How Wales can reform council tax to boost growth and reduce inequality

February 2024

The Welsh Government is currently consulting on three possible changes to council tax in Wales. Although each proposal would improve national redistribution across Wales, none solve the underlying issues of council tax. They would not fix council tax's lack of economic incentives or achieve revenue-neutrality for councils without large adjustments to grants from the Welsh Government.

Instead, Wales should pursue a fourth option for council tax reform that would provide better economic incentives, improve fairness by shifting council tax's purpose from national redistribution to local redistribution, and achieve revenue-neutrality for all councils. As already set out in previous Centre for Cities research to advance fiscal devolution in the three biggest cities in England, this can be done by allowing councils in Wales to set proportional tax rates for each council tax band in combination with annual revaluations.[1]

In the first year, fiscal devolution of Welsh council tax in this manner could see 66 per cent of Wales gain an average council tax cut of almost £400, paid for by the wealthiest 33 per cent of Welsh households seeing an average increase of just under £700. Unlike other proposals, a majority of people in every borough would receive a tax cut from this proposal. As councils would be rewarded for growing their local economy – and by extension the Welsh economy – with a larger tax base, driving local prosperity and housebuilding would become key to financing local government services and delivering lower council tax bills in Wales.

1 Breach A., Bridgett S., and Vera O. (2023), *In place of centralisation: A devolution deal for London, Greater Manchester, and the West Midlands*, Centre for Cities

Wales can do these reforms as regional inequality is relatively low and it has a rational system of local government. With the appropriate adjustments and political commitments England and Scotland could benefit too, but for Wales today there is a real opportunity to lead the rest of the United Kingdom in a progressive and pro-growth direction through fiscal devolution of council tax.

The Welsh council tax proposals are too narrow

At the outset, it is important to distinguish between the amount of resource in the local funding system, and the design of that funding system. Across the UK, there is a problem with a lack of resource in local finance, and more grant is probably necessary in the short and medium term just to keep core services running.

But neither pouring more central government grant funding into the system, nor hiking up council tax, is a solution to that second problem. Whatever the level of resource is, the design of the funding system matters as it determines the size, fairness, and economic incentives of the local tax base for households, businesses, and local government.

In collaboration with the IFS, the Welsh Government has set out three distinct revenue-neutral options for council tax reform in Wales and is currently consulting on them.[2]

Both the existing system of council tax and the proposals 'anchor' bills around Band D. Whatever each Band D bill is in each local authority, every other council tax bill in in each band is the same fixed fraction of that Band D bill across all of Wales, even though local house prices differ between council areas.

The analysis of the IFS presents these three options alongside a hypothetical '12-band proportional' benchmark:[3]

- Option A: a simple revaluation, as Wales previously delivered in 2003.
- Option B: Option A, combined with changes to the anchoring of council tax around Band D, so that relative bills are cut/increased for all households below/above Band D.
- Option C: Option B, combined with one additional band below Band A ('A1') and two above Band I ('J' and 'K').
- Benchmark: Option C, but with bills for each band further adjusted so that the national tax rate for each band mirrors the national changes in property value between bands.

Each of these changes is increasingly progressive, and the debate in Wales over council tax is one of national redistribution between households – how much should council tax bills increase for some Welsh households to provide discounts for other Welsh households?

2 Welsh Government (2023), Consultation on a Fairer Council Tax: phase 2
3 Adam S., Phillips D., Ray-Chaudhuri S. (2023), Assessing the Welsh Government's consultation on reforms to council tax, Institute for Fiscal Studies, Report R287

However, this perspective is too narrow. The problems with council tax go beyond questions of redistribution. If a wider perspective is taken – including what local taxation means for local and national economic growth – it becomes clear that a more comprehensive overhaul of council tax is required than any of those proposed.

Council tax and the Welsh Government's proposed reforms are bad for growth

Council tax in its current form and all three of the Welsh Government's proposals contain two important barriers to growth through how they affect local authorities.

The first barrier is that as the proposals continue to focus on national redistribution across Wales, the council tax changes fail to achieve revenue-neutrality for local authorities, even though council tax is intended to fund local authorities. The proposals compensate for this by changing the grant funding the Welsh Government gives to each council.

