprivation, or rurality.

Each service block uses indicators of relative need and applies weightings agreed through technical working groups involving the Welsh Government, local government representatives, and Welsh Government statisticians. These are coordinated through a dedicated funding distribution sub-group. More affluent councils, such as Monmouthshire, tend to receive relatively less grant, as they are assessed as having a stronger council tax base and a greater capacity to raise local income. More deprived or high-need councils, such as Blaenau Gwent or Merthyr Tydfil, receive relatively more support due to higher levels of social need and weaker local tax bases.

Non-domestic rates, commonly referred to as business rates, are levied on non-residential properties including shops, offices, factories, and warehouses. In Wales, these rates are collected by local authorities but pooled nationally and redistributed through the local government settlement. The rateable value of each property is assessed by the Valuation Office Agency, with periodic revaluations, most recently in 2023. The Welsh Government sets a single national multiplier, applied uniformly across Wales, which is used to calculate the rates payable on each property. Wales has used its devolved powers to adopt a different approach from England, including varying relief schemes for small businesses and the use of retail rate relief to support high streets.

Although councils collect business rates locally, they do not retain the revenue directly. Instead, receipts are pooled and redistributed through the settlement<sup>16</sup> meaning that authorities with large commercial<sup>17</sup> or industrial tax bases do not automatically benefit from local economic growth<sup>18</sup>. This centralised approach is designed to reduce inequality between councils with differing commercial bases, but it may weaken incentives for local authorities to promote economic development. This contrasts with England, which has operated partial, and at times full, business rate retention since 2013. Wales has retained a pooled system to prioritise equity between places. More recently, Wales has introduced Freeports in Port Talbot and

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<sup>16</sup> Business rates are redistributed on the basis of population while RSG is the balancing factor, redistributed using the previously stated formula calculation of relative need.

<sup>17</sup> These tend to be medium to high value properties. There are significant amounts of authorities with predominantly small businesses, and less valuable properties, that do not figure largely in business rate revenues.

<sup>18</sup> It must be noted that very few local authorities are net losers due to pooling and redistribution. The majority actually benefits in most years.

Milford Haven, together forming the Celtic Freeport, as well as in Anglesey, which include elements of business rate relief and retention.

Council tax remains the most significant locally raised revenue source for Welsh local authorities. This property-based tax is levied on domestic properties, each of which is placed into one of nine valuation bands, A to I, based on estimated property values as at April 2003. This differs from England, which uses eight bands, as Wales includes an additional higher band. The distribution of properties in Wales is skewed towards the lower end of the housing market.

Each local authority sets its council tax rate annually, resulting in variation across the 22 Welsh councils. While higher-band properties pay more in cash terms, the tax remains regressive when assessed against relative property values. Nationally set ratios determine the relationship between bands, with Band D typically used as the benchmark for comparison. Council tax liabilities may be reduced through discounts for single occupants, students, and other qualifying groups, while some households and properties are fully exempt. Council tax provides approximately 21–40% of local authority revenue in Wales, making it a critical funding source. Beyond revenue generation, it also supports fiscal autonomy and local accountability, as elected members must justify increases to local taxpayers. Nevertheless, despite its importance, council tax remains effectively the only tax-based local income stream available to Welsh local government.

Welsh local authorities also receive a wide range of specific grants from the Welsh Government and, in some cases, UK departments for defined purposes. These hypothecated grants must be spent on designated services or projects and include funding for schools, such as the Pupil Development Grant, social care initiatives, homelessness prevention, highways maintenance, and other targeted interventions. The scale of specific grant funding varies widely between authorities, depending on need, eligibility criteria, and successful bidding processes.<sup>19</sup> While such grants support delivery in priority areas, they can increase administrative complexity and limit local flexibility, as funding cannot be reallocated to address other pressures.

In addition, local authorities generate income through fees and charges for a wide range of services. These include planning application fees, licensing charges, leisure centre admissions, car parking, trade waste collection, and charges for certain social care services. The scope for charging is constrained by legislation, with some services required to be free at the point of use and others subject to regulated maximum charges. Many authorities have increased reliance on fees and charges to offset financial pressures, although this approach has clear legal and practical limits,

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<sup>19</sup> It must be noted that a significant amount of grant is not driven by bidding, they are formula based.

as high charges may deter use or disproportionately affect lower-income residents. Income from fees and charges typically accounts for around 10–15% of total revenue, although this varies significantly by authority depending on demographic profile, service mix, and local pricing decisions.

For capital expenditure, defined as investment in long-term assets such as buildings, roads, and infrastructure, councils access a range of funding sources. Capital receipts generated from the sale of assets, such as surplus land or buildings, can be used to fund new capital projects. However, these receipts are inherently one-off in nature and dependent on asset availability and prevailing market conditions.

Local authorities can also borrow to fund capital investment, most commonly through the Public Works Loan Board, which provides loans at comparatively favourable interest rates. The Welsh Government sets overall borrowing limits through the annual capital settlement, although councils retain a degree of autonomy under the Prudential Code framework. This allows authorities to borrow provided they can demonstrate that borrowing is affordable, prudent, and sustainable.

