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THE DANGER OF NOT LISTENING TO FIRMS: GOVERNMENT RESPONSIVENESS AND THE GOAL OF REGULATORY COMPLIANCE

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ABSTRACT:

Firms in emerging economies exhibit dangerously low rates of compliance with government regulations aimed at protecting society from the negative externalities of their operations. This study builds on individual-level theories from organizational behavior (procedural justice) and political science (deliberative democracy) to develop new firm-level theory on the mechanism by which a firm is more likely to comply with a regulation after participating in its design by government. We hypothesize and find supporting evidence that such participation increases the likelihood of compliance by positively shaping the firm's view of government legitimacy, but only if the firm views government as responsive to its input. Without this responsiveness, regulatory compliance is even less likely than if the firm did not participate at all. Our empirical work is novel in its focus on the political activities of firms not only within the authoritarian-ruled emerging economy context of Vietnam, but also through study of a highly representative sample dominated by small and medium sized enterprises. We discuss how our work contributes to non-market strategy literatures on corporate social responsibility, self-regulation, and corporate political activity, as well as its implications for public policy.

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As with many high-profile industrial disasters in emerging economies, the deadly Rana Plaza collapse in Bangladesh in 2013 and Tianjin chemical explosion in China in 2015 were quickly followed by revelations of rampant non-compliance by firms with key government regulations.[1] Institutional theory indicates that such dangerous illegal behavior is more likely when firms believe the public does not see regulations as legitimate (Webb, Tihanyi, Ireland, & Sirmon, 2009). Looking to solve similar decoupling of formal rules and informal norms at the level of individuals, political science's deliberative democracy work and organizational behavior's procedural justice literature find that participation in the rule making process can be an effective strategy for increasing compliance by citizens (Fishkin, 1991; Verba, Nie, & Kim, 1978) and employees (Kim & Mauborgne, 1993; Moorman, Blakely, & Niehoff, 1998), respectively. But despite the compelling logic of these microfoundations, evidence on the benefits to society of large-scale, government-driven participation programs is mixed at best (Mansuri & Rao, 2012)—especially in emerging economies with more authoritarian governments (Tang, Wong, & Lau, 2008).

In this paper, we propose an important contingency to help explain these mixed results on how firm participation in the regulatory design process affects regulatory compliance: whether or not the participating firm sees government as responsive to its input. Critics of government-run participation programs argue that too often these programs are implemented as mere formalities and supported by advocates without sufficient consideration of politics and power (Cooke & Kothari, 2001; Turner & Weninger, 2005). Authoritarian governments, like China's, are explicit that their primary goal in implementing participation processes is to maintain control, not to yield

[1] For more on Rana Plaza, see Amy Kazmin (2013), "Bangladesh factory disasters highlight regulatory failures", Financial Times, Aug. 25, available at: http://www.ft.com/intl/cms/s/0/9a551ce8-adab-11e2-82b8-00144feabdc0.html#slide0. For more on the Tianjin explosion, see Stanley Lubman (2015), "The Tianjin explosions: A signal for reform", Wall Street Journal, Sept. 7, available at: http://blogs.wsj.com/chinarealtime/2015/09/07/the-tianjin-explosions-a-signal-for-reform/.

real influence to stakeholders. In fact, in China, public participation in drafting laws appears to be on the decline, despite increased opportunities to do so, and scholars suspect this is because of increased skepticism about whether government is actually paying attention (Stromseth, Malesky, & Gueorguiev, 2016). Such consequences are consistent with procedural justice work showing that consistently unmet expectations generate disappointment, as well decreased confidence and trust in authorities (Dirks & Ferrin, 2002; Morrison & Robinson, 1997; Robinson & Rousseau, 1994). As a result, we argue that society can suffer when government only pretends to listen.

The particular form of participation we examine in this paper is submission of comments by firms on draft versions of government regulations that aim to limit the negative effects of business operations on workers, communities, and the natural environment. Although evidence of their impact is limited (Cuéllar, 2005; McKay & Yackee, 2007; Yackee, 2006), such systems for participation have become a fundamental staple of recommendations on "good regulatory practices," especially for countries at relatively early stages in the development of rule of law (see, for example, APEC, 2014; OECD, 2012). We argue that providing comments on a draft regulation can make a firm more likely to view the rule making process as fair and government as a legitimate authority for determining how to best protect society. This greater government legitimacy, in turn, can make the firm see government regulations as more salient to its own legitimacy and consequently more likely to invest into being in compliance. Crucially, however, if the firm comes away from the participation process feeling ignored by government, it is less likely to see the regulatory design process as fair, and less likely to comply, than if it had not participated at all. This is the mechanism by which we argue that a half-hearted government consultation process can actually worsen the problem of regulatory non-compliance in emerging economies.

To be clear, our argument is not that participation influences compliance in emerging economies in a fundamentally different way than in advanced economies. Instead, our rationale for focusing on emerging economies is two-fold. First, as we discuss in the Background section that follows this Introduction, the "grand challenge" of regulatory non-compliance is far more urgent and the authority and capacity of government to address it through enforcement significantly weaker in emerging economies than in advanced economies. Second, as a result of these realities, there are likely to be far greater opportunities for participation programs to have larger effects in emerging economies than in advanced economies. This makes it more feasible for us to empirically identify and test the relationships of interest. Nevertheless, we still believe the insights of our study are relevant to theory on how firms and government interact across all institutional environments.

Our study proceeds as follows. First, we motivate our research agenda by describing the urgency and complexity of addressing the grand challenge of regulatory non-compliance in emerging economies. Second, we draw upon our two individual-level theories to develop a theoretical framework for how a firm's participation in the regulatory design process influences its own compliance behavior, and how the direction of this relationship is contingent on government's responsiveness to the firm's input. Third, we introduce relevant details of our empirical setting of corruption-riddled and authoritarian-ruled Vietnam, as well as of the unusual, large-scale firm-level survey we use for our empirical analysis. Fourth, we describe the results of the tests of our two main hypotheses, as well as additional tests that explore the underlying mechanisms and the robustness of our findings. Finally, we conclude by discussing the study's key contributions to theory on business-government relations, limitations, and policy implications.

BACKGROUND: A CHALLENGE OF FRIGHTENINGLY GRAND SCALE

> "[T]he ATM electrocution is a tragedy… But the real problem runs deeper: A corrupt system that isn't safeguarding its citizens or giving them enough voice in how society should be organized."
> – Mark Magnier, *Los Angeles Times*, 2010: A1.