Adjusting the amount of grant for councils may sound like a simple solution to achieve revenue-neutrality while pursuing national redistribution. But the effect on incentives is pernicious. Councils that have successfully grown their tax base since 2003 and which would raise a greater amount of revenue are penalised by the Welsh Government with lower levels of grant funding. Conversely, councils that have failed to grow their tax base as much over the same period are rewarded with higher levels of grant funding.

Adjusting grants in this manner may nominally help councils that are relatively poor today, but it does so by harming councils that have improved their economy. A poor council in the Valleys that had, theoretically, successfully managed to strengthen the local economy relative to 2003 would lose funding from adjustments to grant. Meanwhile, an affluent council that has embraced Nimbyism to block local growth would gain extra funding from grants.

Accordingly, with the Welsh Government's proposals, why would councils bother putting much effort into planning for new homes, investing in infrastructure, redeveloping town and city centres, and increasing employment when doing so does not give them more funding to provide local services or cut council tax bills? Any improvement to any local tax base is taken away by the Welsh Government at the next revaluation – which together discourages councils from improving the national tax base across Wales.

The second barrier is that council is tax not 'buoyant'. Most taxes are set as percentage rates, which means the revenues they raise increase as the economy expands and inflation changes prices. These taxes are therefore 'buoyant'. Council tax does not experience this, as Band D bills are set as a fixed sum rather than as a percentage rate, and the bills for the other bands are anchored to Band D.

Council tax's lack of buoyancy further disconnects local councils from their local economies. Improving the economy, increasing land values, and growing the tax base does nothing for receipts, because it does not change Band D bills. Councils are not encouraged to make their local economy more prosperous to grow their local tax base, or by extension the Welsh tax base.

The absence of incentives is not just an economic problem or a question of how much councils 'want' growth. It also creates a dilemma for the funding of local services, as the only ways to inject more resource into the local funding system, even just to keep pace with inflation, is either voting to increase council tax bills or by increasing grants from central government. Similarly, council tax cuts can only be funded by more grant or cuts to services.

The only way that these unpalatable choices can be avoided is by instead allowing local authorities to self-fund the expansion of their services by growing their local tax base – but this is precisely what council tax and the Welsh Governments' proposals prevent.

Council tax's lack of buoyancy and its focus on national redistribution are why council tax in Wales continues to face so many of the same problems as in England despite the Welsh revaluation in 2003. If revaluations were made more frequent, the council tax system would become fairer, but the local growth incentive would be blunted even more by the equally-frequent adjustments to grant. If the next revaluation was delayed by another twenty years, then the same inequalities Wales has now will simply reappear all over again.

The IFS does note that a proportional property tax would be preferable to any of the proposals being consulted upon, that various reliefs which the Welsh Government has committed to are distortionary, and much of their equilibrium analysis is relevant to any reform proposal. The proposals set out would on the metrics prioritised be better than the existing system, and the Welsh Government is to be commended for taking the thorny issue of council tax head on.

But the Welsh Government's proposals are achieving one notion of fairness at the cost of damaging the economic performance of Wales. But council tax reform need not require this trade-off – both can achieved with a different approach.

Fiscal devolution of council tax to councils would be good for growth and fairness

The root of the problem with the Welsh council tax proposals is that they are trying to use a local tax to pursue *national* redistribution. But if instead, the reforms proposed turning council tax into a tool to deliver *local* redistribution, then it becomes straightforward to design a council tax approach that incentivises councils to pursue economic growth, as the rewards of growth are retained locally and used for redistribution.

Centre for Cities has previously set out an approach to council tax reform that achieves stronger growth incentives and fairness in its report on devolution for the Economy 2030 Inquiry, *In Place of Centralisation*. It proposes a new funding model for Greater Manchester, the West Midlands, and London including reforms to council tax.

Three key choices in it can be used to build an alternative to the Welsh Government's proposals through fiscal devolution. These are:

- Anchoring of council tax around Band D should end and be replaced with a proportional property tax. Each council should be able to set their own council tax rate for each band, that issues a bill to each property owner as a percentage of the value of every property.
- Revenue-neutrality for councils. Every council should be able to collect the same amount of funding before and after the reform, so grants do not need to adjust.
- Revaluations should take place every year. In addition to the revaluation the Welsh Government is proposing in the near future, frequent revaluations will ensure that the tax base is closely connected to whether the local economy improves or not. Lots of small changes over time would entail minimal disruption and can be easily calculated by the Valuation Office Agency every year.