Recent legislative changes have provided Welsh councils with additional revenue-raising powers. Authorities may now charge premiums of up to 300% on second homes and long-term empty properties, substantially above the standard council tax rate. This measure is intended both to raise additional revenue and to discourage properties remaining vacant in areas experiencing housing pressures. In addition, Wales has introduced enabling powers for a tourism levy, allowing councils to charge visitors staying in commercially let accommodation. While this has not yet been implemented universally, it represents a potential new income stream for areas with significant tourism activity. Other smaller income sources include returns on investments held in reserves, treasury management activities, rental income from commercial property holdings, income from trading services with other public bodies, and partnerships with private sector organisations for service delivery.

**Table 1: Sources of income**

Source of income	% contribution	% contribution	% contribution
	2023-2024	2024-2025	2025-2026
Revenue Support Grant	46	45	46
Council tax	20	22	22
Re-distributed non-domestic rates (business rates)	11	11	11

Specific grants	23	22	21
Total	100%	100%	100%

Source: StatsWales (2025a)

Table 1 provides a broad breakdown of the contribution of the main revenue streams available to Welsh local government and illustrates the relative stability of these income sources over the last three budget periods. The RSG represents the largest contribution at 46% of projected income in 2025–26. Redistributed non-domestic rates account for 11%, while specific grants 21%. Local council tax contributes 22%. The limited range of income sources illustrated in the table highlights the sector’s reliance on central government grants and its constrained dependence on a single locally raised tax.

# Spending discretion

Welsh local authorities face substantial constraints on their spending discretion, creating a complex balance between statutory duties, ring-fenced funding, and discretionary services. While councils formally have flexibility in how they prioritise and allocate resources, as the RSG is un-hypothecated, this can present a misleading picture in practice. Statutory services such as education, social services, and housing must be funded first to meet minimum legal requirements. As a result, non-statutory services, including local environmental services, libraries, leisure centres, and the arts, are often funded only from remaining resources. Challengingly, these are frequently the services that residents most closely associate with local authority provision.

Table 2, below, sets out the main areas of local authority revenue spending in the latest budget projection, excluding police, fire, and national park contributions. The total projected revenue budget for 2025–26 is £10.3 billion. Education represents the largest component at £3.9 billion. Social services follow at £3.1 billion, while housing accounts for just over £1 billion. Other notable areas of expenditure include local environmental services (£521.7 million), roads and transport (£319.6 million), libraries, culture, heritage, sport and recreation (£235.6 million), local tax collection (£57.3 million), debt financing (£361.8 million), and central administration (£459.4 million).

The most significant fluctuations in spending relate to debt financing, local tax collection, central administration and other revenue, and planning, economic and community development. Debt financing continued its recent upward trend, increasing by a further 7.8% , while spending on local tax collection rose by 16.8%, potentially reflecting the growing importance of collection rates in meeting forecast revenue. By contrast, spending on planning, economic and community development and on central administration declined, likely reflecting pressure on discretionary areas as education and social services costs continue to rise.

**Table 2: Service level Revenue Expenditure**

	£ million	£ million	£ million	%
County and county borough council expenditure	2024-25	2025-26	Change	Percentage change
Education	3,670.4	3,957.2	286.8	7.8
Social services	2,866.8	3,139.3	272.5	9.5
Housing	1,022.1	1,039.6	17.5	1.7
Local environmental services	505.1	521.7	16.7	3.3
Roads and transport	311.8	319.6	7.8	2.5
Libraries, culture and heritage, sport and recreation	230.6	235.6	5.0	2.2
Planning, economic and community development	195.0	159.8	-35.3	-18.1
Local tax collection	49.0	57.3	8.2	16.8
Debt financing	335.6	361.8	26.2	7.8
Central administration and other revenue	487.1	459.4	-27.7	-5.7
Total county and county borough council expenditure	9,673.5	10,251.2	577.8	6.0

Source: Welsh Government (2025b)

Table 3, below, sets out forecast capital expenditure for 2025–26 alongside the previous two budget periods. Combined housing-related capital spending represents the largest category, followed by education, planning and economic development, roads and transport, environmental services, other local services, libraries, culture, heritage, sport and recreation, and social services. The largest increases in capital spending relate to social services, which rose by 41% albeit from a relatively low base, and environmental services, which increased by 35.3% . The most significant reductions were recorded in planning and economic development, which fell by 17.7%, and libraries, culture, heritage, sport and recreation, which declined by 1.2% .

**Table 3: Capital Expenditure**

	£ million	£ million	£ million	%
Capital expenditure	2023-24 outturn	2024-25 forecast	2025-26 forecast	Change between 2025-26 forecast and 2024-25 forecast
Education	509.1	589.9	577.6	-2.1
Social services	38.5	32.2	45.4	41.0
Roads and transport	291.5	227.2	230.4	1.4
Housing (Housing revenue account (HRA))	394.2	553.2	632.1	14.3
Housing (Non- HRA housing)	79.3	74.3	79.3	6.6
Total housing	473.6	627.6	711.4	13.4
Local Services (Environmental)	183.8	150.0	203.0	35.3
Local Services (planning and economic development)	172.6	429.2	353.4	-17.7
Local services (Libraries,	72.9	116.2	114.8	-1.2

	£ million	£ million	£ million	%
culture, heritage, sport and recreation)				
Local services (other)	102.3	142.5	151.7	6.5
Total local services	531.6	837.9	822.9	-1.8
Total county/borough councils	1,844.3	2,314.7	2,387.6	3.1

