Oxera 30 YEARS

Agenda
Advancing economics in business

Oxera and economics consultancy: a retrospective

Economic regulation, and the role that it created for economics consultancies such as Oxera, has changed considerably since the first UK privatisations in the 1980s. Professor Colin Mayer, one of Oxera's founding Directors, looks back at 30 years of economics consultancy and Oxera's place within it, and asks what lessons the past can teach us about future economic policy

Economics consultancy came to the fore in the UK and Europe during the 1980s and 1990s. The privatisation programme that Margaret Thatcher's government set in train, Big Bang,[1] and the reform of competition policy created a new demand for economics. Utility regulation, financial regulation and competition reviews were subjects which required economic techniques that had until then received little or no application outside of the USA.

At the same time, microeconomics was undergoing fundamental advances that provided forms of analyses which were previously unavailable. In particular, there were substantial developments in the application of industrial economics, corporate finance and econometrics. As a consequence of the simultaneous explosion of policy demands, theory and statistical tools, economics consultancy took off—and Oxera was in the right place at the right time.

Management consultancy was already well established, but what differentiated economics from management consultancy was the more technical and focused nature of its activities. Much of the early work was concerned with defining newly emerging frameworks of regulation for airports, electricity, gas, telecoms and water. It was a fascinating period because no one knew what was supposed to happen, how regulators were meant to undertake their functions, or how companies should respond to them. There was, therefore, the opportunity to define a whole area of public policy and corporate practice from scratch, and to work closely with companies, government and regulators in implementing it.

This presented two challenges. The first was to find people with the capabilities and interest in working in this newly emerging area. There were relatively few who were trained in the necessary fields of microeconomics, financial economics or econometrics, and even fewer who could combine these with knowledge of relevant sectors, companies and government policy. The ability to fuse policy and practice with academic skills was essential to the provision of advice that those working in companies and regulatory departments needed, but not many people could provide it. Since then, new postgraduate programmes in economics and finance have proliferated, and the constraint has, to some extent, been relaxed, but recruitment of first-class people who combine the relevant academic, practical and commercial skills remains a primary requirement of Oxera.


Professor Colin Mayer

A second issue that quickly emerged was the basis on which we were offering consultancy services. Companies, governments and regulators frequently employ consultants to support their negotiating positions. That tests the independence of consultants in terms of the objectivity of the advice that they provide. We determined from the outset that the basis on which we would provide advice was as independent consultants, not as advocates for companies, governments or regulators. We used the best economic techniques that were available to us to offer the most robust advice we could, and we told our clients the way we saw it—whether they liked it or not. In some cases, they did not, and they sought to persuade us to say otherwise, but over time Oxera has come to be respected for the independence of its thought, analysis and advice, and for being willing to tell our clients the way it is.

The academic base and links of the company have been critical in that respect, because academics fiercely defend their independence and objectivity, and inherently shy away from situations that conflict with them. The engagement of academics was a distinguishing feature of Oxera from the outset. We were fortunate in involving an outstanding group of academics in the fields of competition policy, finance and regulation to assist with leading and overseeing the work which we undertook. This has been extended recently to the establishment of an academic council, the Oxera Economics Council, which comprises leading economists from all over Europe to assist with identifying new areas of thinking and policy.

What has been the effect of the economic advice that Oxera and others have provided over 30 years? There are three areas that stand out. The first is the standard of practice. The UK is distinguished by the quality of its regulatory and competition policy work. It is no accident that, for nearly 20 years, the UK has been viewed as a model for utility regulation and competition policy, and its advice has been sought by companies, regulators and governments from around the world. Regulation and competition policy in the UK are, for the most part, carefully conceived and professionally executed, with an immense amount of attention given to the detail of implementation. That is a far cry from the highly politicised and pragmatic processes that often prevail elsewhere.

The second is the quality of people working in the field. We started from a position where the areas of utility regulation and competition policy were unknown, and have now reached a point where there are a large number of people working in companies, regulators and government with an immense amount of ability, knowledge and experience. Hopefully, through the training programmes that we have now been running for 20 years, Oxera has made some contribution to that transformation.

The third is persistence. Despite active and sometimes acrimonious debates, the UK system of regulation and competition policy has stood the test of time. There are endless discussions about the performance of utilities, but the type of fundamental questioning of the structure of regulation and competition policy that prevailed in the early days has, for the most part, faded.

There is one area where this is manifestly not the case and where there is more doubt and introspection now than at any time in the past: financial regulation. The UK system of financial regulation failed, and failed big time. Interestingly, economic analysis had less influence on the design of financial regulation than on other areas of regulation, but that does not exonerate it for what happened, or suggest that outcomes would have been different if it had had more influence.

What is interesting about the distinction between utility and financial regulation is the process by which they emerged. Utility regulation had to be designed from scratch. Financial regulation evolved gradually from practice and past policy in bank regulation, over a long period of time. It is only now, very late in the day, that a more fundamental consideration of the role, nature and scope of financial regulation is being undertaken.

The reason why the financial crisis that began in 2007–08 came as such a shock to so many, including economists, was that many of the problems it revealed had not been given any serious consideration. For example, the deficiencies of deposit insurance and its potential to undermine the solvency of countries had not received any attention. As a consequence, the last few years have seen policy-makers and academics scrabbling around to find explanations for what happened and to identify what needs to be done to put the deficiencies right. It has not been an endearing experience for those involved in it.

There are two lessons that should be learned from the crisis. The first is to avoid complacency. Financial regulation had become complacent and failed to undertake the necessary fundamental review that was needed. Utility regulation should avoid doing the same now. It has had a good run to date, but there are shocks in the offing—political, environmental and financial—and it should be prepared for them before they happen.

The second reflects the nature of the response to the financial crisis. The immediate response, apart from panic, was to jettison serious economic analysis and to adopt pragmatic, politically motivated solutions. In part, this was a consequence of the lacuna in serious economic advice that could be drawn on, but in part it reflected a completely misconceived perception that economic analysis was a luxury that could be forgone in the face of crisis.

That is dangerous and damaging. First, it means that policy is dominated, as we have seen over the last two years, by political wrangling which is the source of more heat than light. Second, the root and branch review that is required to reform the system is postponed still further. Third, as a consequence, there is no clear direction of travel to re-establish some semblance of stability.

The position is changing slowly as economists begin to undertake analyses that should have been done decades ago, but this has not yet been reflected in the way in which policy-makers and regulators are reforming the system. Intuition, rather than principles, still prevails, and intuition, in particular in the area of finance, is frequently wrong.

While, therefore, Oxera and the contribution of economics to policy and practice have both made remarkable strides over the last 30 years, there are still considerable risks, in particular of policy failures undermining the justification for rigorous economic analysis. Economics is not just a fair weather luxury, but also a stormy seas necessity. The contribution that it has to make now and in the future is still greater than that it has made to date, and it is important that those in positions of influence continue to recognise the role that it has to play.

Colin Mayer

Colin says: 'Dieter Helm very kindly invited me to join Oxera in 1986. My most memorable moment at Oxera was when it got its first major contract from North West Water (now United Utilities) at the beginning of the 1990s.'

30 years ago, Colin was trying to know more economics than the undergraduate students he was tutoring at St Anne's College, Oxford.

[1] Big Bang refers to the series of major changes made by the UK government in 1986 to the structure and operations of the London Stock Exchange.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Leonardo Mautino: tel +44 (0) 1865 253 000 or email l_mautino@oxera.com

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