Our work is inspired by the tragic story of 10-year-old Chau Linh Uyen. In March 2010, while horsing around with friends after a rainstorm, Uyen rested a hand on an ATM outside her Ho Chi Minh City (Vietnam) primary school. Because of terrible luck and the fact that the machine was not grounded in compliance with existing regulations, the little girl died instantly of electrocution. Police soon revealed that 14 percent of the city's 866 ATMs were not properly grounded and shut down 61 for regulatory non-compliance (Magnier, 2010). This was no isolated tragedy: accidental electrocutions in Vietnam number 400 to 500 per year, many due to regulatory lapses such as faulty wiring or improper weather insulation (VNS, 2009). Such installation and maintenance tasks are commonly contracted out by banks to small- and medium-sized enterprises (SMEs), so the challenge of protecting society is clearly not just one of regulating the behavior of elite firms.

As with more publicized cases involving multinational enterprises, little Uyen's story is symptomatic of a much larger struggle across emerging economies: the daunting task that governments face in trying to minimize the negative effects of firms on their communities. This challenge has grown in recent years with the shift away from state ownership in many emerging economies. While increasing efficiency, this has meant less direct government control over firm behavior and greater challenges in collecting taxes to fund increasing regulatory duties (Tran, 2016). Low per capita GDP levels also tend to reduce the weight that governments give the benefits of social protection relative to the potential costs of lost investment. Furthermore, low GDP is associated with lower government salaries and thereby problems attracting talent and motivating effort. These difficult conditions within the bureaucracy increase motivations for

corruption, which, in turn, drives firms to hide activities from the government (Friedman, Johnson, Kaufmann, & Zoido-Lobaton, 2000; Webb et al., 2009). Ultimately, rates of industrial accidents by country are negatively correlated with governance quality (Takala et al., 2014) and positively correlated with levels of corruption (Damania, Fredriksson, & Mani, 2004).

These observations are consistent with the argument that rules truly matter only if they are enforced (Greif, 1993; Ingram & Clay, 2000; Ostrom, 1990). But enforcement by what means? Although increased penalties can increase compliance (Andreoni, Harbaugh, & Vesterlund, 2003), penalties are usually too small to make compliance the dominant utility maximizing choice when the costs of compliance are substantial (Andreoni, Erard, & Feinstein, 1998). Furthermore, punishment is also costly for the enforcer and thereby hard for resource-constrained governments in emerging economies to effectively implement.

There is evidence that an emphasis on punishment can actually reduce government's moral authority, increasing the degree to which firms focus more on the appearance of compliance over more substantive compliance (Short & Toffel, 2010). Blatant and formalized decoupling of appearance from reality may be particularly dangerous in emerging economies, where government capacity for enforcement is limited. A common solution is for low-capacity regulators to focus limited resources on very public punishment of major infractions by large firms. These punishments are meant to serve as a warning to other large firms, but they also tend to underline the government's inability to keep up with enforcement of violations of less visible SMEs. In this context, government's legitimacy takes on heightened importance for influencing the compliance behavior of the vast majority of firms. As such, solutions focused primarily on enforcement are not likely to serve as constructive guides for emerging economy governments that aim to increase compliance by all types of firms.

Firms, Participation, and Regulatory Compliance

> "It is not always feasible to consult the whole people, either directly or indirectly, in the formation of the law; but it cannot be denied that, when such a measure is possible, the authority of the law is much augmented. This popular origin… contributes prodigiously to increase its power."
> – de Tocqueville (1838)

Theories underlying the motivation for consulting affected actors in the design of societal rules trace their roots back to the direct democracy of Ancient Athens. In political science's deliberative democracy literature, scholars have taken the mantle from Aristotle, Rousseau, and John Locke with continued work on the broad societal benefits of citizen participation in the design of laws and regulations. Meanwhile, in management research, a parallel theory on the benefits to organizations of including middle-level managers and other employees in the development of organizational rules and policies has been developed and tested under the heading of procedural justice. We draw on both of these individual-level theories to develop a firm-level theoretical framework of how participation in the government's design of business regulations affects that firm's subsequent regulatory compliance. In doing so, we follow a rich history of using micro-level theories to strengthen macro-level theory (Bitektine & Haack, 2015; Klein, Dansereau, & Hall, 1994; Zucker, 1977).[2]

The key insight we draw from our individual-level anchor theories is that, in both political and organizational contexts, people are more likely to see authorities and their rules as legitimate when they also perceive the rule-making process to be fair—and that participation in the rule-making process leads to such perceptions of fair process. Looking first at deliberative democracy,

[2] We use the term "individual-level", rather than the more common, but less precise "micro-level", to clarify that we are using theory on the behavior of people to build theory on the behavior of firms.

the argument is that "outcomes are legitimate to the extent they receive reflective assent through participation in authentic deliberation by all those subject to the decision in question" (Dryzek, 2000: p. 651). Scholars in this tradition emphasize the importance of participation being truly inclusive and broadly based (Fung & Wright, 2001). Deliberative democracy research has shown that participation by citizens in the shaping of government policies can produce more sympathy with opposing views (Fung, 2006), respect for evidence based reasoning (Verba et al., 1978), and, critically, a greater commitment and a higher probability of societal consensus around decisions made by government (Fishkin, He, Luskin, & Siu, 2010)n. It also allows for greater appreciation of the complexities and tradeoffs authorities face (Beierle & Cayford, 2002; Fearon, 1998; Thomas, 1995).

Political scientists have shown that related mechanisms can operate in authoritarian states as well, naming it "authoritarian deliberation" (He, 2006) and "consultative authoritarianism" (He & Warren, 2011; Truex, 2014). Building on the idea that the state can foster legitimacy for itself by convincing citizens that it is capable of improvement (Lipset, 1959), Nathan (2003) argues that the Chinese Communist Party has proven resilient due to its success in creating means for citizens to give formal voice to complaints. Truex (2014) finds evidence that the legitimizing benefits of participation are most salient among China's most politically marginalized citizens. All of this work helps to explain the fact that Chinese legislation has been significantly less likely to be amended when exposed to public comment, even controlling for importance and issue area of the document. In fact, consistent with a positive effect of participation on long-term public acceptance, no Chinese law requiring public comment has ever been repealed (Gueorguiev, 2013).