**Source:** Welsh Government (2025b)

Table 4, below, describes the projected financing of capital expenditure in 2025–26, divided between external and internal financing sources. Capital grants from the Welsh Government and other UK Government departments account for 43% of total financing. Borrowing and credit arrangements represent 39%, comprising 7% of borrowing supported by government and 32% of unsupported borrowing and other credit arrangements. Capital expenditure charged to non-Housing Revenue Account (HRA) revenue accounts accounts for 8% of financing. Capital receipts, capital grants and contributions from other sources, the major repairs allowance, and capital expenditure charged to HRA revenue accounts each account for less than 3% . While borrowing and credit are long-established components of local government capital finance, it is notable that unsupported borrowing represents the second largest single source of capital funding after government capital grants.

**Table 4: Financing of Capital Expenditure**

Capital Finance	2024-5 %	2025-6 %
Capital grants from the Welsh Government and other UK Government departments	39 %	43 %
Capital grants and contributions from other sources	3 %	2 %
Capital receipts	3 %	3 %
Major repairs allowance	2 %	2 %
Capital expenditure charged to a revenue account (non-HRA)	10 %	8 %

Capital expenditure charged to a revenue account (HRA)	5 %	3 %
Borrowing and credit arrangements that attract government support	7 %	7 %
Other borrowing and credit arrangements <sup>20</sup>	31 %	32 %

**Source:** StatsWales (2025b)

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<sup>20</sup> Effectively the borrowing and credit that sits outside of Welsh Government support, instigated by local authorities themselves.

# Equalisation of resources between location

In Wales, equalisation is a central principle of the devolved local government finance system. It aims to ensure that residents across all 22 Welsh local authorities can access broadly comparable levels of public services for similar levels of local taxation, regardless of local variations in wealth, property values, or service pressures. Because local authorities depend heavily on Welsh Government funding, around two-thirds of revenue income, equalisation is achieved primarily through the distribution of the RSG and the redistribution of non-domestic rates (NDR), operating alongside the relative needs assessment. Together, these elements comprise Aggregate External Finance (AEF), which is the principal vehicle for resource equalisation in Wales.

The total Standard Spending Assessment (SSA) for each authority represents a notional estimate of the resources required to deliver a standard level of services. These assessments are set against the total funding available, with the RSG distribution adjusting for differences in fiscal capacity, effectively transferring resources from areas with higher tax-raising ability to those with lower capacity or greater need. This operates in parallel with the redistribution of pooled business rates, which are allocated broadly in proportion to population. This mechanism ensures that authorities with large commercial tax bases, such as Cardiff or Swansea, do not receive disproportionate benefit, while smaller or more rural councils continue to receive a needs-based share. Pooling business rates also promotes predictability and a clear redistributive effect. This allows councils to plan budgets with greater certainty than would be possible under local retention schemes, such as those operating in England.

Equalisation also interacts with council tax. While councils set their own council tax levels, the RSG calculation assumes an average council tax yield when determining allocations. Authorities with higher-than-average tax bases and lower relative need receive proportionally less grant, while those with weaker tax bases or higher needs receive more. This system constrains, but does not fully eliminate, variation in service spending between areas.

Despite its redistributive intent and relative transparency compared with many international systems, the Welsh approach has limitations. One concern is the reliance on population and socio-economic data that may be several years old. Rapid demographic or economic change can therefore result in funding that does not fully

reflect current circumstances. In addition, because equalisation is delivered largely through central grant distribution, local authorities exercise limited control over their total income. This degree of centralisation can dampen local accountability and innovation, and there is a case that local autonomy is constrained as a result. This highlights a key tension in all redistributive local government finance systems, that between the ability of individual authorities to stand on their own feet (particularly wealthy authorities), and for all locations to have the chance to deliver local services to minimum levels of quality (particularly those locations with fewest resources). While the redistribution formula is published, its complexity can make it difficult for councillors and members of the public<sup>21</sup> to understand how allocations are determined. Given the narrow range of income sources available to councils, the RSG allocation can also become a zero-sum exercise, intensifying disagreement between authorities during periods of fiscal constraint. There are therefore opportunities for improvement. The RSG and associated equalisation arrangements could be simplified through the use of fewer, clearer indicators, combined with the introduction of new measures linked to health inequalities, environmental costs, and digital service demand. Alongside this, a clear plain-language explanation of the funding formula could improve transparency and understanding. More significantly, the Local Government Finance (Wales) Act 2024 introduces statutory revaluation cycles from 2028 onwards, which should reduce disparities between areas that have experienced rapid property value growth and those with slower growth. At present, equalisation is still calibrated against 2003 council tax values. Moving to multi-year funding settlements would further enhance stability and enable councils to plan investment over a longer horizon. Such an approach would also make equalisation outcomes more predictable, smoothing year-to-year fluctuations and supporting more sustainable budgeting.

Finally, Wales's evolving fiscal powers create scope for additional local or regional revenue sources, such as a visitor levy or environmental charges, to supplement existing funding streams. If carefully designed, these measures could introduce targeted flexibility without undermining the equalisation framework. These opportunities are explored further in the following section, which considers options for reform.