Together, these principles result in a council tax system that is much more buoyant and fairer than either the present Welsh council tax system or the Welsh Government's proposals, as council tax will adjust to local needs, allowing local resources to fund local services.

This can be shown by considering how modelled hypothetical council tax rates under this system play out in a local authority and then across Wales. The full data underpinning our council tax modelling for Wales is available on the Centre for Cities' GitHub page, and the methodology is described in Box 1.

Box 1: Methodology

The modelling in this briefing takes the same methodology used to model council tax reform within *In Place of Centralisation* and adapts it to Welsh circumstances. In essence, the revenues raised by the current council tax system in 2022 are used to set the estimated revenues under a new system where, after revaluation, a hypothetical set of percentage-based tax rates for each council tax band and local authority.

The council tax bills for each band in each local authority in Wales in 2022 (including police precepts but excluding community council precepts) are multiplied by the number of homes in each band to generate an estimate of total revenues in 2022 under the current system.

For simplicity's sake, the current council tax bands are kept – more could be added as in the Welsh Government's 'Option C' proposal if more progressive outcomes are desired – and revalued by 315 per cent, which is how much house prices have increased in Wales by from 2003 to 2022. House price data from transactions is then used to generate an estimate of the number of homes within each Welsh local authority that fall into each revalued band.

The median house price within each band (with conservative estimates for Bands A and I) is then multiplied by the number of houses within each revalued band to estimate the total value of all Welsh residential property by band by local authority. A hypothetical set of percentage tax rates by band is then applied to each local authority to raise a near-equal amount of revenue to the current estimated revenue for council tax.

To estimate for how this then changes bills for households, the model needs to account for how revaluation changes the bands of individual dwellings. It therefore assumes that the current distribution of bands by local authority maps onto the current distribution of prices, such that if 15 per cent of dwellings in Swansea are currently in Band A, then the prices of the 15 per cent cheapest properties in Swansea are the prices of its Band A properties, and so on. This therefore does not capture changes to the nature of properties, such as extensions or depreciation.

These current bands are then joined to the revalued bands by price to generate an estimate for how many properties of each current band are in each revalued band. The change in bills is then calculated for each possible combination of current and revalued bands by local authority, which is then used to generate an estimate for how many households see their council tax bills rise and fall after revaluation in the new hypothetical revalued council tax structure.

The estimates are cautious in their assumptions for local authority finances. The model benchmarks revenue-neutrality against an estimated £2.5 billion that could be raised from a reformed council tax in Wales in 2022, when in reality local and police authorities in Wales billed £2.35 billion in council tax in 2022.[4]

This is primarily because the model's council tax base is broader than the current system. The various council tax exemptions (such as the single adult discount, exemptions for students etc. as well as the means tested council tax reduction scheme [CTRS] which is funded separately via a grant from the Welsh Government) are not explicitly taken into account in this model, but can be easily incorporated by policymakers, as discussed later in the paper.

Many of the equilibrium effects (e.g. effects on house prices) set out in the IFS report will have similar directional effects as in this proposal (e.g.

