

# Regional Access to Capital and Investment Finance:

*Summary of results from TPI Research Programme*

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## Abstract

This report synthesises findings from The Productivity Institute's research programme on regional access to capital and investment finance in the UK. It argues that weak and uneven UK investment (both public and private) stems from structural short termism, institutional centralisation, and geographically skewed capital markets. Highly liquid London centred financial systems, combined with limited local institutional capabilities of financial institutions, generate deep insider–outsider divides that disadvantage economically weaker regions. New empirical evidence shows that post 2008 capital markets have persistently priced most UK regions outside London and the South East as high risk, reinforcing regional divergence. Public investment allocations and land use planning further amplify these disparities, while the UK's unusually centralised fiscal–governance architecture restricts local agency and policy coordination. Comparative international analysis highlights alternative institutional models, in particular the use of development banks and devolved fiscal systems, which better support regional investment. The research outlines reform options, including redesigned governance frameworks, improved local financial intermediaries, and coordinated public–private investment platforms to enhance capital flows and long term productivity growth across UK regions.

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## Introduction

It is often argued that one of the key reasons why UK productivity growth is so weak is due to the low levels of both private and public investment we see in the UK economy. Yet, exactly why this is the case is somewhat unclear. The UK economy is highly deregulated with investor interests well protected, while also displaying a regulatory structure which ensures competition is almost all areas of the economy. In addition, the London capital markets are amongst the deepest and most liquid in the world. As such, the UK ought to be an environment in which investors are systematically confident to invest for the medium and the long-term, largely irrespective of shorter-term business cycles. However, this is not what is typically observed when the UK is compared to its major peer group of countries across Europe, North America, and East Asia, many of which continually invest a greater share of national income than the UK.

The explanation typically sought is based on the notion that the UK economy systematically exhibits 'short-termism', with UK investors, and investors in the UK, typically favouring rapid shorter-term returns over longer higher cumulative returns. This 'short-termism' has the potential to damage the long-run potential of the economy, especially in arenas involving or requiring major transitions or transformation. Yet, the reasons for this apparent short-termism are not well understood. Short-termism can arise due to behavioural features in which investors value the future relatively little compared to the present, and there may be cultural, institutional political or purely economic reasons for this, although at this stage these are not in any way clear. On the other hand, shorter-termism may also be a consequence of the time profile of costs and returns on an investment, in which the UK displays a set of constraints or influences which adversely impact long-term investment. In the UK context it may be the case that both of these explanations display some veracity, but in order to make sense of these, it is essential to articulate short-termism as a phenomenon in its own right which arises as an outcome of more fundamental behavioural or institutional factors. Short-termism therefore has to be assessed together with the full set of factors that determine levels of investment of different types.

The textbook model of investment describes a world in which all prices including the discount rate reflect social marginal valuations, and investments are undertaken if and only if their expected present value is non-negative. These decentralised private decisions lead to a socially efficient outcome. If the UK faces under-investment, then this raises the question as to what are the distortions that might lead UK investments to deviate from this efficient textbook-type pattern? They are broadly of three types. The first of these possible distortionary arise from the fact is that management of firms and of the financial capital that pays for investment is imperfect, and possibly systematically biased to favour short-term over longer-term projects. The second is that the market environment is such that the costs and benefits paid and received by investors do not match social valuations; e.g. if investors cannot appropriate all the benefits created by their investment then investment will be inefficiently low. The third is that the policy environment is creating obstacles – leading to under-investment, or alternatively excessive support for investments of different types.

In the specific UK context, various possible explanations have been put forward to account for the apparent puzzle of low UK investment levels, including claims that:

- UK investment projects have particularly high costs, or face a variety of barriers or delays;
- Investment returns in the future are given a low value by investors relative to investment costs incurred in the present and near future
- the returns that the investor expects from a completed project are low.

If these explanations are indeed reflective of key features of the UK economy, then they are likely to reduce UK investment levels relative to other economies. However, it may well also be the case that the incidence of these problems falls more on some types of investment than on others. In particular, certain sectors or certain regions may bear the brunt of these adverse investment-related features.

This research programme investigates the three possible distortionary effects and the three possible explanations put forward above in the specific context of economic geography. In particular, we investigate the extent to which there are any regional, urban or geographical distortions to investment markets arising either from the behaviour of market participants, or from the policy environment, distortions which mean that certain parts of the economy, i.e. certain regions, underperform relative to others in terms of their ability to achieve productivity gains.

Finance for economic development comes in various forms, ranging from:

- Private investment capital for large commercial projects or for dynamic and innovative start-up and scale-ups;
- Bank capital and personal finance for small and medium sized firms and small projects;
- Corporate businesses e.g. housing and retail developers
- Though to public capital and revenue – and often in parallel or in tandem with private investment capital - in the form of grants, loans and taxes for hard, soft and social infrastructure, R&D, and land-development programmes.

Successful local and regional economies tend to display portfolios of fundings which combine all of these forms of capital provision in building complementarities, with many sources working alongside each other as part of integrated development projects aimed at turning around (Frick et al. 2023) or bolstering local economies. However, in the UK, there are large regional variations in the availability of both private and public investment capital aimed at enhancing local economic development.