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<sup>21</sup> An important finding in the report is that the resilience and appetite of individuals to serve as councillors in Wales is increasingly shaped by the financial challenges facing local authorities. As councils grapple with budget constraints, service reductions, and rising demand, the role of a councillor becomes more complex and emotionally demanding. This can deter potential candidates who may feel ill-equipped to navigate such pressures or fear being held accountable for unpopular decisions. For those already serving, sustained financial strain can lead to burnout, reduced morale, and a sense of diminished impact, all of which threaten the long-term sustainability of local democratic representation.

# Evaluation of local government finance in Wales and opportunities for reform

Revisiting the conceptual framework structured around five attributes enables a final assessment of the local government finance system in Wales:

1. The structure of sub-national government;
2. Legislative frameworks and oversight;
3. Available income sources;
4. Discretion over spending;
5. Equalisation mechanisms.

Applying the scoring methodology set out in Appendix 1, Wales achieves a score of 10.5 out of a maximum of 25. This places the system at the boundary between low resilience and autonomy, characterised by systemic weaknesses requiring reform, with scores in the range of 6 to 10, and moderate resilience and autonomy, where significant constraints remain but the system is viable, with scores in the range of 11 to 15. This result indicates considerable scope for reform. Scores across the five attributes were distributed as follows:

**Table 5: Evaluation of local government finance in Wales**

Theme	Score	Interpretation
Structure of sub-national government	2.5	Weak-adequate structure of local government
Legislative framework and oversight	2.0	limited devolved powers, heavily constrained by central ringfencing and reporting burden.
Available income sources	1.5	Limited Revenue Autonomy and basket of available income sources
Discretion over spending	2.0	Significant constraints associated with ring

Theme	Score	Interpretation
		fencing and statutory obligations
Equalisation mechanisms	2.5	Adequate Equalisation but opportunity for significant reform
Total score	10.5 /25	Low resilience and autonomy

In terms of the structure of local government, Wales has 22 single-tier unitary authorities established in 1996. The single-tier model provides a degree of functional clarity and is reinforced by more recent collaborative arrangements, including Regional Partnership Boards and Corporate Joint Committees. However, there is significant variation in the size of authorities, which makes economies of scale difficult to achieve and can coincide with a relatively weak local income base. This is particularly evident among smaller rural authorities. That said, structural reform has already been the subject of several independent reviews and attempted legislative changes. Evidence from England suggests that debates about council size and structure can ultimately take on a disproportionate role in discussions of local government finance resilience, often crowding out more substantive reform options. It is the view of the authors involved in this report that other aspects of the local government finance system are more significant for future reform.

In relation to legislative framework and oversight, Wales demonstrates a partially devolved local government system, with meaningful powers transferred but still subject to central constraints. Significant devolved authority exists through the Government of Wales Acts (1998, 2006, 2017), supported by Wales-specific legislation such as the Local Government Finance (Wales) Act 2024. The Partnership Council for Wales also provides an established forum for collaborative engagement and discussion of shared strategic issues between local and national government.

These strengths are, however, tempered by persistent constraints. Some fiscal powers remain reserved to Westminster, particularly in relation to taxation, which limits overall fiscal autonomy. Audit Wales provides comprehensive and consistent oversight, but this also creates an additional compliance burden for councils. More importantly, the Welsh Government retains substantial influence through funding mechanisms, while local government lacks robust constitutional protection. The practical consequences are evident in local authority budgets. Although councils receive un-hypothecated RSG, statutory responsibilities in education, social services, and housing absorb the majority of resources. Discretionary services such as leisure, culture, and regulatory functions are therefore most exposed to reductions.

When considering local income sources, Welsh local government collectively has a very constrained range of tools in international terms and remains heavily dependent on grant funding. Business rates are fully pooled and redistributed by central government, and the ability to vary fees and charges is tightly constrained by national parameters. Positively, compared with England, Welsh councils retain autonomy over council tax rate setting, as England operates caps and referendum requirements. The Local Government Finance (Wales) Act 2024 has also introduced reforms to council tax and non-domestic rates, and councils have had the ability since 2017 to apply premiums on second homes and long-term empty properties.

Nevertheless, grant dependency through the RSG and specific grants remains a dominant feature of the system. Council tax remains the only significant locally controlled tax, there are no local income tax powers or locally assigned shares of national income tax, and business rate retention is only available in limited and prescribed circumstances, such as Freeports, Investment Zones, and City and Growth Deals. Discretion over spending exhibits similar characteristics. Welsh local authorities possess a moderate degree of formal spending discretion, but this is heavily constrained in practice by statutory pressures. The RSG is un-hypothecated, allowing councils to determine local priorities, and the Welsh Government's Programme for Government commits explicitly to reducing administrative burden through grant consolidation and de-hypothecation. Councils also retain flexibility in how services are delivered and maintain discretion over non-statutory provision.

In reality, however, these freedoms are narrowly circumscribed. Statutory obligations in education, social care, housing, and planning consume the majority of local authority budgets. Discretionary services experience disproportionate reductions as statutory demand continues to rise sharply. While progress has been made in reducing ring-fencing, the combination of growing statutory pressures and tight settlements leaves councils with little meaningful discretion beyond funding minimum service levels. Wales operates a relatively transparent, formula-based equalisation system through the distribution of the RSG and the redistribution of non-domestic rates. This system benefits from ongoing local government involvement through the Distribution Sub-Group, which maintains the formula using a suite of 68 indicators covering population, sparsity, deprivation, and service need. The methodology is published annually and benefits from collective engagement across the sector, while funding floors are used to limit year-on-year volatility.