Organizational behavior's procedural justice stream supplements deliberative democracy with additional detail on the psychological mechanism and evidence of its relevance to the setting

of firms. A fundamental idea in procedural justice is that "experienced fairness matters more than expected utilities" (Makkai & Braithwaite, 1996: p. 83). Providing people voice in the making of rules appears to help achieve this sense of fairness even when the participation does not ultimately affect the substance of those rules (Thibaut & Walker, 1975). Perceived fairness of process allows people to accept the inevitable constraints that regulation places on personal liberties as a necessary means for achieving benefits, such as stability and predictability, for the group with which they associate themselves (Blader & Tyler, 2013). In an organizational setting, fairness of process also makes employees feel better about their job (Folger & Konovsky, 1989; Lind & Tyler, 1988) and more valued by their employer (Moorman et al., 1998). Researchers have found similar evidence of greater legitimacy accruing to authority through participation in the contexts of tax payment (Murphy, 2005), police-community relations (Mazerolle, Antrobus, Bennett, & Tyler, 2013; Sunshine & Tyler, 2003), and regulation of fishing (Kuperan & Sutinen, 1998; Sutinen, Gauvin, & Gordon, 1989). In sum, the literature indicates that participating in the making of rules can lead people to view those rules as more legitimately serving group-level interests.

This heightened legitimacy for authority makes people more likely to comply with rules. Because rule breaking within organizations tends to have less harsh consequences than illegal behavior, there is more empirical evidence in support of a link between the legitimacy of rules and compliance in the management literature than in political science. In organizational settings, increased compliance shows up as employees demonstrating greater commitment to organizational goals (Kim & Mauborgne, 1993; Korsgaard, Schweiger, & Sapienza, 1995; Moorman et al., 1998; Naumann & Bennett, 2000; Rhoades, Eisenberger, & Armeli, 2001), less willingness to quit their jobs (Rhoades et al., 2001), and a greater likelihood of reporting the wrongdoing of others

(Feldman & Lobel, 2008). Moorman et al. (1998) show evidence that participation ultimately makes people more likely to engage in constructive organizational citizenship behavior.

Our primary interest in this paper is the citizen-like behavior of firms, not individuals. Our individual-level anchor theories help us to build the microfoundations of a firm-level theory through what they show about the behavior of firm owners and top managers (henceforth entrepreneurs). Entrepreneurs are in position to critically shape both the participation and the compliance of their firms. Specifically, they not only personally represent their firms in government participation programs, but then also shape firm-level compliance behavior through: 1) their establishment of intent to either comply or not with government regulations; and 2) the actions they take to put in place top-down policies that translate intention into reality.

With regard to the first component of this mechanism, Tyler (1990) argued that people have an intrinsic desire to comply with rules. This desire forms an important basis for the explanatory powers of procedural justice. Related recent work pushes back on the tendency in the management literature to assume that entrepreneurs are always profit maximizing and argues that they are instead significantly influenced by issues of reciprocity in their relations with stakeholders that range from business partners to government and their local communities. This attention to reciprocity makes firms boundedly—rather than narrowly—self-interested and, as such, leads their behavior to be meaningfully influenced by non-pecuniary objectives, including contextually defined social values (Bosse & Phillips, 2016; Bosse, Phillips, & Harrison, 2009). Other scholars have offered a qualification to this thinking, arguing that family firms, in particular, follow a different institutional logic than the profit maximization logic followed by shareholder-driven public firms (Gomez-Mejia, Cruz, Berrone, & De Castro, 2011). They hold that family firms place

greater stress on nonfinancial goals (Zellweger, Nason, Nordqvist, & Brush, 2013) and "socioeconomic wealth" considerations (Berrone, Cruz, Gomez-Mejia, & Larraza-Kintana, 2010).

The second component of this participation-compliance mechanism, the translation of intent to comply into actual compliance, is probably also easier to carry out for SMEs than for elite corporations, given the latter's extensive layers of management. Scholars have shown, for example, that SMEs have structural advantages in implementing corporate social responsibility (CSR) policies (Baumann-Pauly, Wickert, Spence, & Scherer, 2013; Weaver, Trevino, & Cochran, 1999). This central role of entrepreneurs actually tends to extend to a broader range of firm sizes in emerging economies because of issues of social distrust that complicate the outsourcing of responsibilities to middle managers (Bloom, Eifert, Mahajan, McKenzie, & Roberts, 2013). Therefore, building off the extensive individual-level work in the deliberative democracy and procedural justice research streams, we hypothesize that a firm is more likely to comply with a regulation after participating in government's design process.

> *Hypothesis 1: A firm that participates in the regulatory design process is more likely to comply with the resulting regulation than a firm that does not participate at all.*

The Backlash Threat: Government Responsiveness to Participation in Regulatory Design

The legitimacy mechanism underlying Hypothesis 1 (H1) rests upon a simple but important assumption: participating firms must feel that the input they provide matters to government. In practice, however, government participation programs have been criticized as symbolic gestures that do not allow for meaningful influence over government policy decisions (Cooke & Kothari, 2001). Institutional theorists have argued that organizations can, under certain circumstances, improve their standing with external stakeholders through such empty gestures (Suchman, 1995; Westphal & Zajac, 1994). But when it comes to dealings with insiders, who can directly see

deviations between stated policies and actual reality, MacLean and Behnam (2010) show that such a façade can have the cost of institutionalizing non-compliance with other organizational policies. In our setting of business-government relations, government officials and the firms they regulate are all insiders. For government officials, the implication is that a symbolic participation program could lower adherence to other rules meant to enhance the quality of regulations, from their design to their enforcement. For firms, in turn, it seems only natural that their likelihood of regulatory compliance could fall with greater awareness of government itself not following its own laws.

There is ample psychological evidence that such disregard of firm participation by government could lead to a backlash that can do more than simply undo the positive participation-compliance relationship. Unmet expectations of fairness have been shown to violate expectations of reciprocity and result in efforts at reprisal that are of greater significance than the rewards offered in response to fairness (Fehr & Gächter, 2000; Henrich et al., 2010; Offerman, 2002). Procedural justice studies have similarly shown that consistently unmet expectations can generate a permanent sense of disappointment and anger, as well decreased public confidence and trust (Dirks & Ferrin, 2002; Morrison & Robinson, 1997; Robinson & Rousseau, 1994). Relatedly, Ariely, Kamenica, and Prelec (2008) show that people consider effort towards an unpleasant, tedious task far more costly if they are told that it will be ignored than if they are told it will be reviewed.

In our context of commenting by firms on draft regulations, we propose that firms are more likely to see the participation process as symbolic when their comment receives no response from government. Such a lack of government responsiveness engenders disappointment among entrepreneurs, who spend scarce time and energy analyzing a draft regulation and providing suggestions for improvement. A thus jilted entrepreneur could have a lower opinion of the fairness of government's regulatory design process than they would have if they had not participated at all.

This would then result in them holding a lower opinion of government's legitimacy as a regulator, and their firm would therefore be less likely to pursue compliance with the resulting regulation.

Hypothesis 2: A firm that participates in the regulatory design process, but sees government as unresponsive to that participation, is less likely to comply with the resulting regulation than a firm that does not participate at all.