In terms of private capital provision for firms, it has often been argued in the media and various academic policy circles that short-termism is a key feature of UK financial markets, and that in terms of the geography of finance, this short-termism provides an explanation for such skewness. In the UK, the geography of investment is highly skewed, and this is often pointed to as a reason why the UK exhibits large core-periphery regional productivity inequalities. Currently, venture capital and angel investments are highly skewed towards the most productive regions, with London alone currently accounting for some 50% of all VC investments, a share which increases to over 75% when we also include the wider South East (Beauhurst 2023). These represent the highest geographical concentrations of such investments on record, and London and its hinterland still remains as Europe's largest target market for VC and angel investments.

However, why this spatial inequality in early-stage financing is so profound is, as yet, unclear. One argument which is often put forward in the media and politics is that there is inherent short-termism in UK capital markets. Yet, this implies that (i) commercial discount rates on UK credit and investment finance in the UK in more peripheral regions must be systematically higher than elsewhere, or (ii) it implies that UK business collateral requirements or investment leveraging ratios must be more onerous in more peripheral regions. However, there has currently been no strong evidence of any regional skewness in SME credit finance (Stansbury et al. 2023), an observation which appears consistent with the argument that London capital markets are highly

liquid and therefore any apparent regional capital differences cannot be a result of inefficient capital markets. Yet, there are also important arguments which push in the opposite direction, and suggest that structural features of the UK banking financial markets, allied with the institutional features of the UK governance system, may combine to produce credit-related outcomes which are highly skewed geographically. There are several aspects to these arguments.

First, in terms of economic geography, the highly centralised nature of the UK banking and financial services system (Mayer et al. 2021) means that the knowledge-generation processes inbuilt in relationship-type banking systems are not evident in UK system. Banking and financial information is overwhelmingly algorithmic in nature, precluding much of the ‘deep’ nuanced knowledge which is built up as a result of long-term relationship banking, as is widespread in the SME arena in countries such as the USA, Germany and The Nordics.

Under these conditions, where risk and uncertainty are major investment features, especially in start-up and early-stage potentially innovative activities, then investors are unwilling to deploy time and resources in situations which required expending significant additional efforts in information-gathering and knowledge-generation. Similarly, the asset ownership aspects of UK businesses, including forms of share ownership and firm and corporate governance rules (including share buy-backs), may also play a role, with UK firms being more financially reliant on external markets and less able to defend themselves via dual class shares.

How these differences interact with taxation regimes alongside may also be relevant. However, at a regional scale, in the absence of such deep and long-term local knowledge, the perception on the part of financial agents and brokers in London is therefore that they can just as easily subcontract market searches globally to overseas agents as to other parts of the UK, and in particular, to overseas markets where this deep local knowledge is indeed a key feature.

Under these conditions, London-based agents and brokers are typically unwilling to expend significant time and effort in search of investment opportunities in more distanced – and to London-based agents more obscure - parts of the UK, instead preferring to subcontract such activities to overseas agents. Only potential investment opportunities located nearby London, and which easily allow for frequent on-site face-to-face interactions between finance specialists and decision-makers with firm owners and managers, are therefore taken seriously in terms of knowledge-acquisition, information-gathering, discussion and negotiation by London-based agents and brokers. As such, in terms of responding to financial opportunities, what initially appear to be agglomeration-related arguments, instead may simply reflect broader insider-outsider features.

Second, in terms of publicly funded investments, there is also very large geographical skewness to the allocations of productivity-enhancing public investments. The funding for investments whose primary role is to foster economic development, namely R&D, education, transport, infrastructure, heritage arts and culture, are all heavily skewed to the already-prosperous regions of the UK, and this skewness has been increasing over recent decades (O’Brien and Miscampbell 2020).

These publicly funded investment patterns have traditionally been justified on a purportedly ‘space-blind’ model of ‘excellence’, in which investments are made on the ex ante basis of higher expected returns to public funding. Notwithstanding the fact that there is little ex post evidence of such returns being higher (Coyle and Sensier 2020), the geographical concentration of so

much growth-enhancing public investment itself may well have contributed to the relative growing 'obscurity' and 'backwater' features of many parts of the UK.

These growing core-periphery or insider-outside features of the UK's interregional economic system, appear to be exacerbated by the UK's institutional structure. In the UK, the 'obscurity' associated with geographical peripherality is accentuated by the fact that so much of the UK governance and institutional system is itself highly centralised, with only very limited data-generating and knowledge-generating activities being locally driven. As such, in the UK the specifically local and regional data and knowledge-landscape that London-based brokers and agents have readily at their disposal for analysing investment opportunities in more peripheral locations is very limited, as is the governance landscape.

The highly top-down and over-centralised UK governance system, especially in England, means that there is very little sub-central institutional capacity available to support the types of business-mentoring, local knowledge-acquisition and data-generation activities essential for the investment community. In particular, there are very few local and regional knowledge intermediaries who are able to provide the levels of reconnaissance, understanding and advocacy typically evident in federal countries such as Germany, Australia, Canada and the USA, or highly decentralised unitary countries such as The Nordics. Local knowledge is very limited at an institutional level, and local agency is always at the risk of inconsistency and instability on the part of central government. In national terms, the lack of agency on the part of local stakeholders is an endemic problem, which is likely to increase risks, and to stymie long-term coordinated and strategic economic development processes.