Despite these strengths, significant weaknesses remain. The formula was last comprehensively reviewed in 2001–02 and has since been updated incrementally rather than through systematic reassessment. Some indicators have historically relied on outdated census data, although this is gradually improving. Rural authorities continue to argue that sparsity and higher service delivery costs are insufficiently

recognised, while annual settlements provide limited certainty for medium-term planning. There is no formal independent mechanism for periodic review, and debate persists over whether the formula adequately captures the full range of need across Wales.

The key vulnerabilities in Welsh local government finance can be summarised as follows:

- **Financial Dependency:** Welsh councils have minimal fiscal autonomy and are highly vulnerable to Welsh Government funding decisions.
- **Structural Fragmentation:** 22 authorities of varying sizes can create inefficiencies.
- **Limited Revenue Tools:** Reliance on council tax alone for local revenue means authorities cannot diversify income or respond to local economic conditions.
- **Limited discretionary space:** constrained by ringfencing and statutory obligations.
- **Limited certainty in financial planning:** the yearly settlement process makes forward planning very difficult.

The key strengths can be summarised as follows:

- **Collaborative oversight:** partnership working between the Welsh Government and local authorities creates shared ownership of the system. This is comparable to international examples and stronger than arrangements in England.
- **Spending flexibility:** un-hypothecated RSG enables local priority-setting within statutory limits.
- **Fair distribution:** while there is scope for improvement, the formula-based allocation supports transparent and broadly equitable distribution of resources.

# Reform opportunities

Reform in Wales should not rely on wholesale replacement of the existing model with a single alternative. International experience across Europe and the wider OECD shows that the most resilient and equitable systems are diversified, combining modernised property taxation, selective local income or sales tax powers, enhanced tourism levies, and targeted charging frameworks. A blended system of this kind can provide Welsh local authorities with stable, adequate, and equitable revenue while maintaining fairness, competitiveness, and ability to pay.

Below are key areas for reform, each grounded in international practice.

## 1. Tighten and 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. This mirrors regular recalibration processes in countries such as Germany, where the federal fiscal equalisation system systematically adjusts expenditure needs and tax capacity (German Federal Ministry of Finance, 2025). Greater transparency and a simpler methodology would align Wales more closely with European norms. While not the core focus here, there is also scope to revisit the Barnett Formula, where a relative needs approach similar to Australia's Commonwealth Grants Commission could address long-standing distributional concerns (Commonwealth Grants Commission, 2025).

## 2. Improve equalisation using contemporary indicators

Wales already operates a comparatively transparent equalisation framework through the RSG and redistributed non-domestic rates. Many OECD systems undertake periodic updates using current indicators:

- **Finland** integrates demographic, geographic, and socio-economic metrics updated annually (Finnish Ministry of Finance, 2025).
- **The Netherlands** applies detailed cost-weighting factors within its Gemeentefonds (Government of the Netherlands, 2025).
- **Switzerland** incorporates fiscal capacity and structural cost differences across cantons (Swiss Federal Finance Administration, 2025).

Wales can draw on these models to introduce better data, contemporary indicators, and improved process transparency.

### 3. Rebalance cost liability

A review of which tier of government should bear the costs of health, social care, and education is fundamental. The majority of Welsh local authority expenditure is locked into these statutory services. International counterparts have rebalanced responsibilities in ways that free local governments to focus more clearly on discretionary and place-shaping roles:

- **Finland's SOTE reform** transferred responsibility for health and social care to 21 new wellbeing service counties, allowing municipalities to concentrate on education and local development (Finnish Institute for Health and Welfare, 2025).
- **Denmark's 2007 structural reform** aligned functions and financing across tiers of government, reducing duplication and clarifying accountability (Kjaer et al., 2010).

A similar realignment in Wales could sharpen local government's focus on community services, prevention, and local economic growth.

### 4. Revenue diversification

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.
- **Italy and Spain** assign regional surcharges on income or consumption taxes.

Providing Welsh local authorities with controlled access to local income or sales taxes, selective levies, and new tourism or environmental taxes, where enabling legislation is already in place, would expand fiscal autonomy and create a closer alignment between local policy choices and revenue generation.

### 5. Modernise fees and charges

Fees and charges represent a meaningful share of local revenue internationally, but Wales's framework remains comparatively restrictive.

- **Austria and Germany** allow municipalities broad discretion to set charges for services ranging from waste collection to planning.

- **New Zealand** makes extensive use of user charging within local government, guided by clear cost-recovery principles (Office of the Auditor-General, 2021).

A reformed Welsh framework could support local innovation and reduce pressure on core taxation.

## 6. Introduce multi-year settlements

Most OECD countries provide the local government sector with multi-year budget certainty:

- **The Netherlands** operates four-year settlement frameworks.
- **Sweden** relies on three-year budget cycles.
- **Germany** uses medium-term financial planning to guide subnational budgeting.

Wales should align with this international norm. England's cautious shift towards multi-year settlements also provides a relevant precedent within the UK context.