DATA AND METHODS

Research Setting: Emerging Vietnam

Following the introduction of a new company law in 1999 that reduced entry barriers and signaled a shift in the country's economic reform program, Vietnam saw a nearly twenty-fold increase in registrations of new domestic private firms. New registrations between 2000 and 2014 numbered approximately a quarter of a million firms. Importantly for our theory, nearly all of these firms are classified as SMEs or even microenterprises. According to Vietnam's annual General Statistical Office Enterprise Census, 66 percent of these firms had ten employees or less and 82 percent had twenty or less (General Statistics Office, Multiple Years). Over the same period, Vietnam signed trade agreements with the US and the World Trade Organization that accelerated a process of rapidly building up a market-oriented regulatory framework from scratch that included significant importing and adapting of regulations from abroad (Gillespie, 2008).

Despite these significant reforms, as of 2016, Vietnam was still ruled by a single party, the Vietnamese Communist Party, and its government still ranked among the world's most corrupt.[3] State-owned enterprises (SOEs) still accounted for approximately one third of its economy and retained favored status in the country's 2013 Constitution (Malesky, 2014). Government policies

[3] See, for example, indices by Transparency International (https://www.transparency.org/country/#VNM), the World Economic Forum (http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/), and the World Bank (http://data.worldbank.org/data-catalog/worldwide-governance-indicators).

discriminated against domestic SMEs in favor not only of these SOEs, but also foreign investors and even a new class of politically connected domestic entrepreneurs. Local firms with government or military connections even got privileged access to bank credit, despite no evidence of superior performance (Malesky & Taussig, 2009). According to Gillespie (2008):

> "State control over public discourse favors the interests of business elites, while small-scale entrepreneurs struggle to make their views known. Lawmakers exposed to this asymmetric discourse rarely adjust global legal rules to suit the transactional requirements of small-scale entrepreneurs."

Vietnam's government appeared to be both ambivalent about the legitimate economic role of SMEs and vulnerable to regulatory capture. This, in turn, appeared to result in a reciprocal questioning of government's legitimacy by SMEs. This unhealthy dynamic was further exacerbated by the government's limited regulatory capacity and the fact that widely dispersed SMEs were more difficult to regulate than large firms that tended to be geographically concentrated. All of these features made Vietnam a fitting setting in which to examine the complex grand challenge of regulatory compliance in emerging economies.

Despite its authoritarian and nominally communist status, Vietnam's institutional setup also made the country a good fit for testing the effect of business participation in the design of new regulations. First, Vietnam's regulatory framework had many holes in terms of basic social protections, so significant further design of the regulatory framework was unavoidable. Second, and perhaps surprisingly to some, public participation in legal drafting had been used increasingly and strategically by the Vietnamese Communist Party, with the specific goal of generating legitimacy for, and information about, key policy changes (Gillespie, 2008; O'Rourke, 2004; Sidel, 2002). Constitutional revisions in 1992 (Thayer, 1992) and 2013 included well-publicized public feedback processes. In 2013, these comments were substantial, with one group using the online

forum to call for removal of Article IV, the clause that mandates Communist Party rule, from the constitution (Malesky & Morris-Jung, 2015).

Central to our study, in 1996, Vietnam's National Assembly adopted "The Law on the Promulgation of Legal Normative Documents," popularly known as the *Law on Laws* (LoL). The current (2008) version of the LoL contained a provision (Article 61) requiring that any government office charged with drafting a regulation must post the draft for public comment for a minimum of 60 days. The office must study the comments and file an internal report on why the comments were or were not accepted. Articles 33 and 34 laid out the format for facilitating participation:

> "Collection of comments and ideas as inputs for the development of the draft decree can be undertaken in the form of direct comments and suggestions, circulation of the draft decree for comments and suggestions, organizing consultation workshops, making use of websites of the Government and the lead drafting agency or mass media."

There was, however, significant distance between the *de jure* policies around participation in the regulatory design process and their *de facto* implementation in Vietnam. In fact, clear public frustration in Vietnam over lack of government acknowledgement of the deluge of comments it received on the draft constitution in 2013 served as an important inspiration to us for Hypothesis 2 (H2). Nevertheless, our data, described below, does document the occurrence of participation in Vietnam's regulatory design process, which enabled us to empirically implement our study.

Sample

All of our data came from the 2013 version of an annual survey carried out by the Vietnam Chamber of Commerce and Industry (VCCI). The survey is known as the Vietnam Provincial Competitiveness Index (PCI) survey.[4] It is mailed annually to domestic private firms in all 63 of

[4] See pcivietnam.org for more on the survey, which is funded by the U.S. Agency for International Development.

Vietnam's provinces, with stratification by province, industry, age, and legal form. In 2013, the response rate was 30 percent and the final sample size was 7,500 firms. Due to missing data, the sample in our main analyses consists of 5,633 firms. Crucially, the sample is highly representative of the size distribution of domestic private firms in Vietnam, meaning it is dominated by SMEs.[5]

We focus on the PCI's 2013 iteration for two reasons. First, we were fortunate that VCCI allowed us to run a participation module in the survey that year to document firm participation. Second, the 2013 PCI's release followed closely on the heels of public comments on Vietnam's new Labor Code, the advantages of which we detail in the description of our dependent variables.

Empirical Analysis Strategy

Our empirical analysis proceeds according to the following four steps. First, we address non-random selection into provision of public comments by using a variant of propensity score matching called entropy balancing. This method holds constant key confounders that might be associated with both our dependent and independent variables. Second, using weights generated by this procedure, we test H1 by regressing our measures of compliance with the Labor Code on indicators of business participation. Third, we test the backlash hypothesis (H2) by separating participation into that which received a government response and that which did not. Fourth, we use mediation analysis to unpack the mechanism behind the participation-compliance relationship and test how much of the positive effect of government responsiveness on regulatory compliance is mediated by firm perceptions of government legitimacy. Performing this final test necessitated

[5] Online Appendix A (See online appendices for this paper at: https://dataverse.harvard.edu/dataverse/emalesky) directly links each question that we use from the PCI with the variable that we use in our analysis. Furthermore, because these variables are drawn a single survey instrument, tests to ensure the relationships we uncover do not result from Common Method Variance (CMV) are presented in Online Appendix B (see online appendices for this paper at: https://dataverse.harvard.edu/dataverse/emalesky).

using factor analysis to construct a latent operationalization of legitimacy from several PCI survey questions. Results on these questions are discussed in annual PCI reports (VCCI, Multiple Years).

Dependent Variables

We operationalize our key outcome of interest, a firm's regulatory compliance, in four ways. Two measures—*Formal Labor* and *Compliance Scale*—are used in primary analysis and the two others serve as alternative constructs to test the sensitivity of our findings.