Third, the structural lack of local agency has been exacerbated by the fact that the local institutional capacity in many parts of the UK's local and sub-central government systems has been gravely weakened over recent decades. In terms of fiscal and financial powers, the efficacy of many aspects of local government has been underpowered or even undermined by changes in terms of local legal powers, resources, remits and personnel, which increasingly have favoured centralisation rather than local agency. The long-term impacts of these four-decade long trends are that local and sub-central government has much more limited capabilities for fostering local economic development than is the case in other countries. These limited capabilities driven by four decades of centralisation are accentuated by the resulting fragmentation and centrally orchestrated funding competition between local and sub-central government bodies which inherently evolved as a natural outcome of an increasingly top-down and centralised governance system. This means that for the promotion of economic development, the scaling-up of policy initiatives across administrative and jurisdictional boundaries has also become increasingly difficult, leading to policy domains which are often too small to be meaningful.

The lack of local agency, limited local capacity and the vulnerability of local decisions to central government policy whim changes, means that the policy coordination failures across different areas of UK governance are themselves both a cause and consequence of short-termism in many of the institutional aspects of the UK economy. Any resulting risk aversion due to a combination of an over-centralised fiscal governance and banking system may in turn be reflected in risk aversion in UK capital markets.

Similarly, the financial and fiscal relationships between different levels of government may also be characterised by short-termism (McCann 2022a), as political pressures tend to lead to frequently changing policy settings and priorities (Coyle and Muhtar 2021). Such frequently changing political pressures will militate against meaningful coordination in the medium and long-term between widespread institutions and stakeholders (McCann 2022b). This may also

exacerbate any inherent short-termism in the fiscal and financial relationships of different levels and arenas of governance (McCann 2022a). As such, the apparent short-termism in UK capital markets may actually reflect systemic economy-wide structural coordination failures characterised by short-termism, centralisation, and fragmentation, rather than being a key underlying and causal key failure in its own right.

Fourth, these short-termism and risk-related problems in the UK financial and institutional settings are also likely to be made more serious due to the workings and operations of the UK land markets and the land-use planning system. In the UK, real estate is a primary form of collateral for start-up, younger or smaller businesses, and this implies that other factors related to land use planning and housing markets may heavily impact on investment flows in a manner which is not the case in other countries where either home ownership is less widespread, or where regional real estate pricing differences are lower.

At a larger scale, how the land-use planning system interacts with local land markets is crucial for fostering local economic development, and especially for the provision of commercially viable and attractive sites for investments in critical locations with the potential to foster further growth and development. In the UK, the land-use planning system is notoriously slow and unresponsive to market forces, and unpredictable in terms of outcomes as it is subject to so many planning appeals.

The costs of UK infrastructure provision are higher than in most other OECD countries (Dimitriu and Hopkinson 2023; Ruparel et al. 2024) and the operation of the land-use planning system is a key determinant of the land market distortions and inefficiencies (CMA 2024). Indeed, these problems are exacerbated by the fact that the UK land-use planning system in reality is anything but a 'planning' system, and instead is largely an ad hoc 'plan-less' (CPiAP 2023) development control system (McCann 2023b), which wholly fails to use the potential of the planning system as a tool of economic development.

The problems of the system inevitably weigh relatively more heavily on relatively riskier locations, namely the economically weaker regions, where the need for clarity and responsiveness is paramount in order to help such regions attract capital investment in less favourable conditions. The UK land-use planning system has seen various reforms over recent years, but although land-use issues are de jure the remit of local government, local discretion is de facto hampered by a heavily centralised top-down system of 'guidance' set out in national planning policy frameworks. Again, this further limits the agency of sub-central governance institutions to act in a manner appropriate for the local context.

All four of these arguments suggest that there are real and powerful forces inhibiting capital flows to economically weaker UK regions, and empirical evidence is now starting to emerge which points to exactly that. As we will see below, part of our research work at TPI (Daams et al. 2024a,b; 2025a,b) has already uncovered major differences in risk perceptions associated with different regions on the part of the investment community.

The research will consider the construction of 'platforms' or built-for-purpose institutional frameworks which better allow for these types of public-private coordinated interventions to be effectively undertaken in economically weaker places in a manner which is attractive to the investment community. A particular emphasis will be given to those activities and actions which involve interventions in the local land markets. We will examine the financial, fiscal, resource-base, legal, and governance features of successful arrangements, and identify realistic and implementable improvements in the UK financial-fiscal and institutional set-up which can help

the UK governance systems to catalyse private sector investment in economically weaker regions.

This research therefore examines the various features of this problem with the aim of identifying the underlying reasons for these spatial variations in investment capital for economic development. The overall objective of the research is to identify potential institutional reforms which could help the UK's economically weaker regional economies to build stronger and more stable financial and capital bases.

Private investment capital markets operate across domains which extend much further than local and regional development, and similarly, public investment also operates across arenas which go well beyond simply local and regional development. Therefore, in this research we constrain our analysis and consideration to ~~just~~ those areas of the private investment markets and the public investment arenas which are directly or indirectly focused on enhancing local and regional economic development; in particular, we consider those arenas where constellations of private and public investment capital often work in partnership to foster economic development. This requires us to consider the economic development challenges evident in the private investment markets, in the public finance and fiscal domains, and also at the interface between these two arenas. Our UK-based research is being complemented and calibrated against a series of international case-studies highlighting best-practices.

In order to examine these complex and intertwined issues, the research programme involves three broad lines of enquiry:

- i. An analysis of locationally-specific data from investment projects, activities and transactions at different spatial units and levels.
- ii. An analysis of the behavioural and organisational logic of the UK banking and financial system and the resulting portfolio of activities of its institutions, in the context of the broader fiscal and public policy arena which shapes such investment decisions
- iii. An examination of whether and how the Covid-19 lockdowns and the subsequent work-from-home revolution have reshaped the productivity advantages of certain places over others.