## 7. Consolidate grants further

The Nordic model provides a clear benchmark for grant design:

- **Denmark, Finland, and Norway** rely heavily on un-earmarked block grants, with ring-fencing generally below 10%.

In the short term, reducing ring-fencing in Wales 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.

## 8. Deepen partnership working and collaborative delivery

Wales already outperforms England in terms of structured collaboration between tiers of government. International models demonstrate the value of strong partnership arrangements between central and local government:

- **Italy's Unified Conference** provides statutory co-decision forums across governmental tiers (Presidency of the Council of Ministers, 2025).
- **Germany's local government associations** systematically influence federal and Länder legislation, including the Federal Cities Association, the

Association of Rural Districts, and the Association of Towns and Municipalities.

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 greater scale.

## 9. Strengthen financial monitoring and transparency

Many countries deploy simple and comprehensible financial health indicators:

- **Japan's traffic-light system** remains the most widely cited example (Kawato, 2010).
- **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.

## 10. Pursue meaningful subsidiarity

Internationally, the most resilient systems embed fiscal subsidiarity by aligning revenue control with service delivery responsibilities:

- **Switzerland, Spain, and Italy** assign substantial tax bases to subnational tiers.
- **Japan's Trinity Reform** exposed a mismatch between where money was spent, with a local to national ratio of 4 to 2, and where revenue was controlled, at 2 to 4, 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.

### The political challenge

As demonstrated by Sweden's reforms in the 1990s, Denmark's 2007 reorganisation, Finland's ongoing consolidation, and early-2000s reforms in Japan and Italy, fiscal modernisation inevitably produces short-term winners and losers. However, across the OECD, jurisdictions that undertake comprehensive reform rarely revert to previous arrangements. This persistence suggests that reformed systems tend to

deliver more stable, equitable, and effective outcomes than outdated models maintained through inertia.

## Prioritisation

These reform recommendations have been prioritised using the following factors:

- legislative complexity
- fiscal impact
- political sensitivity
- administrative readiness
- precedent within the UK
- alignment with international norms that have been implemented incrementally elsewhere

### Prioritised recommendations (short to long-term)

#### Tier 1: Short term (relatively easy, low political friction, strong precedents)

##### 1. Tighten and modernise the settlement process

*Why this is feasible:* This can be delivered within existing Welsh Government powers and aligns with regular recalibration practices seen in Germany and the Netherlands. The political risk is limited, as the reform improves transparency and technical accuracy rather than redistributing power or resources.

*International precedent:* Annual or periodic equalisation recalibration in Germany, Finland, and Australia.

##### 2. Improve equalisation using contemporary indicators

*Why feasible:* This builds on an existing Welsh model that is already comparatively transparent. The changes required are largely technical rather than political in nature.

*International precedent:* Finland's annually updated cost factors and Switzerland's data-driven equalisation methodology.

##### 3. Strengthen financial monitoring and transparency

*Why feasible:* Wales already has the necessary data infrastructure in place through existing reporting, audit, and settlement processes. The task is primarily to refashion existing indicators into a clear, public-facing format, making implementation administratively light and low cost. International models such as Japan's traffic-light system and Germany's early-warning frameworks demonstrate that complex fiscal information can be presented in an accessible, comparable, and forward-looking way. For Wales, this would enhance democratic accountability and improve clarity in an otherwise opaque policy area, offering both the Welsh Government and the WLGA stronger risk signalling and a firmer basis for evidence-based engagement.

International precedent: Japan's traffic-light model; Germany's early-warning systems.

#### **4. Deepen partnership working and collaborative delivery**

*Why feasible:* Wales already performs well in this area, and collaboration is politically acceptable. No significant redistribution of powers or resources is required.

*International precedent:* Italy's Unified Conference and German municipal associations.

### **Tier 2: Short to medium term (politically delicate but institutionally manageable)**

#### **5. Introduce multi-year settlements**

*Why feasible:* This aligns with the gradual move towards multi-year settlements in England and largely requires changes to Welsh Government internal budget planning processes.

*International precedent:* Three to four year settlement cycles in Sweden, Germany, and the Netherlands.

#### **6. Further grant consolidation (reduce ring-fencing below 10% and then work towards the full eradication of ring-fenced grants)**

*Why feasible:* Some progress has already been made. While consolidation is administratively straightforward, it may be politically sensitive where ministers prefer ring-fenced programmes.

*International precedent:* Denmark, Finland, and Norway favour un-earmarked block grants. In Italy, extensive ring-fencing is constitutionally prohibited.

#### **7. Modernise fees and charges**

*Why feasible:* This would require regulatory reform but not a major legislative overhaul. It remains politically acceptable provided appropriate protections for vulnerable groups are maintained.

*International precedent:* Austria, Germany, and New Zealand, which allow broad local discretion over user charges.

### **Tier 3: Medium to long term (structural changes, legislative implications, high political stakes)**

#### **8. Revenue diversification (local income tax, sales tax increments, tourism levies)**

*Why challenging:* Assigning income or sales tax powers would require UK-level cooperation and is politically sensitive due to concerns about tax burden and competitiveness. Tourism levies are the most feasible element, as enabling legislation is already in place.

