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

Carlo Cambini[1]
Politecnico di Torino and European University Institute

Laura Rondi[2]
Politecnico di Torino and CERIS-CNR

June, 10th 2011

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.

JEL Classification: D92, K23, L33, L51, L90

Keywords: Regulatory Institutions; Firm Investment; Agency Independence; Partisan Politics, Private and State ownership

---

* We thank Marc Bourreau, Tomaso Duso, Philippe Gagnepain, Rachel Griffith, Klaus Gugler, Giuseppe Nicoletti, Marco Pagano, Alessandro Sembenelli, Carine Staropoli, Davide Vannoni and Andrea Vindigni, and seminar participants at the 8th IIOC Conference (Vancouver, 2010), the 37th Annual Conference of the EARIE, (Istanbul, 2010), CES – University of Paris I, OECD-Economic Department, CSEF–University of Naples, University of Trento, the 2nd Industrial Organization Workshop on Theory, Empirics and Experiments (Otranto), and at WZB-Humboldt University in Berlin for comments and suggestions. We are grateful to Bernardo Bortolotti and FEEM- Fondazione ENI Enrico Mattei for balance sheet, ownership and political institutions data and to Fabrizio Gilardi for regulatory data. We also gratefully acknowledge financial support from the Italian Ministry of Education (No. 20089PYFHY_004).

[1]: Politecnico di Torino, DISPEA, Corso Duca degli Abruzzi, 24, 10129 Torino, Italy. Tel: + 39-0115647292, Email: carlo.cambini@polito.it .

[2] *Corresponding Author:* Politecnico di Torino, DISPEA, Corso Duca degli Abruzzi, 24, 10129 Torino, Italy. Tel: +39-0115647232, Email: laura.rondi@polito.it , http://www.ceris.cnr.it/Rondi.htm