## (i) An analysis of locationally-specific data from investment projects, activities and transactions at different spatial units and levels.

This research has involved the analyses of detailed location-specific and transaction-specific data on large real estate investments in commercial activities in different places and at different time periods. These investment data provide us with derived demand signals of investors' expectations regarding the future performance of the local economy at particular time periods. The uniquely detailed data has allowed the TPI research team to develop for the first time detailed measures of investment risk premia and yields for all cities and regions across the USA, UK and Europe.

Our first successful analysis was undertaken for the USA, and was published as:

M. Daams, P. McCann, P. Veneri, R. Barkham and D. Schoenmaker, "Capital Shocks and the Great Urban Divide", 2024, *Journal of Economic Geography*, 24.1, 1–21

In this article we exploited the signals of capital pricing and availability in US cities which were obtained from our uniquely detailed data on real estate investments. We identified how places were differently affected by the global financial crisis and provide insights which offered an alternative explanation of why US economic growth continues to experience spatial divergence after many decades of convergence. Investment pricing uncovers that before the crisis capital was allocated efficiently across localities, whereas the global financial shock favoured large and prosperous places. These findings for the first time point to persistent post-crisis asymmetry in local capital market conditions and underscore the capital risk safety aspects of agglomeration.

This analysis was then extended to examine the case of the UK and was published as:

M. Daams, P. McCann, P. Veneri, and R. Barkham, "Capital Shocks, the Great Recession, and UK Regional Divergence", 2024, *Regional Studies*, 58.12, 2256-2275

This paper used our uniquely detailed large-scale commercial real estate investment data to examine how financial markets perceived the attractiveness of investing in UK regions during the last two decades. Our analysis demonstrated that prior to the 2008 Global Financial Crisis all regions of the UK were perceived similarly in terms of risks, whereas the crisis engendered a flight to safety of capital into London. Other UK regions shifted rapidly into junk bond territory, and have remained there ever since. These asymmetric capital shocks have led up to a profound and adverse shift in the subsequent productivity growth of the UK regional economies which were most adversely affected by these capital shocks. Whereas in the USA, as our *Journal of Economic Geography* Paper showed, the 'flight to safety' favoured large cities over all other places, in the UK the 'flight to safety' favoured London and its immediate hinterland over all other places.

The third paper in this suite of papers then examines how these regional capital market pricing shocks are related to the logic and behaviour of the UK banking system. These issues are discussed in our third published paper on this theme, namely:

M. Daams, C. Mayer and P. McCann, 2025a, "Regions, Cities and Finance: The Role of Capital Shocks and Banking Reforms in Shaping the UK Geography of Prosperity", *Fiscal Studies*, 46, 475–490

This paper examines the role played by financial markets and, in particular, changes in the price of and access to capital, along with institutional changes in the financial system, in shaping UK regional growth fortunes. This issue has been largely overlooked in debates on UK regional productivity disparities, but our new data and analyses are now shedding powerful light on it. By calculating UK city and regional risk premiums, and comparing them with European averages, the demand side re-emerges as an important part of the story. The ‘external finance premium’ (Bernanke 2022) is far higher in the UK’s economically less productive regions, and the difference with London is equivalent to the sovereign yield gaps between the UK and Romania. The greater volatility and interregional risk spreads of the UK economy raises profound questions regarding the institutional logic and structure of the UK banking and financial system.

The fourth paper in this research agenda examines the extent to which the UK capital market partitioning uncovered in the above papers also implies that the Sterling-Zone is moving away from being an Optimal Currency Area in comparison to the Eurozone, or the non-Euro parts of Europe, or the USA. The TPI Working Paper is:

M. Daams, P. McCann, P. Veneri and R. Barkham, 2025b, “Is the UK Sterling-Zone an Optimal Currency Area? Comparisons with the Euro Area and the Rest of Europe Using City and Regional Investment Data”, TPI Working Paper 050, The Productivity Institute, Manchester, See: <https://www.productivity.ac.uk/research/is-the-uk-sterling-zone-an-optimal-currency-area-comparisons-with-the-euro-area-and-the-rest-of-europe-using-city-and-regional-investment-data/>

Using our uniquely detailed data we develop a series of new tests to examine the extent to which the UK Sterling-area and the Eurozone correspond to Mundell’s (1961) original notion of an optimal currency area. Financial capital is the most geographically mobile factor, and the factor input which can respond most rapidly, and move most quickly, towards equilibrating adjustments in response to economic shocks. As such, how capital prices adapt to shocks across different geographies provides a powerful test consistent with Mundell’s arguments. Our analysis spans the shocks associated with the 2008 global financial crisis. The results suggest that in the post-crisis era, the Sterling-area is less of an optimal currency area than either the Eurozone or the non-Euro parts of the EU. This also helps to explain why post-crisis, UK monetary policy, and in particular quantitative easing (QE), appears to have had no real beneficial traction outside of the London area, as already highlighted in our *Regional Studies* and *Fiscal Studies* articles discussed above.

The paper is currently under review at an international academic journal.