*International precedent:* Sweden and Denmark (local income tax), France (multi-tax mix), Italy and Spain (regional surcharges).

#### **9. Rebalance cost liability (e.g., social care, health, education)**

*Why challenging:* This would involve major structural reform across Welsh Government and, in some areas, the UK Government. It is resource intensive and likely to require broad political consensus.

*International precedent:* Finland's SOTE reform, delivered over multiple years and highly contested, and Denmark's 2007 reforms.

### **Tier 4: Long term (strategic, long-horizon reform requiring UK constitutional/fiscal change)**

#### **10. Pursue meaningful subsidiarity (devolve revenue to match service responsibility)**

*Why most difficult:* This implies substantial devolution of taxation powers, constitutional change, and potential redesign of UK-wide fiscal frameworks, including the Barnett Formula).

*International precedent:* Switzerland's fiscal federalism; Spain and Italy's tax autonomy; Japan's Trinity Reform.

*A diagnostic exercise to assess subsidiarity is feasible* in the short term, but implementing full subsidiarity would be the most politically and institutionally demanding reform on this list. It is also potentially the most transformative, as it would alter the scale, scope, and nature of public spending authority in Wales.

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# Appendix 1: Method

A mixed research methodology has been applied in this study. Taken together, the empirical and secondary information provides the foundation for developing an original system-based perspective of the Welsh local government finance system that is rarely seen in international literature. The empirical research is based on expert interviews with local government finance stakeholders and academics. Respondents were identified using stringent criteria, including demonstrable system-wide understanding, operational involvement in fiscal processes, and experience spanning multiple tiers of governance or oversight. Given the limited population of individuals meeting these criteria, an expert-based purposive sampling approach (Li, 2021) was adopted, supplemented by reputational snowballing through the Wales Centre for Public Policy network to ensure broad sector coverage and reduce potential sampling bias.

The research process included the following stages:

- Initial scoping sessions through scheduled panel meetings with sector stakeholders, alongside consultation with the Independent Working Group on Sustainable Local Government for the Future, including senior officers such as chief financial officers and chief executives from all 22 principal authorities in Wales. These sessions involved structured exploratory questioning to map institutional arrangements, identify system-level constraints, and surface tacit operational knowledge. They also helped refine the conceptual parameters of the study and guided the research team towards primary documentation, modelling tools, internal guidance, and practitioner resources not typically available in the public domain.
- Successive rounds of evidence testing, where the research team returned to sector experts with emerging findings. This process, delivered through semi-structured validation interviews and targeted evidence-checking exercises, supported systematic cross-referencing and sense-checking of interpretations. Analytical memoranda were produced after each round, recording areas of consensus, points of disagreement, and unresolved issues. These memoranda informed subsequent enquiry and revision, contributing to a progressively more robust account of system operation.
- A dedicated refinement stage with a local authority chief leadership working group, again through the Independent Working Group on Sustainable Local Government for the Future, reviewed the technical accuracy, interpretive coherence, and policy relevance of the findings. This step ensured that the

assessment of system resilience was both empirically grounded and institutionally credible at senior operational levels.

This layered and iterative methodology was essential in developing shared understanding of both the technical detail and practical nuance of local government finance in Wales. Alongside stakeholder engagement, the research also undertook a systematic review of secondary academic literature, government documentation, and legislation, focusing on statutory powers, procedural obligations, and institutional mandates shaping local authority finance. Documentary analysis followed a coding framework aligned with the five thematic dimensions of the Local Government Finance Assessment Framework, ensuring close integration between empirical insights and formal institutional structures.

In parallel, quantitative data was sourced from government departments and related organisations to capture the scale, composition, and distribution of income sources across Wales. Data quality assurance was undertaken through dual-source triangulation, checks for consistency over time, and reconciliation with published financial outturns. This evidence base provided an important verification mechanism, enabling triangulation between documentary analysis, financial data, and practitioner evidence, and strengthening both descriptive accuracy and analytical robustness.

## Local Government Finance Assessment Framework

The originality of the framework, used in this study, lies in its synthesis of multiple analytical traditions, bringing together insights from fiscal federalism, institutional analysis, and resilience theory to create a holistic evaluative tool calibrated to the distinctive features of devolved systems. Unlike existing comparative frameworks that typically focus on a single dimension such as revenue autonomy or expenditure discretion, this multidimensional approach captures the interaction between fiscal structures, institutional relationships, democratic accountability, and adaptive capacity. It enables both aggregate scoring for overall system assessment and disaggregated analysis that highlights specific strengths, weaknesses, and reform priorities.

The significance of this methodological contribution spans several domains. Empirically, the analysis provides the first systematic comparative assessment of Welsh local government finance resilience against international benchmarks, generating new evidence on Wales's position within the wider OECD landscape. Theoretically, it advances understanding of how different configurations of fiscal powers, intergovernmental relationships, and institutional arrangements influence the ability of local government systems to respond to fiscal shocks, demographic change, and service demand pressures. Methodologically, the framework offers a transferable

tool that can be adapted for use in other devolved or federal contexts, supporting future comparative and longitudinal analysis.