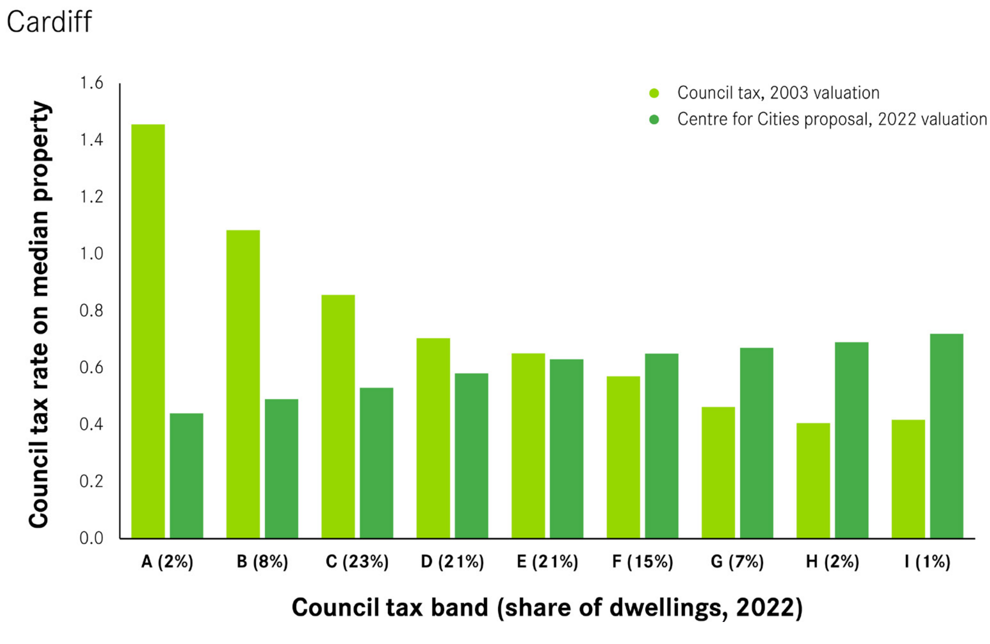
4 Welsh Government, Budget Requirement (BR1) data collection, 2023 https://statswales.gov.wales/Catalogue/Local-Government/Finance/Council-Tax/Budget-Requirement/budgetrequirement-by-authority

higher/lower council tax bills will decrease/increase property values), but the magnitude will vary depending on the choices made by each local authority.

As an example, consider Cardiff. Relatively few properties change council tax bands in Cardiff (7 per cent) in Centre for Cities' revaluation, making it a good candidate to illustrate the effects of fiscal devolution.

Figure 1 shows in light green the current council tax rates in Cardiff for each band in 2022. It can be seen that council tax is currently regressive, as the more expensive a house is, the higher its band and the lower its tax rate. A typical household in a Band A dwelling – with a house price of £75,000 – is paying £1,091 a year, or a 1.45 per cent tax rate, while a household in a Band I dwelling – with a house price of at least £915,000 – is paying £3,819 a year, which is a 0.42 per cent tax rate. This same regressive curve is replicated across every council in Wales due to the Welsh Government's anchoring around Band D.

Figure 1: Council tax in Cardiff in 2022, before and after fiscal devolution



Source: Price Paid Data, HM Land Registry 2023; Council tax levels by year and band, Stats Wales 2023; Table CTSOP1.0, Number of properties by Council Tax band, DHLUC 2023; House Price Index, Nationwide 2023.

The dark green bars show a hypothetical council tax structure for Cardiff under fiscal devolution, with the share of dwellings in each band after revaluation shown on the bottom axis. The council sets proportional tax rates for each band individually to raise in total the same amount of funding for Cardiff as the tax structure of the light green bars. This has four positive effects.

First, the flexibility allows the local authority to turn council tax from a regressive into a progressive (or if the council chooses, a flat, or even a simply less regressive) tax. This delivers a big tax cut for those in each council area's less expensive properties. For example, Band A households with this new hypothetical structure have seen their council tax bill fall to 0.44 per cent of the value of their property, or £330 a year.

Second, council tax rates for those in each borough's more expensive properties do not increase to levels currently considered unacceptable. For example, Band I properties in the hypothetical structure have seen their council tax bill increase to £6,588 a year. But this amounts to a tax rate of 0.72 per cent a year – a lower rate than the 36 per cent of households (currently) in a Band A, B, or C property are currently paying. If a 0.72 per cent rate is unfair for the less than 1 per cent of households in properties worth over £915,000, why is it fair to tax the third of the city living in properties worth less than £200,000 at rates higher than 0.72 per cent, as Cardiff does today?

Third, because the council tax base is no longer regressive, it is now much broader, which means most households get a council tax cut even though the same amount of revenue is collected. After accounting for the effects of revaluation, the households in the cheapest 71 per cent of dwellings in Cardiff see an average council tax cut of £364 a year.

To pay for this, the corresponding average council tax increase for those in the most expensive 29 per cent of dwellings amounts to £761, with the households in the 16 per cent of dwellings in Band F seeing an increase of £333 a year. The flexibility of council tax under fiscal devolution means that these changes can be phased in over time.

Fourth, council tax is now much more buoyant, so growth in the economy now grows the council's tax base. As bills are now issued as a percentage of a property's value, revenues will rise as land values rise, raising more money for services or opportunities for council tax cuts. Buoyancy also means building houses, especially those in higher bands, provides greater revenues for local services over time, allowing the council to fund services through growth instead of higher taxes while also keeping housing affordability under control.