The fifth aspect of this research agenda examines how economic risk and uncertainty are communicated via the news media, and the extent to which news media accurately reflects how investors perceive risks at UK city and regional levels. The working paper on this topic is:

Ming-Wei Hsu, Philip McCann and Michiel Daams, 2025, “News Media Framing of UK City and Regional Economic Uncertainty: Disconnections from Investors’ Perceptions”

In this paper, we examine the extent to which UK local city and regional sentiment and concerns regarding economic risk and uncertainty are reflected both in national media narratives and also investors’ perceptions of local risk and uncertainty. Using large language models (LLMs) with a detailed model-training process we demonstrate that UK national media narratives most closely reflect London-specific concerns, and much less so, those of other UK cities and regions. Media concerns in London reflect investors’ concerns, but outside of London, UK media concerns are

almost entirely disconnected from investors' concerns, thereby making city-region devolution challenges even greater.

This paper is currently under review at an international academic journal.

This research strand has garnered the attention of the Financial Conduct Authority (FCA), and we are now working with them examining the role played by financial centres and financial services clusters in shaping regional and national growth.

## **(ii) An analysis of the behavioural and organisational logic of the UK banking and financial system and the resulting portfolio of activities of its institutions.**

The aim of this part of the research programme is to examine in what ways the UK financial-institutional system can be rewired in a manner which helps to build a more robust finance-investment-knowledge-innovation ecosystem in economically weaker places. The focus here throughout the project is the context where devolved sub-central government, public-sector and private-sector institutions – along with quasi-public sector bodies such as universities, development agencies, research centres, technology-transfer agencies, science parks etc. - would aim to work together in fostering economic development and regeneration in weaker localities.

In order to undertake this research, we produce a state-of-the-art landscape review and inventory of how the UK financial-institutional governance system operates, its key features, and its challenges regarding local economic development in the light of international comparator evidence. We analyse the key features of this system against the backdrop of the experiences of other OECD countries. We also examine the OECD-wide patterns and trends in these economic development arenas, and then analyse in detail the roles, remits and actions of specific types of actors and institutions in Germany, France, Australia, Canada, the Netherlands and USA, insights from which may be applicable to the UK context. In particular, we look in detail alternative institutional arrangements and initiatives evident in other countries which potentially could be grafted onto the UK systems in a manner which could foster improved regional access to capital and an improved UK-wide investment climate.

This work has two main overarching elements to it, namely the institutional-design challenges (including the operation of land-use planning regimes), and the central-sub-central fiscal issues which together influence private sector capital flows into regions, and four embedded work packages aimed at unpicking these issues. We examine the sources of funding deployed in urban regeneration activities, the institutions (including special purpose vehicles) which leverage and channel these funding streams, and the decision-making arenas and processes governing how these are deployed. We will also study how economic development banks such as the KfW in Germany, Bpifrance in France, the EIB European Investment Bank in Luxembourg, and the EBRD European Bank for Reconstruction and Development in London, all operate their investment programmes in these types of economically weaker localities. For each of these international comparator examples, we will investigate the logic of their set-up, design, and objectives, and we will examine how their activities help to overcome issues of financial short-termism and myopia in economic development markets.

The first paper arising from this research agenda is the 72-page, 25,000-word NIESR Occasional Paper:

P. McCann, 2022, *The Fiscal Implications of 'Levelling Up' and UK Governance Devolution, 2022*, Occasional Paper LXIII, National Institute of Economic and Social Research, London, July, See: <https://www.niesr.ac.uk/wp-content/uploads/2022/07/OP-63-The-Fiscal-Implications-of-Levelling-Up.pdf>

This paper for the first time decomposed and analysed the UK central-sub-central fiscal system in the light of OECD-wide evidence. By considering the fiscal and accountability issues which need to be addressed in order to help weaker productivity regions in the UK to catch up, it becomes readily apparent that the challenges associated with devolution and Levelling Up are far greater than they at first appear. This is because the underlying central-sub-central fiscal system of the UK inherently pushes against Levelling Up. Reform of the system in order to facilitate Levelling Up requires more profound changes than is typically understood, and this can only be understood by comparing the UK system with other OECD countries. In this regard, the UK fiscal system is seen to be an outlier, unlike any other country.

The combination of nine key features which characterise the UK central-sub-central fiscal system needs to be fundamentally altered if Levelling Up is to work in the long run. Minor fiscal and governance changes will make no real difference. These nine features are:

- (i) The UK increasingly relies on a cost-based rather than a revenue-based interregional fiscal equaliser system. Cost-based systems tend to provide much weaker fiscal stabilisation underpinnings than do revenue-based systems.
- (ii) By international standards, the UK devolved very low levels of sub-central government revenue, expenditure and investment. Correspondingly, UK sub-central governments enjoy very low levels of autonomy and authority.
- (iii) The UK has an unusual distribution of sub-central government liabilities; among OECD countries, only Australia has a broadly similar composition of liabilities, although the sub-central governance systems of the two countries are profoundly different.
- (iv) The shares of UK sub-central government debt which are securitised are amongst the lowest of any OECD country, and the lowest of all large OECD countries. As such, the UK is not only unlike federal countries, but also unlike most other unitary countries, particularly large ones.
- (v) The UK central government exerts direct controls on almost all aspects of UK sub-central government, thereby creating distortions in policy objectives and limiting local policy-making discretion.
- (vi) In the UK, all sub-central government powers and responsibilities derive from central legislation, leading to a system of very strict rules and regulations. In contrast, many other countries assign these powers through local or regional legislation. The UK's shift to performance budgeting at the sub-central government level, combined with high-powered grant-seeking incentives, further skews local decision-making toward central government priorities.
- (vii) One of the most significant obstacles to devolution or decentralisation in the UK is the issue of constitutional checks and balances, and in particular the nature of parliamentary sovereignty and the British conception of public accountability.
- (viii) The legal changes in Scotland following the recommendations of the Calman and Smith Commissions, and in Wales following the Silk Commission, mean that the UK is now rapidly becoming a quasi-federal state. This goes together with highly unequal national governance components, each with very different sub-central governance arrangements, and lacking a clear definition of the centre of government.