All four of these variables capture compliance with Vietnam's Labor Code (*10/2012/QH13*), which passed June 18, 2012 and went into effect on May 1, 2013, just two months before implementation of our survey. The Labor Code was subject to extensive participation by domestic firms and debate in the National Assembly.[6] Analysis of available data led us to believe it was the regulation most likely to be on the minds of firms when they sat down to participate in the survey.[7] Another advantage of the Labor Code for the purposes of our study is that it affected every firm in Vietnam and therefore represents a general measure of compliance. More fine-grained regulations would only apply to specific industries or types of firms.

Our main operationalization of regulatory compliance is *Formal Labor*, which is each firm's self-reported share of long-term employees with formal contracts. We focus on labor contracts within the Labor Code because it was subject to the greatest amount of public debate and represented a clear change over previous regulation. Article 18 of the new code makes clear that

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[6] For more on the Labor Code, see: http://www.lexology.com/library/detail.aspx?g=d414c255-0475-49b7-80d2-92bf8b585350.

[7] We make this claim based on evidence that it had the highest documented participation of any regulation in the past decade: the Labor Code's comment page on VCCI's VIBonline.com portal received 7,077 page views, compared to 3,859 for the next highest regulation, and 592 for the median regulation (This is based on web scraping of VIB online website for page views at http://www.vibonline.com.vn/Duthao/default.aspx). Additionally, a Google Trends analysis of the degree of interest in a key set of Vietnamese regulations during the time in question and further confirms the Labor Code's dominant position (See Online Appendix C for figure on the outcome of this Google Trends analysis at: https://dataverse.harvard.edu/dataverse/emalesky).

labor contracts are required and must be signed between the employer and the employee before starting long-term, full-time work. The requirement for contracts includes seasonal workers, for whom contracts were not required under earlier versions of the code. Article 19 adds that workers must be informed of working conditions and their duties and rights, before signing the contract. This avoids the situation where employers try to escape statutory obligations to workers, such as paying for their insurance.

The first row of Figure 1 illustrates the distribution of our primary dependent variable for regulatory compliance. Mean compliance across the sample is 72 percent, which could be interpreted as a relatively high number. This makes sense, as provision of a formal contract to all workers is a relatively low cost regulatory requirement. There are also benefits to the firm of compliance, in the form of a long-term orientation and greater commitment to the firm on the part of workers. Furthermore, unlike with many forms of compliance, the direct beneficiary, the employee, can easily monitor and directly pressure the firm on compliance. All of these are also reasons why we believe firms are more comfortable accurately reporting on their provision of formal contracts than on other measures of regulatory compliance.

Over the entire sample, about 56 percent of firms are fully compliant with 100 percent of workers under contract. Amongst the 46 percent that are to some degree non-compliant, four percent (240 firms) do not have a single one of their 2,830 employees under formal contract and about 15 percent have less than half their workers under formal contract. Furthermore, 21 percent did not answer the question at all, indicating sincere concern about revealing a lack of compliance.[8]

[8] In this paper, we do not present results correcting for missing data. Nevertheless, results based on imputing responses to the formal contracting question using advanced statistical procedures such as multiple imputation (implemented using the *STATA MI* function) reveal similar answers.

Overall, the relatively high level of compliance should make it harder for us to find an effect of participation on compliance.

Insert Figure 1 About Here

Figure 1 introduces two additional complications that we must account for in our analysis. First, according to the *LoL*, firms have a 180-day implementation period after the law goes into effect to alter their operations in compliance with a new law. In the case of the Labor Code, this date fell on October 31, 2013. Because the PCI research team mailed out the survey in several tranches between September and December of 2012, about 49 percent respondents received the survey in the last two months of the implementation period and 51 percent received it after the implementation period had expired.[9] Because the dates of the PCI mail-out are randomly assigned, there are no differences in key characteristics of firms (size, connections, business sector) between firms who received the survey early and late. Yet, it is clear that firms receiving the survey after October 31st faced a very different enforcement regime and were therefore more likely to be in compliance than those in the earlier period. We account for this in our analysis below by including a dummy variable for whether a firm received the survey before or after the implementation period, which allows us to hold constant the enforcement regime.

The heavy skew of *Formal Labor* toward full compliance poses a second complication. Methodologically, censoring at 100 percent could potentially bias OLS analysis, and standard errors are likely to be inefficient. Moreover, the measure risks introducing substantial noise into the estimation. Certainly, most respondents did not formally review and quantify their labor contracts before answering the survey, relying primarily on rapid educated guesses. Thus, it is not clear that

[9] Due to the capacity of local post offices, it is not possible to mail out all 8,000 PCI surveys at the same time.

the 10-point distinction between 60 and 70 percent of employees under contract is theoretically meaningful: both firms are only in partial compliance with law. To address this problem, we created a three-point scale, which scored a firm as non-compliant (0) if it had less than 50 percent of employees under contract, partially compliant (1) if it had between 50 and 99 percent of employees contracted; and fully compliant (2) if the firm had 100 percent of employees under contract. We complement our analysis of continuous compliance by checking the sensitivity of all models to an ordered probit (oprobit) analysis on this trichotomous scale.

Two alternative dependent variables help probe the robustness of our estimations. If we are right that participation was most likely to relate to the Labor Code, our theory would predict increased compliance not just on formal contracting but on other stipulations of the code as well. Article 50 provides such a measure by requiring that labor contracts are invalid if they prohibit workers from joining unions, which is a right guaranteed by Article 5. Thus, our third measure of compliance with the labor law, *Trade Union*, is based on PCI question E16 about whether employees of the firm have established a labor union to represent worker interests. Only 16.4 percent of the PCI sample has formal labor unions. Other firms either have no labor representative or rely on informal procedures. Low compliance on the union measure results from the fact that it places substantially more costs on the enterprise than labor contracting alone.

Our final dependent variable, *Recruitment Budget*, is a behavioral measure based on the assumption that complying firms should feel more constrained in their ability to replace workers. As a result, firms should invest more heavily in identifying and hiring workers for the long-term. To this end, we use the share of a firm's budget spent on labor recruitment. We take the natural log to normalize the distribution.

Independent Variables

We use three different variables to represent participation by firms in the drafting of new business regulations and the corresponding responsiveness of government to their comments (See Online Annex A for the wording of each survey question). *Participation* equals one if a firm contributed any comment on a draft piece of regulation to the government within the past year and equals zero if it did not. More than a fifth of firms in our sample (21.4%) reported doing so. Our second measure, *Participation with Government Response,* narrows down to those commenting firms whose comment received a formal government acknowledgement. Controlling for *Participation with Government Response* means *Participation* captures the variation in *Labor Contract* associated with unacknowledged participation and thereby allows us to test H2. According to firm responses, fully two-thirds of all commenting firms did receive responses (13.6% of the sample). Our third and final measure, *Effective Participation*, is a higher form of government responsiveness, in that the firm understands its comment to have contributed to altering the regulation. More than a third of commenting firms in our sample (7.6% of the sample) felt their input had made a real difference.