All these changes together make council tax fairer and provide greater encouragement for councils to pursue growth than today.

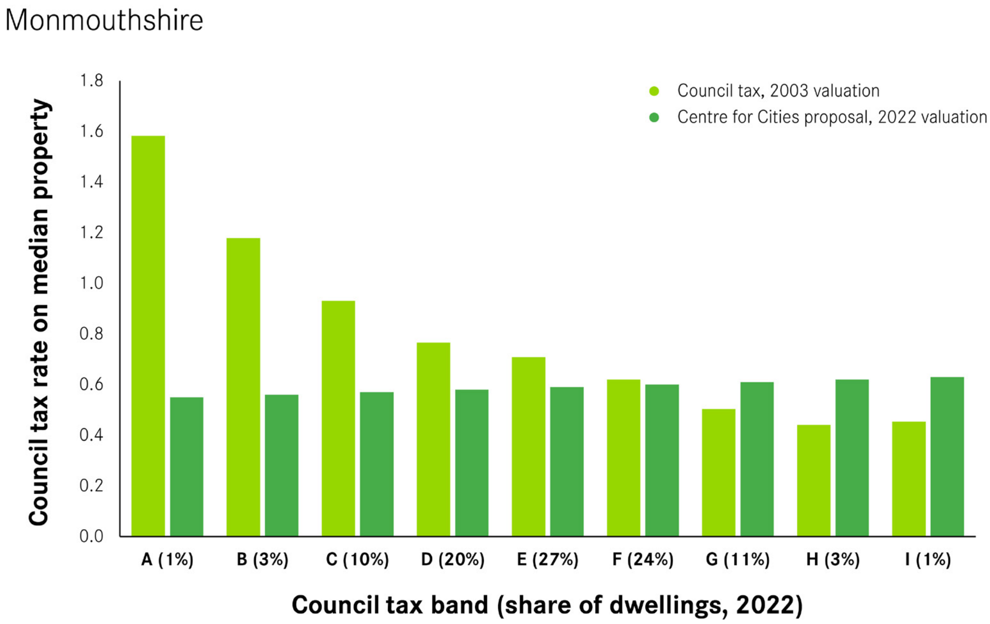
Every part of Wales could see council tax cuts from fiscal devolution

Crucially, fiscal devolution of council tax is scalable. It's not just Cardiff that benefits – the same effects can be felt in every part of Wales including very different local economies.

Figures 2 and 3 both show the same effects of fiscal devolution of council tax in Figure 1, for Monmouthshire and Merthyr Tydfil, an affluent rural authority and a poorer ex-mining community in the Valleys respectively. Both show the same patterns as Cardiff, but adapted to local conditions.

Monmouthshire has a larger tax base than Cardiff and more dwellings in higher bands than the rest of Wales. A reasonable worry from residents is therefore that council tax reforms might have a disproportionate impact on Monmouthshire, and the Welsh Government's proposals face a tension between mitigating this impact and redistributing across Wales.

Figure 2: Council tax in Monmouthshire in 2022, before and after fiscal devolution