(ix) The over-centralised UK governance system militates against both central government learning and local government institutional capacity-building. Its extreme pyramidal nature, combined with a lack of any meaningful meso-level governance tiers outside the three devolved administrations and London, disincentivises citizen engagement with government, especially in the weaker parts of the country. At the same time, this unusual governance architecture fosters short-termism in policy-making and encourages large-scale interventions.

The second paper in this research strand is:

P. McCann, 2023, “Levelling Up UK Regions: Scale-Related Challenges of Brexit, Investment and Land Use”, 2023, *Contemporary Social Science: Journal of the Academy of Social Sciences*, 18.3–4, 298–317

This paper discusses three of the key reasons why productivity growth in the UK is both so weak and also so regionally unbalanced. These reasons are Brexit, low levels of public and private investment, and the operation of the land-use planning system. In each case the national implications of these issues also have direct regional corollaries and causal mechanisms, which unless comprehensively addressed, heavily constrain the ability of Levelling Up to work. A reconsideration of the nature and scale of these issues also highlights the limited nature and scale of the current institutional and policy responses aimed at rebalancing UK productivity and prosperity.

The third paper to emerge from this research strand is:

P. McCann, 2024, “Levelling Up: The Need for an Institutionally Coordinated Approach to Regional and National Productivity”, *Regional Studies*, 58.5, 1145–1156

This paper, which is also based on interviews with key personnel in the international comparator bodies examined, argues that the UK’s endemic regional–national productivity problems cannot be addressed by the UK’s current institutional and governance set-up. This paper argues that the establishment of an appropriate institution, body or forum is essential in order to fill the current governance vacuum. The appropriate nature, form and logic of such a body can be gleaned by observing various international comparator bodies in Australia, New Zealand, The Netherlands and the USA, which undertake different aspects of the types of roles and tasks that a UK body must necessarily undertake. The options for a UK body comprising elements of these comparator institutions are discussed in detail.

The fourth paper in this research strand is:

P. McCann, 2024, “Levelling Up Economics”, *Oxford Open Economics*, 3, i616–i624, Dimensions of Inequality: The IFS Deaton Review

This commentary argues that our awareness of the nature and scale of UK interregional inequalities has only lately begun to develop in a manner which is appropriate, given the scale of the challenge. The UK economics profession across government, business and academia has been slow to understand the gravity of the issue, in comparison to many other OECD countries. Indeed, this intellectual failure reflects a more fundamental failure on the part of the whole UK institutional and governance system, which has evolved, largely for historical and political reasons, into a form that is entirely inappropriate and ineffective for addressing these issues. The problem now is that reforming the system via devolution-related reforms is far more difficult than

it otherwise might have been if these issues had been addressed decades earlier, as has been the case in other OECD countries

The fifth publication in this strand is:

“Land Use and Planning Reforms: Strategic Context, Challenges and Policy Recommendations”, 2024, TPI Briefing Note, The Productivity Institute, Manchester, 12 August, (with N. Alcock, C. Aldington, A. Crook, J. Gill, v. Goodstadt, P. Hildreth, J. Hoskins, M. Henson, P. McCann, H. Murison, K. Penney, M. Rawstron, M. Sensier, J. Steer, C. Wong, I. Wray, K. Wray), See: <https://www.productivity.ac.uk/research/land-use-and-planning-reforms-strategic-context-challenges-and-policy-recommendations/>

This short briefing note encapsulates the key TPI-research-based recommendations for devolved governance regarding the interaction between land-use powers and fiscal powers. It was explicitly referred to in the new January 2026 Greater Manchester growth strategy document *Economic Growth in Greater Manchester*.

The sixth paper on this suite of papers is the 72-page 25,000-word NIESR Occasional Paper:

P. McCann, 2025, *How Can Urban Wealth Funds and Regional Wealth Funds Help UK Regions to Rejuvenate?*, NIESR Occasional Paper LXVI, National Institute of Economic and Social Research, London, August, See: <https://niesr.ac.uk/wp-content/uploads/2025/08/JC887-OP66-INTERNAL-PAGES-DIGITAL-v5.pdf?ver=0tADNa9MHg3yBaeAiTv5>

This paper examines the case for, and context in which, an urban wealth fund (UWF) or a regional wealth fund (RWF), can realistically and meaningfully be established in UK cities and regions in a manner which helps to encourage investment capital back into economically weaker regions. Much of the current discussion regarding the links between industrial strategies, governance devolution and national productivity growth, largely fails to consider in detail the particular effects on, or specific responses to, the capital markets, at the local, city, regional or national levels and the consequential local financial and fiscal implications of these effects and responses. The wealth fund model offers an important potential step in the required reforms needed to increase the investment attractiveness of weaker places. However, this paper will argue that the particular way that they are being currently articulated in the UK context, such as via a National Wealth Fund, falls far short of what is required to help rejuvenate cities and regions, and if anything, risks diverting attention away from the most important financial and fiscal challenges facing these localities.

