CIFREM SEMINARS

REGULATORY INTERDEPENDENCE, INVESTMENT AND POLITICAL INTERFERENCE: EVIDENCE FROM EU

with Carlo Cambini

LAURA RONDI

POLITECNICO TORINO

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Faculty of Economics
Via Inama, 5 – Trento

This paper examines the implications of “modern” regulatory governance - i.e. the creation of Independent Regulatory Authorities (IRAs) - for the capital 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 particularly sensitive to regulatory decisions and outcomes. We therefore analyze and empirically investigate i) whether the inception of IRAs may reduce the time-inconsistency problems undermining company investment, and ii) whether governments’ political orientation and residual state ownership interfere with investment decisions. We control for the potential endogeneity of the key institutional variables by drawing 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. The executive’s political orientation also matters, as company investment increases under more conservative and market-oriented governments, but the impact seems to reverse when the IRA is in place. Our evidence suggests that the interaction of politics with the functions of the IRA can undermine investment decisions whenever a formally independent regulator coexists with a strongly ideologically driven executive, as this is likely to introduce instability and uncertainty in the regulatory framework.