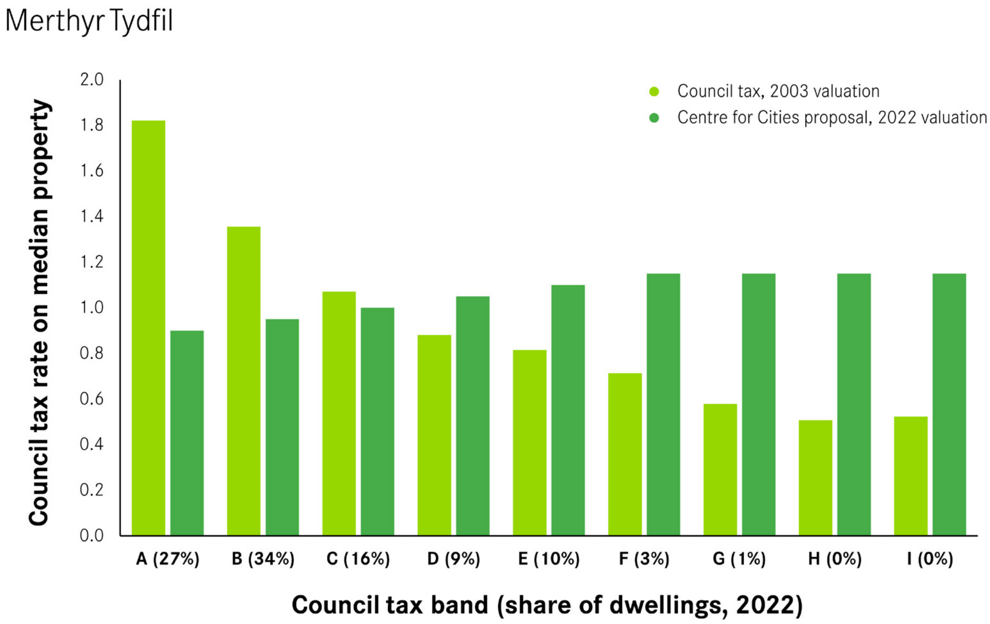


Source: Price Paid Data, HM Land Registry 2023; Council tax levels by year and band, Stats Wales 2023; Table CTSOP1.0, Number of properties by Council Tax band, DHLUC 2023; House Price Index, Nationwide 2023.

But this is not a problem under fiscal devolution of council tax. As Monmouthshire's tax base is larger, the tax rates can be lowered, including for residents of properties that are expensive by Welsh standards but average by local standards, while still achieving local revenue-neutrality. After revaluation, 67 per cent of households in Monmouthshire get an average council tax cut of £311 from fiscal devolution, while the average council tax increase for the remaining 33 per cent of households is £460.

In contrast, as Merthyr Tydfil has a much smaller tax base, it has the opposite worry – that council tax may have to increase for most residents just to sustain revenue-neutrality. No dwellings are in the top H and I bands, and 61 per cent of dwellings after revaluation are in Bands A and B.

Figure 3: Council tax in Merthyr Tydfil in 2022, before and after fiscal devolution



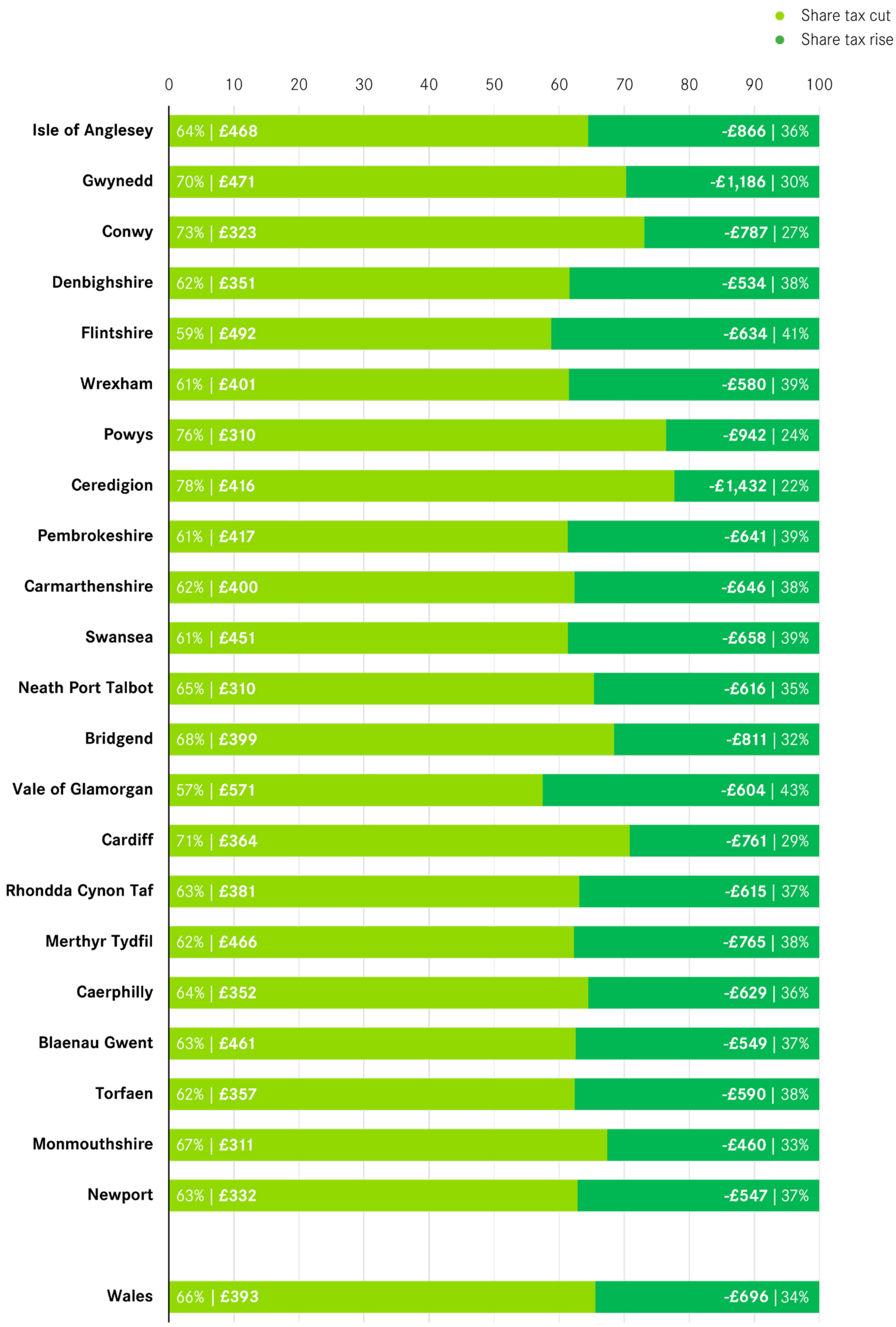
Source: Price Paid Data, HM Land Registry 2023; Council tax levels by year and band, Stats Wales 2023; Table CTSOP1.0, Number of properties by Council Tax band, DHLUC 2023; House Price Index, Nationwide 2023.