From a policy perspective, the diagnostic value of the framework is particularly valuable. By mapping current performance against defined standards across multiple dimensions, it identifies not only overall funding adequacy issues but also structural weaknesses in fiscal design, governance arrangements, and adaptive mechanisms that may be addressed through reform. This level of detail supports evidence-informed policymaking by distinguishing between challenges that primarily require additional resources and those that would benefit from institutional redesign or process change. The transparency of the scoring criteria, alongside the detailed explanation set out in Appendix 1, supports methodological robustness and allows policymakers and practitioners to interrogate the evidence underpinning the analysis and recommendations.

The framework also has strong potential for future research and policy learning through its suitability for longitudinal application. As Welsh local government finance evolves, whether through incremental adjustment or more substantive reform following the 2026 Senedd election, the framework provides a consistent basis for tracking changes in resilience and autonomy over time. This enables evaluation of policy interventions, assessment of fiscal settlement changes, and monitoring of progress toward sustainability goals, creating a foundation for cumulative learning and more informed decision-making in this critical area of public governance.

# Appendix 2: Welsh Local Government Finance Assessment Framework

## Scoring Guide: 1 (Lowest) to 5 (Highest Resilience/Autonomy)

Theme	Score 1	Score 2	Score 3	Score 4	Score 5
Structure of Sub-National Government	Extreme fragmentation preventing effective delivery; overlapping responsibilities; minimal collaboration; severe diseconomies of scale; structural inflexibility.	High fragmentation with many small authorities; unclear functional boundaries; limited collaboration; significant inefficiencies; structural rigidity.	Single-tier with variable sizes; some authorities below optimal scale; mostly clear responsibilities; basic collaboration; ongoing reform discussions.	Single-tier with adequate scale; clear responsibilities; effective joint working; some structural flexibility; limited fragmentation.	Multiple tiers providing subsidiarity; clear functional assignment; optimal scale; strong collaboration; flexibility for innovation and mergers.
Legislative Framework and Oversight	Minimal local autonomy; highly centralised control; detailed prescription; no statutory protections;	Limited devolved powers; heavily constrained by central legislation; intrusive oversight; weak protections; low intervention	Mixed powers (some devolved, some reserved); moderate oversight; statutory basis with limited protections; intervention powers	Significant devolved powers; balanced supportive oversight; constitutional/statutory recognition; reasonable intervention	Comprehensive devolved powers; enabling legislation; light-touch outcome-focused oversight; strong legal protections; clear

### Scoring Guide: 1 (Lowest) to 5 (Highest Resilience/Autonomy)

Theme	Score 1	Score 2	Score 3	Score 4	Score 5
	frequent interventions; excessive compliance requirements.	thresholds; heavy reporting burdens.	rarely used; standard accountability.	thresholds; clear accountability frameworks.	appeals against intervention.
Available Income Sources	No meaningful local tax powers; all rates centrally determined; fees fully prescribed; no commercial revenue; grant dependency.	Single tax base with minimal rate-setting; heavily restricted taxation (caps/referendums); prescribed fees; minimal commercial capacity; grant dependency.	One main local tax with some rate-setting; property tax with limited flexibility; standard fees with some discretion; limited commercial opportunities; grant dependency.	2-3 local tax sources with rate-setting; property tax with full autonomy; reasonable fees flexibility; some commercial revenue; grant dependency.	Multiple significant tax bases (property, income, consumption); full rate-setting autonomy; meaningful fees flexibility; diverse revenue sources; ability to introduce new taxes.
Discretion Over Spending	Heavily prescribed spending; extensive ring-fencing; most services detailed mandates; centrally determined	Significant constraints; substantial ring-fencing; detailed service standards mandated; prescribed workforce/procurement rules; regular efficiency targets.	Reasonable discretion within statutory constraints; moderate ring-fencing; must maintain service standards; some workforce restrictions; occasional spending guidance.	Substantial discretion over priorities; limited ring-fencing; flexibility over most non-statutory services; some workforce/procurement	Full discretion over priorities; minimal ring-fencing; freedom to cease non-statutory services; flexible workforce/procurement; no spending caps.

### Scoring Guide: 1 (Lowest) to 5 (Highest Resilience/Autonomy)

Theme	Score 1	Score 2	Score 3	Score 4	Score 5
	workforce terms; strict spending caps.			ent flexibility; minimal controls.	
Equalisation Mechanisms	No systematic equalisation or highly inequitable; arbitrary allocation; severe needs misalignment; undermines revenue incentives; highly unstable; creates/exacerba tes disparities.	Outdated/opaque formulas; poor needs assessment; significant distortion of tax incentives; infrequent reviews; unpredictable changes.	Formula-based with some anomalies; reasonable needs assessment with gaps; some tax incentive distortion; periodic reviews with delays; annual settlements.	Formula-based with good needs assessment; generally fair distribution; maintains tax incentives; regular reviews with stakeholder input; 2- 3 year settlements.	Transparent formula- based system; balances needs and resources effectively; preserves tax incentives; regular independent reviews; predictable multi-year allocations.
Total Score Interpretation (out of 25)					
Score Range	Assessment				
21-25	High resilience and autonomy - strong local government finance system.				
16-20	Good resilience and autonomy - system functions well with some areas for improvement.				
11-15	Moderate resilience and autonomy - significant constraints but system viable.				
6-10	Low resilience and autonomy - systemic weaknesses requiring reform.				
1-5	Very low resilience and autonomy - fundamental structural problems.				

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