Control Variables

Fully specified models include provincial fixed effects to hold constant the location and local regulatory enforcement regime, two-digit sector fixed effects based on revision four of the United Nation's International Standard Industrial Classification (ISIC-Rev4), and a dummy variable for whether the firm was surveyed after the implementation period.

Confounding Variables

Several potential confounders could be associated with both participation and compliance, leading to omitted variable bias. Figure 2 illustrates this by showing the lower compliance of SMEs with the requirement to provide formal contracts to all employees. To address this threat, we include a number of variables in the entropy balancing procedure described in the Data Analysis section. *Employment Size* is an ordinal variable from one to eight representing the following categories of increasing value for each firm's total employees: less than five, five to nine, ten to 49, 50 to 199, 200 to 299, 300 to 499, 500 to 1,000, and more than 1,000. *Capital Size* is an ordinal variable from one to eight representing the following categories of increasing value for the firm's total equity capital in billions of Vietnamese dong (VND): less than 0.5, 0.5 to less than 1, 1 to less than 5, 5 to less than 10, to less than 50, 50 to less than 200, 200 to less than 500, and 500 and above. In line with our theoretical focus on SMEs, the vast majority of sample firms are small, averaging just over three on the eight-point labor and equity size scales. Most (82%) have fewer than 50 employees and 42 percent have less than 10. Similarly, 84 percent have less than VND 10 billion (US$476,000) in equity capital.

Insert Figure 2 About Here

The variables *State Ownership* and *Former SOE* are dummy variables that equal one if the government currently or formerly owns an equity stake in the firm. *Connected Owner* equals one if the firm owner was ever a government official, military officer, or manager of a state-owned enterprise. *Former Household Enterprise* equals one if the firm began operations before formally registering with the government as a company. We also account for the firm's legal form as a sole proprietorship, partnership, limited liability company, or joint stock company.

As it is well established that customers can put pressure on suppliers to comply with local labor regulations (Greenhill, Mosley, & Prakash, 2009; Mayer & Gereffi, 2010; Mosley, 2010), we include dummy variables to measure whether the firm's primary customers are foreign companies based in Vietnam, third-party buyers for indirect export, or direct export consumers.

Mediating Variables of Government Legitimacy

Although our study focuses on compliance with regulations designed at the national government level, we construct our measures of legitimacy measure using survey questions about perceptions of provincial, not national, government. This is because the primary interface between most firms in Vietnam and government authorities occurs at the provincial level. This is the level at which Vietnamese firms do their original registration and the level at which officials engage directly with them based on a combination of directions from their relevant national ministry bosses in Hanoi and their local bosses on the provincial People's Committee. For example, in a locality like Ho Chi Minh City, firms would engage directly with regulators from the city's Department of Labor, Invalids, and Social Affairs, who would determine their general approach to regulation within their jurisdiction based on a combination of formal instructions from the national Ministry of Labor, Invalids, and Social Affairs and from the city's leadership. Previous research has shown that there are significant differences in how provinces choose to carry out national policies that meaningfully impact how Vietnamese firms view the quality of their government (VCCI, Multiple Years).

With this in mind, we construct a latent measure representing firm perceptions of government legitimacy using the following indicators from the PCI survey. We use firm responses to three different survey questions to get closer to a proper proxy of firm views of government legitimacy. While none of these measures capture legitimacy perfectly on their own, together they

do capture an important piece of the concept. In sum, we separate perceptions of legitimacy into three components: 1) overall attitude of the authorities; 2) whether authorities abuse their positions; and 3) fairness in application of government rules.

Our first measure is *Government Attitude*, based on responses to the question: "*What do you perceive as the attitude of provincial government officials towards private business?"* This is a particularly relevant measure of firm perceptions of government legitimacy in Vietnam, given significant variance around the country in the degree to which local officials have embraced the country's transition away from full reliance on state-owned firms and official skepticism about private entrepreneurs. We expect that firms that rank government low on this measure will also have more questions about the legitimacy of government's authority in determining which non-state business activities harm society. Responses were given on a five-point scale ranging from 1 (Negative) to 5 (Positive). Half of firms (50.1%) chose the neutral category (3). Few ranked the government lower (6.3%), leading to an average score of 3.45.

Our second measure of legitimacy, *Regulatory Abuse*, is based on responses to whether entrepreneurs agree with the following statement: "*Government officials use compliance with regulations to extract informal fees from business."*[10] We see this as our best question for judging firm views of the legitimacy of government's regulatory authority, since seeing an association of regulations with bribe extraction is sure to signal skepticism that government is primarily concerned with protection of workers, communities, and the environment. Firms were asked to answer on a four-point scale ranging from 1 (Strongly Agree) to 4 (Strongly Disagree), meaning that a higher score implies a more positive evaluation of the intentions behind government regulation. Reflecting the substantial cynicism in our setting, nearly half of our sample agreed

[10] Informal fee (*chi phí không chính thức*) is the commonly used term for bribe in Vietnam.

(37.8%) or strongly agreed (5.5%) with this statement. The two variables measuring firms' views of government legitimacy are modestly correlated with one another (0.26).

Finally, *Fairness in Implementation* measures legitimacy based on responses to the following survey question: "*The attitude of the provincial government does not depend on the firm's contribution to local development (e.g. number of employees hired, amount of tax paid).*" This measure is intended to gauge the strong beliefs among private firms in Vietnam that connected and financially important firms receive special privileges in regard to regulatory treatment from officials. This tendency is captured in the sub-index of the PCI measuring Policy Bias Sub-Index. Among SMEs, there are strong beliefs that important firms are harassed less by regulators and are less likely to face fines. As such, this measure taps into a different conception of legitimacy, fairness, and equity of treatment under the law. Firms were again asked to answer on a four-point scale ranging from 1 (Strongly Agree) to 4 (Strongly Disagree). In analysis, we reversed the scale, so that a higher score implies a more positive evaluation of the intentions behind government regulation.

Table 1 presents the results of the factor analysis with varimax rotation. This procedure identified a single latent variable with eigen values above one. The three legitimacy variables load onto *Legitimacy*, which explains 56 percent of the variation in the variable grouping. Using a simple regression based prediction, we generate the variable and use it in our mediation analysis below. Correlation tables and summary statistics for all dependent, independent, and mediating variables are presented in Table 2 below.