But again, the flexibility of council tax under fiscal devolution allows adaptation, even in a less affluent authority. A broader and more progressive tax base ensures most people in Merthyr Tydfil pay lower rates of council tax without others facing extortionate increases. After revaluation, 62 per cent of households get an average council tax cut of £466 under fiscal devolution of council tax, while 38 per cent have an average council tax increase of £765.

In fact, most people in every local authority in Wales would be able to expect a council tax cut from Centre for Cities' proposals, even after accounting for the effects of a revaluation. Figure 4 shows that 66 per cent of Welsh households could expect an average tax cut of £393, paid for by 33 per cent of households in each local authority's highest banded properties seeing an average council tax increase of £696. These estimates are illustrations of the scale of the changes rather than predictions – the actual figures would depend on how local authorities decide to use their freedom to set council taxes.

Figure 4: Most people in every council area in Wales could get a council tax cut from fiscal devolution

Average council tax cut and rise



Source: Price Paid Data, HM Land Registry 2023; Council tax levels by year and band, Stats Wales 2023; Table CTSOP1.0, Number of properties by Council Tax band, DHLUC 2023; House Price Index, Nationwide 2023.

Under this approach to council tax, every part of Wales would receive similar growth incentives towards housebuilding and the local tax base. Altogether, as each council pursues growth instead of tax increases to fund services, the national tax base of Wales would expand, providing resources at the national level to again either fund services or keep taxes low.

Council tax should be connected to the local economy by becoming a tool for local redistribution

But how is this possible? How can authorities with very different economies achieve revenue-neutrality with tax cuts for households when the Welsh Government's proposals struggle so much to achieve this?

The answer is that under fiscal devolution, council tax bills in the same band vary much more between the authorities than they do at present. This occurs as anchoring around Band D has been removed, so each council is able to decide its own local council tax curve to match local house prices.

Currently, Band B bills in Monmouthshire and Merthyr Tydfil are £1,385 and £1,593, respectively. Under fiscal devolution, residents of Band B properties both get tax cuts, but to £658 and £1,116 respectively. Similarly, Band F bills in Monmouthshire and Merthyr Tydfil are each £1,385 and £1,593. These increase under fiscal devolution to £3,599 and £6,758 respectively.

This is justifiable if council tax becomes a tool for local redistribution instead of national redistribution. The Welsh Government has other taxes and powers that can be used to redistribute across Wales. For council tax to become fairer while also being more closely connected to the local economy to provide stronger growth incentives, council tax must be allowed to fit each local economy instead of being anchored around a central formula.

