

Response to the Consultation on the Draft Guidance on the Operation of the CMA's UK Internal Market Functions by Professor Philip McCann, *Professor of Urban and Regional Economics, University of Sheffield*

Background Context

I am an economist working on urban and regional economics, including the effects of Brexit on UK regions, the economic challenges associated with sub-national/sub-state devolution, and also on broadly what people nowadays call the 'Levelling Up' agenda. As such, for the purposes of this consultation, I will keep my comments to a few specific points as they relate to how I understand the *economics* of the internal market workings, and therefore the issues on which the Office for the Internal Market will be required to provide advice.

My views on the guidance on the operation of the CMA's UK internal Market Functions, and specifically on the role and activities of the Office of the Internal Market, fall into three main categories, namely the effects of the Northern Ireland Protocol, secondly on the decisions of the Devolved Administrations; and thirdly, on the future of devolution within England (including Combined Authority City-Regions) including the issues associated with the forthcoming Shared Prosperity Fund and the Levelling Up White Paper.

On the Northern Ireland Protocol

My instinctive response is that if I were a potential investor based in Great Britain or internationally, I would steer clear of developing further trade relationships - whether via direct exporting or importing, or via direct investment – in Northern Ireland. The reason is that the current ambiguity over the primacy between the UK Internal Market and the EU Single Market, arising from the apparent willingness of the UK Government to override certain Treaty provisions if required, could lead to unanticipated outcomes. Moreover, the Internal Market Act provisions for ex post legal challenges and redress would increase my ex ante risks and my implied costs of financing, irrespective of whether or not they are actually activated in the future. As such, a better strategy would be to let others shoulder those first-mover risks and wait and see the outcome. The effects of this would be to work entirely counter to the principles of the internal market. The only way around this problem that I can envisage is to use the Common Framework as the primary mechanism for settings standards and the Act as a last resort fall-back, exactly as the Institute for Government argue (Sargeant and Thimont Black 2021).

Devolved Administrations (DAs)

Most of the issues regarding the Devolved Administrations and the UK Internal Market are well-rehearsed and set out clearly in various reports (Dougan et al. 2021; IFG 2020; Sargeant and Stojanovic 2021; Sargeant and Thimont Black, 2021; Weatherill 2021) so I will not comment on most of these issues, only on specific issues relating to the economics of the internal market.

Regarding Parts 1 to 3 of the Act, if any of the Devolved Administrations implement legislation which aims, for example, at higher environmental standards, these potentially could discriminate against firms from other parts of the UK with lower standards. Even if firms within the DAs complied with the legislation, on the non-discrimination principle such legislation could be set aside for firms from other parts of the UK with lower standards. This would hurt local firms aiming to comply with the higher local standards, as they could be undercut by

firms from other parts of the UK with lower standards, as is already well-known. At the same time, this would also hurt firms *from other parts of the UK* who are also aiming to achieve higher standards, because of their doubts regarding the authority of such legislation. In other words, it disincentivises firms from all parts of the country to upgrade their environmental-technological standards.

Again, the only way around this problem that I can envisage is to use the Common Framework as the primary mechanism for setting standards and the Act as a last resort fall-back, exactly as the Institute for Government argue (Sargeant and Thimont Black 2021).

Another example would be the effects of distance – for example food miles. If a Devolved Administration implemented a policy, for example, that for environmental reasons they wanted to limit food miles – such that suppliers can only be located within a certain specified distance of the DA’s market, that could also be set aside for other firms in other parts of the UK on the non-discrimination argument.

In both cases, the redress would be “where it cannot reasonably be considered a necessary means of achieving a legitimate aim” (Weatherill 2021 p.6). However, how would it be possible to test, substantiate or prove this principle, given that it is based on a different set of political and social priorities than the pure functioning of the Internal Market? The OIM would be being drawn into discussions about issues on which it has no competence. On what basis would the internal market requirement override environmental considerations? Indeed, if the UK aims to prioritise net zero in its national policies, then the OIM could end up being torn between different narratives from the UK national government, not just Westminster and the Devolved Administrations, and would find itself in an impossible position, weakening or even undermining its legitimacy.