Insert Table 1 & 2 About Here

DATA ANALYSIS

Entropy Balancing

Self-selection into participation and non-random selection of responses to comments by government officials raise concerns of bias in our analysis. The key threat can be seen in the first panel of Table 3, where we assess differences in confounding variables based on whether a firm provided a comment (shaded) or not (white). Commenting firms differ from non-commenting firms on a number of observable characteristics: they are slightly larger, more likely to have resulted from privatization or to still have state investment, more likely to have owners with political connections, and slightly more likely to sell goods to foreigners. Since these features are also theoretically correlated with compliance, not addressing their impact could bias results. Relatedly, it is possible that an unobserved factor is driving both the choice to participate and compliance with the downstream regulation. For instance, firms more afraid of punishment by authorities may try harder to influence the draft law and also pay more careful attention to abiding by the final version.

While not the experimental ideal, matching techniques have been proposed as one possible remedy to this selection problem (Dehejia & Wahba, 2002). In this section, we employ a variant of matching suggested by Hainmueller (2012) called entropy balancing (ebalance). Ebalance reweights observations to generate statistically a region of common support where commenting and non-commenting are comparable on structural covariates. Ebalance does this directly by incorporating covariate balance into the weight function that is applied to the sample units.[11] The

[11] Due to space constraints, we do not present additional ebalance tables, but analyses using the variables *Government Responsiveness* and *Effectiveness* of comments were re-run balancing on these variables specifically, rather than using the weights derived from balancing on *Participation*. Substantively, results are the same.

benefit over other propensity score matching approaches is that we do not need to shed observations and reduce statistical power.

To apply this technique, we impose a set of balance constraints, which imply that the covariate distributions of the treatment and control groups in the preprocessed data match exactly on all pre-specified observations. We take care to use only pre-treatment variables in the balancing equation. The entropy balancing algorithm then searches for the set of weights that satisfies the balance constraints but remains as close as possible to a set of uniform base weights to retain information. This recalibration technique assures maximum balance between the treatment and control groups (Hainmueller, 2012). After re-weighting, commenting firms and non-commenting systems match directly in terms of average value, variation and skew (see the second panel of Table 2). Another assumption of the technique is that, if the region of common support is large enough, our balancing on observable confounders reduces potential biases caused by unobservable confounders. Of course, balance on unobservables can never be fully verified.

The weights generated by ebalance were then employed in weighted regressions. For analyses using *Formal Labor*, we employ an Ordinary Least Squares (OLS) model to test our hypotheses. We cluster standard errors at the province level, the primary sampling unit for our survey. We use ordered probit and clustered standard errors for analyses using *Compliance Scale*.

Insert Table 3 About Here

Testing the Main Relationship between Participation and Compliance

Table 4 presents results of our analysis of H1. Models 1 through 4 investigate the straightforward effect of political participation on our main measure of regulatory compliance, *Formal Labor*. Model 1 begins with a stripped down regression including only our core independent variable,

Participation, and shows an initial correlation with compliance that is positive and weakly significant. When we use the ebalance weights in Model 2, however, the significance disappears and the coefficient effectively declines to zero. Subsequent regressions using provincial and industry fixed effects also show no significance. We observe the same pattern of null results in oprobit analyses using our compliance scale (Models 7-10). In short, there does not appear to be an independent relationship between just providing a comment and subsequent compliance.

Insert Table 4 About Here

Submission of a comment on a draft regulation does not account for government responsiveness. A firm may only feel it truly participated if it receives acknowledgement from government of its participation. Model 5 investigates this possibility by replacing *Participation* with our stricter definition of political participation, *Participation with Government Response*, in the fully-specified model, which uses ebalance, province, and industry fixed effects. In this case, the result is a coefficient that is highly significant (p=0.001). Interpreting this coefficient, all else equal, firms that commented on draft regulations and received acknowledgement of their comment from government had 3.2 percentage points higher share of workers with formal contracts than those that either did not comment at all or commented but did not receive a response. Results are similar in 6, where we replace *Participation with Government Response* with our strictest definition of responsiveness, *Effective Participation*. While slightly less significant, we observe the same positive relationship between responsiveness and compliance using our three-point scale in Models 11 and 12. Calculating, the marginal probabilities, we see that *Participation with Government Response* and *Effective Participation* increase the probability of full compliance by 1.6 percent and 3.0 percent respectively.

Testing the Backlash Hypothesis (H2)

We dig deeper into the differences in effect of our participation measures in Table 5. H2 holds that the degree to which a government is responsive to their ideas heavily influences the constructive effect of political participation by businesses on regulatory compliance, and that firms may reduce regulatory compliance if they feel the participation process is a mere formality. We test this hypothesis more directly in Models 1 and 2 of Table 5, where we return to *Participation* as our participation variable and constrain our sample to firms that did not receive a response to their comments from government, comparing them to firms that firms did not comment at all.

We observe the expected negative coefficient on *Participation*, which is statistically significant at the $p<0.05$ level. Firms that provided comments, but did not hear a response from government have ***lower*** compliance (3.5 percentage points) than firms that did not comment at all. Again, we observe a similarly signed and sizable coefficient in the oprobit analysis with the probability of full compliance declining by 7 percent.

In Models 3 and 5, we constrain our sample to include only firms that commented on a draft regulation and examine whether having received feedback from the government had an effect on the compliance of this subsample. Consistent with our earlier results, the coefficient on *Participation with Government Response* in Model 2 is highly significant ($p<0.01$) and substantively large. *Ceteris Paribus*, firms that received acknowledgement from government about their comment had a 5.6 percentage point higher share of workers with formal contracts than those who commented but did not receive a response. Again, results are robust to using our three-point scale as the dependent variable where the probability of full compliance increases by 6.5 percent.

Models 3 and 6 combine our variables for political participation. The results offer a refined depiction of the results described above. The coefficient on *Participation* is negative and highly

significant in both models. In interpreting this coefficient, it is important to understand that the presence of our other, stricter political participation variable, *Participation with Government Response*, within the same models means that the results on *Participation* specifically capture the variation in *Labor Contract* associated with public comments that did *not* receive any feedback from government. This is evident in the similarly sized coefficients to Models 1 and 4. The coefficient on *Received Response* remains positive, significant, and similarly sized to both Models 3 and 6. As with *Participation*, the size of its coefficient also remains consistent with its size in the subsample analysis.[12]

In Models 7 and 8, we substitute in our alternative dependent variables into the fully specified models to examine compliance with the Labor Code. Model 7 indicates that firms that received a government response were 14 percent more likely to have a trade union, in compliance with Article 50. In Model 8, we find that recipients of government responses spent nearly 20 percent more of their annual budget in the past year on labor recruitment, which we take to be behavioral indicator of compliance. We do not, however, find evidence for backlash in either model, as there is no indication that unanswered comments generated reduced compliance according to these two measures. In both cases, the coefficient on *Participation* is not statistically distinguishable from zero.