The shift to local redistribution is compatible with the desires of the Welsh Government to reform council tax reliefs. Lower bills for most households, especially those in the cheapest properties, would release funds that could be used to provide relief for 'asset-rich, cash-poor' households in higher bands that see their bills rise from fiscal devolution. At present, the Council Tax Relief Scheme in Wales spends £280 million a year on providing relief for 260,000 low-income households.

The final implication of this programme of fiscal devolution is that by moving from nominal bills anchored around Band D to percentage tax rates, council tax would shift from being a tax on occupiers to a tax on property. The result is that renters would no longer be billed for council tax, as landlords would be billed instead. This would also make it easier to broaden the tax base further, as properties exempt due to difficulties with collection – such as student residences – could finally be re-introduced back into the local finance system.

Fiscal devolution can go further than council tax

Fiscal devolution is not just about council tax, but Wales has an opportunity with this consultation to show the rest of the UK how to fix council tax, and by extension deliver wider reform of local finance. When considering broader fiscal devolution, there are though three lessons for both for the Welsh government and reformers in England and Scotland.

First, greater buoyancy in the local funding system would further improve the growth incentive for councils in Wales, Scotland, and England. The obvious candidates for this are full devolution of business rates back to councils, and a grant formula that distributes funding on a per head basis rather than a deprivation basis. Councils would be encouraged to develop their commercial property offers to employers and would no longer be punished for improving their local economies, both of which would help improve the national economy.

Second, fiscal devolution that reforms council tax, business rates, and grant is likely easier to deliver in Wales and Scotland than England, as regional inequality in the latter is so much greater. Shifting from national to local redistribution is therefore a bigger political and technical challenge in England, and as set out in our proposal for a 'triple deal' will likely require income tax sharing and even some autonomy over local income tax rates to close local funding gaps.

And third, council tax reform in Wales and in Scotland is relatively straightforward as both have a consistent and rational system of local government – again unlike England, where the sheer variation of councils makes all manner of things more challenging to do and reform.

If instead England's councils were reorganised to align with their local economies, then council tax reform would become much easier, as every council would contain affluent, poor, and middling neighbourhoods who each contribute to their local economy but with different relationships to local taxation and local services. The American experience of fiscal devolution, where affluent communities secede to create fragmentary low-tax 'cities' while neighbouring poorer communities are forced to set high taxes to provide minimal services, would be avoided.

Ultimately, for both Wales and the wider UK, the key lesson is that local finance cannot solely or even primarily prioritise national redistribution. Local economic growth and local redistribution should be at the centre of policymakers' minds on this topic, not just because there are few other tools for policy to shape these issues, but because they add up across the country to shape national economic growth and national fairness.

The Welsh Government is to be commended for taking on the challenge of local finance, and much of the accompanying analysis of the IFS is relevant to the wider debate, but they can go further. Wales has a real chance with this consultation to not just address the problems with local finance in Wales, but also to provide leadership that shows the rest of the United Kingdom how to deliver both growth and fairness at the same time. Fiscal devolution of council tax is the only way to do this, and it is the right option for every place in Wales, for Wales itself, and for every part of Britain.

Contact

Anthony Breach, Associate Director

a.breach@centreforcities.org | 020 7803 4306

About Centre for Cities

Our mission is to help the UK's largest cities and towns realise their economic potential.

We produce rigorous, data-driven research and policy ideas to help cities, large towns and Government address the challenges and opportunities they face – from boosting productivity and wages to preparing for Brexit and the changing world of work.

We also work closely with urban leaders, Whitehall and business to ensure our work is relevant, accessible and of practical use to cities, large towns and policy makers.

For more information, please visit www.centreforcities.org/about

Partnerships

Centre for Cities is always keen to work in partnership with like-minded organisations who share our commitment to helping cities to thrive, and supporting policy makers to achieve that aim.

As a registered charity (no. 1119841) we rely on external support to deliver our programme of quality research and events.

To find out more please visit: www.centreforcities.org/about/partnerships

Centre for Cities Second Floor, 9 Holyrood Street, London SE1 2EL

www.centreforcities.org

Centre for Cities is a registered charity (No 1119841) and a company limited by guarantee registered in England (No 6215397)