The seventh paper in this suite of papers, and which is currently under preparation, is:

S. Frick, P. Prenzel, C. Aldington and P. McCann, 2026, “What Role for State Development Banks to Address Regional Inequality? SDBs and the Spatial Diffusion of Private Sector Funding”, Forthcoming

This paper builds on a detailed programme of documentary research and interviews with key personnel in the EIB European Investment bank in Luxembourg, KfW in Germany and BPI France, in order to identify how these institutions operate in terms of providing investment capital to weaker regions, and what lessons might be learned for the design of similar institutions in the UK. In particular, we examine how the financial structure, capabilities and scale of each institution relates to their intended remits, and how good financial governance systems work. This will also involve an analysis of the relationships between these intermediary institutions and the financial

systems and capabilities of other public bodies, including sub-central government bodies, such as city-regions and states governments. In particular, these international observations will be compared with the set-up and design of the various UK institutions – including the UK Infrastructure Bank (UKIB), the British Business Bank (BBB), Challenger Banks, local venture capital funds, initiatives such as Northern Gritstone, the British Growth Fund and also curtailed initiatives such as BankNorth - and other institutions focussed on assisting with capital flows to start-ups and scale-ups, including university science parks, investment zones, catapults etc. This is being done with a view to identifying the extent to which they are able to counteract any market short-termism or geographical myopia.

The eighth paper in this suit of papers, and which is still currently under preparation, is:

P. McCann, 2026, “UK Regional Productivity Growth: The Role of Housing, Infrastructure and Land-Use Planning”, NIESR Occasional Paper, Forthcoming

This paper examines the complex interactions between housing markets, land-use planning, infrastructure provision decisions, and regional investment opportunities. These issues, and in particular the issue of housing provision, is typically discussed in UK media and policy circles in a very partial manner and from a very narrow set of perspectives. This paper therefore examines these issues from a systemic perspective, in which the underlying buoyancy of the local land markets plays a catalytic role in shaping investment flows and facilitating the managing of, and the returns to, publicly funded infrastructure investments. In particular, we build on two seminal Kate Barker (2004, 2006) reports on land markets and the land-use planning system in order to examine the efficacy of any reforms in this arena, which also need to be considered against the backdrop of the UK’s currently weak central-sub-central fiscal stabiliser mechanisms, and the precarious financial position of many local governments. The research will also be set against the backdrop of discussions regarding how these issues are handled across OECD countries, building on both the OECD reviews of land-use systems and also the EU Plurel programme. The insights from these different land-use planning systems are also be related to the different central-sub-central fiscal arrangements evident in different countries.

The ninth piece of work in this agenda, which is just currently commencing, involves an examination of the fiscal and financial viability of UK local governments when considering their asset sales. Working alongside IPPR, we are embarking on a Freedom-Of-Information request programme across UK local governments in order to understand their portfolio of public asset sales, which we will then relate to our city and regional risk pricing calculations described above. This is being done in order to identify how changing public sector balance sheet positions relate to private capital market shocks and also the central-sub-central fiscal pressures faced by localities.

(iii) An examination of whether and how the Covid-19 lockdowns and the subsequent work-from-home revolution have reshaped the productivity advantages of certain places over others.

The UK economy was significantly shocked by the Covid-19 lockdown and the ensuing work-from-home (WFH) revolution facilitated via the rise of online meetings platforms such as Zoom and Teams allowed for a spatial reorganisation of commuting patterns. In particular, the so-called ‘donut’ effect, whereby workers would increasingly move away from the city centres to more outlying and suburban areas was widely commented on across OECD countries and increasingly well documented. Yet, how these changes might affect the UK are unclear, given that while the UK today is one of the countries with the highest number of workers taking advantage of hybrid working patterns, land use changes are also tightly controlled and constrained by the land-use planning system. During the lockdown crisis, across the OECD countries, the WFH revolution was widely predicted to offer new economic advantages to smaller and more remote places as it was assumed that workers would be better able to enjoy working from more remote locations. However, our suspicion was that precisely the opposite may occur, with the larger cities being the real winners from expanded market areas.

The first paper on this topic is:

S. Bond-Smith and P. McCann, 2025, “Shadows and Donuts: The Work-From-Home Revolution and the Performance of Cities”, *Journal of Regional Science*, 65:1401–1422

in which we prove analytically that while the widely discussed ‘donut’ effect is true, there is also an additional ‘shadow effect’ whereby WFH enhances large city productivity by increasing both the market area and the labour market areas of those cities. Contrary to the expectations of geographic decentralisation enabled by remote work, this phenomenon draws workers relocating from outside metropolitan regions closer to major urban areas, reinforcing urbanisation trends and thereby casting productivity shadows over smaller cities.

The second paper on this topic is:

L. Bjerke, S. Bond-Smith, P. McCann and C. Mellander, 2025, “Work-From-Home, Relocation, and Shadow Effects: Evidence from Sweden”, The Productivity Institute Working Paper No.054, See: <https://www.productivity.ac.uk/research/work-from-home-relocation-and-shadow-effects-evidence-from-sweden/>

in which we demonstrate empirically using the whole working population of Sweden that the theoretical insights arising from the Bond-Smith and McCann (2025) paper are indeed correct.