Current and Future Devolution in England

Each of these points above also apply to the emerging devolution agenda embedded in the current ‘Levelling Up’ narratives. For example, a City-Region Mayor (Andy Street, Dan Jarvis, Ben Houchen etc.) could decide that key priority is the technological upgrading of specifically local supply chains. These regions are heavily exposed to Brexit and many of the local supply chains lack the resilience to respond to the emerging shocks. For these reasons, they could require that suppliers to their local innovation policies or public interventions need to be both local and also of a certain quality threshold. Indeed, such local public procurement policies are becoming a cornerstone of many local innovation strategies. Moreover, the experimentation inherent in these locally-driven approaches are also intended nationally to provide learning opportunities for other localities, underpinning a UK-wide culture of governance experimentation, innovation and capacity-building. These policies could be challenged by third parties on the non-discrimination principle, thereby disincentivising local firms from responding to the innovation policies developed by the city regions and inhibiting local governance leaders from implementing such policies (Sargeant and Stojanovic 2021). Again, while the Internal Market Act (2020) allows for Westminster government to invest resources directly in local areas in order to promote local economic development, the internal market principles could work against the locally-designed and locally-driven priorities of Devolved City-region authorities.

Again, the problem is that the redress would be “where it cannot reasonably be considered a necessary means of achieving a legitimate aim” (Weatherill 2021 p.6). However, how would it

be possible to test, substantiate or prove this principle, given that it is based on a different set of political and social priorities than the pure functioning of the Internal Market – in this case the promotion of devolution aimed at enhancing innovative approaches to governance and policy? The OIM would be being drawn into discussions about issues on which it has no competence. On what basis would the internal market requirement override devolved decision-making considerations as a key part of the Levelling Up agenda? Indeed, if the UK aims to prioritise Levelling Up in its national policies (including a forthcoming White Paper), then the OIM could end up being in an impossible position torn between different narratives from the UK national government, regarding the relations between Westminster and City-Region governance within England.

This is not a hypothetical issue, and various different lines of localism thinking are now underpinning policy actions across the UK. The so-called ‘Preston Model’ (Preston City Council 2021; CLES 2019) is the most notable public policy example of this line of local-supply thinking, whereby local anchor institutions such as universities, hospitals etc. contract specifically and explicitly with local suppliers in order to develop local supply chains and to construct ‘community wealth building’ and social capital (CLES 2019). These principles have been adopted for over a decade in Manchester (CLES 2017) and are now being adopted in other local government areas, especially in economically weaker regions in the north and midlands of England. Many of these arguments and recommendations could work directly against the internal market non-discrimination principles.

However, this is not just an issue for the centre-left political arena. On the centre-right political arena, pages 22-27 of the Danny Kruger report to the Prime Minister (Kruger 2020) regarding the role of social covenants in ‘Levelling Up’ contain many of these lines of thinking regarding ‘social value’ and community empowerment of procurement decisions. Again, many of these arguments and recommendations could work directly against the internal market non-discrimination principles. If some of these Kruger recommendations become Government policy, and there is a strong chance that this will be the case, then the OIM could find itself having to advise on the balance of the provisions of the Public Services (Social Value Act) 2012¹ versus the internal market requirements, a topic on which it has no competence.

Indeed, these wider localism lines of thinking and acting also pervades the food and hospitality industry – the ‘locally sourced’ food agenda. Potentially, this could be against the non-discrimination principle, because even if theoretically all foods can be supplied anywhere, in reality, if local foods are chosen in preference over non-local foods for marketing/branding/image reasons, then while *de jure* it may be legal *de facto* in terms of the operation of the UK internal market it may not be. Again, the OIM could be drawn into advising on wider issues beyond simply the workings of the internal market, issues on which it has no real competence.

The final issue concerns the Shared Prosperity Fund, the replacement for the EU regional funding programmes. As yet, we know little or nothing about what this entails. However, while the Internal Market Act allows for direct investments by the Westminster government in local areas for reasons of enhancing local economic development, the issues outlined above all appear to work directly against the local innovation and capacity-building requirements which are essential if Levelling Up is to succeed. If Levelling Up is reduced simply to central government sending funds to where it desires according to centrally-planned policy schema,

¹ <https://www.legislation.gov.uk/ukpga/2012/3/enacted>

then Levelling Up will not happen. It would be a tragedy if the internal market provisions – which rightly are aimed at ensuring an efficient UK market system – also inadvertently end up undermining the wider aims of Levelling Up the UK economy. The UK-wide inefficiencies associated with interregional inequalities dwarf the inefficiencies associated with discrimination and non-discrimination principles.

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