Regulatory Independence, Investment and Political Interference: Evidence from the European Union

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Abstract

This paper examines the implications of “modern” regulatory governance - i.e. the inception of Independent Regulatory Authorities (IRAs) - for the investment decisions of a large sample of EU publicly traded regulated firms from 1994 to 2004. These firms provide massively consumed services, and this is why governments are highly sensitive to regulatory decisions and outcomes. We therefore analyse and empirically investigate if: i) the inception of IRAs reduces the time-inconsistency problems that lead regulated firms to underinvest, and ii) governments’ political orientation and residual state ownership interfere with investment decisions. To control for potential endogeneity of the key institutional variables, we draw our identification strategy from the political economy literature. Our results show that regulatory independence has a positive impact on regulated firms’ investment while private vs. state ownership is not significant. However we also find that government interference in the functioning of the IRA may re-introduce instability and uncertainty in the regulatory framework, thus undermining investment incentives.

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