The third paper on the topic is:

J. Simonen, S. Karhinen, P. McCann and R. Svento, 2024, “The Drivers of Intra- and Inter-Regional Labour Mobility over the Industry Life Cycle of the High-Tech Sector”, *Journal of Regional Science*, 64.5, 1507-1831

in which we demonstrate on the basis of the whole Finnish population working in high-tech industries that the labour market, labour mobility, and job-change dynamics operating in declining agglomerations are fundamentally different to those operating in growing

agglomerations. Understanding this is crucial if we are to be able to unpick the local productivity-related effects of the WFH-induced shadow effects described above.

The fourth paper entitled “Urban Scaling as Spatial Equilibrium” by Steven Bond-Smith, Hadi Arbabi, Ming-Wei Hsu and Philip McCann, proves for the first time that the canonical AMM urban economics model is consistent with the urban scaling literatures. This paper is now currently under review at an international journal.

The fifth paper which is currently being written used the proofs in the fourth paper above to adapt the work-from-home shock – as described by Bond-Smith and McCann 2025 above – to the empirics of the UK spatial economy.

We are currently in the process of preparing the sixth paper, which links the empirics of the post-covid economy to the previous five papers.

The fourth, fifth and sixth papers in this research strand are being developed in conjunction with the Department for Transport who are funding our research.

In terms of linking the access to capital to regional productivity, our argument is simply that larger cities will be in an enhanced position for investment as a direct result of the market expansion effects associated with the WFH revolution. In addition, from a public investment perspective, this also changes the marginal costs of capital associated with commuting time and preferences, since the WFH revolution changes optimal commuting frequencies and how these vary with location. This also alters the Generalised Costs of Travel (GCT) adopted by the Department for Transport in their investment pricing and investment returns calculations that they undertake for all potential public investments. Our work will ultimately lead to a revision of the GCT framework underpinning public transportation infrastructure planning.

## Engagement

In February 2025 we organised an event at the University of Oxford Blavatnik School of Government to discuss all of these issues in detail. The meeting included members of the Bank of England, senior Treasury officials, economists at the DBT Department for Business and Trade, DLUHC the Ministry of Housing, Communities and Local Government, analysts and policy-makers in UK city-regions mayoral combined authorities, think-tanks, Homes England, the UK National Wealth Fund, British Business Bank, members of the Devolved Administrations, as well as experts from the Fraunhofer, Germany. We will hold another such event in the summer of 2026.

## Media Coverage

October 2024, Our work at The Productivity Institute on regional access to capital and capital shocks referred to explicitly in CityAM: <https://www.cityam.com/financing-growth-how-the-citys-frailties-have-hamstrung-productivity/>

February 2025, *The Times* article entitled “UK’s One-Size-Fits-All Monetary Policy Doesn’t Work Outside London” by Mehreen Kahn on 10 February, discussed the detailed findings our TPI Working Paper “Is the UK Sterling-Zone an Optimal Currency Area? Comparisons with the Euro Area and the Rest of Europe Using City and Regional Investment Data”, 2025, TPI Working Paper 050, The Productivity Institute, Manchester, (with M. Daams, P. Veneri and R. Barkham), See: <https://www.thetimes.com/business-money/economics/article/uks-one-size-fits-all-monetary-policy-doesnt-work-outside-london-7bj6z2pv>

July 2025, The *Reuters* article entitled “Most of UK Stranded in 'Junk Bond' Territory as London Dominates, Research Says” by Andy Bruce on 11 July discussed the detailed findings of our *Fiscal Studies* article “Regions, Cities and Finance: The Role of Capital Shocks and Banking Reforms in Shaping the UK Geography of Prosperity”, (with M. Daams and C. Mayer), See: <https://www.reuters.com/world/uk/most-uk-stranded-junk-bond-territory-london-dominates-research-says-2025-07-10/>

January 2026, Our 2025 *Fiscal Studies* (M. Daams, C. Mayer and P. McCann) paper entitled “Regions, Cities and Finance: The Role of Capital Shocks and Banking Reforms in Shaping the UK Geography of Prosperity”, 2025, *Fiscal Studies*, 46, 475–490, was discussed in detail – including our data graphics – in the article “The Left-Behind Economy and What to Do About It: New Insights into Regional Inequality” by Martin Sandbu in the *Financial Times*, 29 January, See: <https://www.ft.com/content/91def526-e08f-4f00-8335-7c16a6873910>

January 2026, Our 2024 TPI Briefing Note - “Land Use and Planning Reforms: Strategic Context, Challenges and Policy Recommendations”, The Productivity Institute, Manchester, 12 August, (N. Alcock, C. Aldington, A. Crook, J. Gill, v. Goodstadt, P. Hildreth, J. Hoskins, M. Henson, P. McCann, H. Murison, K. Penney, M. Rawstron, M. Sensier, J. Steer, C. Wong, I. Wray, K. Wray), See: <https://www.productivity.ac.uk/research/land-use-and-planning-reforms-strategic-context-challenges-and-policy-recommendations/>

This report was referred to explicitly in the official January 2026 Greater Manchester Combined Authority Mayor’s report entitled *Economic Growth in Greater Manchester*, in which it stated “This approach is supported by The Productivity Institute’s paper Land use and planning reforms: strategic context, challenges and policy recommendations which makes the case for strategic planning at a Combined Authority level aligned with local rotating finance vehicles/institutions for improved productivity.”