Insert Table 5 About Here

There are two key takeaways from the analyses presented in Table 5. First, while we do not find support for H1 using our most basic measure of participation, we find solid support for it once we recognize that government responsiveness to firm participation matters. Second, the negative

[12] Similar results are obtained if we replace *Received Response* with *Effectiveness*.

effect on regulatory compliance of comments unacknowledged by government, relative to firms that provided no comments at all, is consistent with our expectations in H2.

Disaggregation by Size

As we note in the Introduction, we expect our theory to have greater relevance for SMEs than for larger, politically connected firms. We directly test this implication by dividing our sample between firms with less than or equal to 200 employees and firms with over 200 employees. We then re-run all of the fully specified models from Table 5. Table 6 presents the results, which constitute strong support for our contention that participation and responsiveness have greater effect on the regulatory compliance of smaller firms. On our two primary measures of compliance, acknowledged comments matter only among SMEs. For larger firms, the effect is not significant and even has the incorrect sign. Thus, the inclusion of large firms in Table 5's Model 4 actually appears to have biased against us finding support for H2, our backlash hypothesis. A similar pattern is observed on the alternative recruitment measure, but not for the trade union measure.

Insert Table 6 About Here

Mediation Analysis

Finally, we test whether the influence on a firm's regulatory compliance of giving feedback during the regulatory design process is mediated by firm perception of the legitimacy of government (H2), using the mediation variables we constructed above. Given our results on H1, we focus our analysis on participation that was responded to by government. We employ the latent variable for legitimacy constructed by factor analysis above.

Following Preacher and Hayes (2008), we use a two-equation structural model to perform the mediation analysis and product of coefficients approach to calculate indirect and direct effects.[13] In the first regression, we regress *Legitimacy* on *Participation with Government Response*. The final equation regresses our compliance measure on the predicted Legitimacy measure from the previous equation alongside the original *Participation with Government Response* measure. Both equations adhere to our fully-specified models from previous analysis, which employ the ebalance weights to hold confounders constant, control for whether a firm received the survey after the implementation period, introduce province and sector fixed effects, and cluster standard errors at the province level.

1. $\text{Legitimacy}_i=\delta_0+\delta_1\text{GovResponse}_i+\delta_2\text{After}_i+p_i+s_i+u_i^{leg}$
2. $\text{Compliance}_i=\beta_0+\beta_1\text{Legitimacy}_i+\beta_2\text{GovResponse}_i+\beta_3\text{After}_i+p_i+s_i+\varepsilon_i$

Because we control for the original government response measure in the second equation, we can then reconstruct the direct effect of government response and the indirect effects mediated by legitimacy. According to Preacher and Hayes (2008), the direct effect of *Participation with Government Response* is β_3, while the indirect effect *Participation with Government Response* through *Legitimacy* is $(\delta_1 * \beta_1)$.[14]

Table 7 presents results of the mediation analysis. The shaded Panel 1 provides results using our continuous measure of compliance, while Panel 2 uses the three-point scale. Both panels follow a similar progression through the specifications. The first presents results of regressing our

[13] We implement using STATA's SEM command, following the procedures outlines in UCLA's Institute for Digital Research and Education http://www.ats.ucla.edu/stat/stata/faq/sem_mediation.htm/.
[14] We also employ the Imai et al. estimation approach, based on the potential outcomes framework as a robustness test. Implemented using STATA's *medeff* command (see Hicks and Tingley 2012).

mediator variables on government response (equations 1 above). The second model shows the indirect and direct effects of government response (equation 2).

Consistent with our theory, *Participation with Government Response* is a significant predictor of *Legitimacy* ($p<0.01$). Using the continuous scale, response to comments increases feelings of legitimacy by about a quarter of a standard deviation. In the second equation, we see evidence that *Participation with Government Response* has an insignificant but positive and strongly significant indirect effect mediated through legitimacy ($p<0.001$). The findings are similar whether we use the noisier continuous measure of formal labor or the three-point scale.

Insert Table 7 About Here

Table 8 calculates the quantities of interest derived from the analysis. We find that the total effect of government response to a firm comment is about 2.4 percentage points more contracted employees. Of this, 1.8 percentage points are achieved directly, while 29 percent (0.548) of the effect of government response is indirectly mediated by the *Legitimacy* mechanism. Studying the compliance scale, the effects are even stronger, accounting for 36 percent of the total effect of *Participation with Government Response*.

Insert Table 8 About Here

In sum, depending how compliance is measured, between 23 percent and 36 percent of the effect of *Participation with Government Response* is mediated by *Legitimacy*. Firms that receive a government response to their comments have more positive feelings about the attitude of government actors toward their business. This attitude appears to affect how those actors view the role of regulation, as these firms are less likely to view regulations as merely a way to extract

bribes from private businesses. As a result, firms are more likely to adhere to the principles articulated in the law through compliance.

Empirical Limitations

Empirical research on the regulatory compliance behavior by firms is difficult and rare. This is in large part because, naturally, firms resist such research. This is especially true if they are, in fact, acting illegally and face real costs if caught. As a result, our empirical work examines a version of regulatory compliance that, while relevant to all firms, is also particularly simple and low cost with regard to both actual investment requirements and risk of non-compliance penalties. Furthermore, by selecting a labor protection, we limit ourselves to testing the effect of participation on regulatory compliance relating to internal stakeholders. This means that some of the costs that arise from non-compliance are likely to have a direct effect on firm performance. This is likely to make it easier to convince firms to shift from non-compliance to compliance. We suspect that the internal costs will be lower and the externalities higher for regulations aimed at environmental protection, but see this as an important issue worthy of rigorous empirical testing.

We are also limited in our ability to concretely identify causal effects because we are working with observational, cross-sectional survey data.[15] The most obvious problem that results from this is non-random selection into the participation group and consequently unobserved heterogeneity among participating firms. Relatedly, our reliance on cross-sectional data means we cannot distinguish whether participation increased perceptions of government legitimacy or positive views of government made participation more likely. Previous work has demonstrated that less educated and poorer citizens face higher entry barriers, such as legal literacy, and opportunity

[15] As noted earlier, we explore the challenge of CMV in Online Appendix B (see online appendices for this paper at: https://dataverse.harvard.edu/dataverse/emalesky.

costs to political participation. In their review of participation around the world, Mansuri and Rao (2012) confirm that such programs are dominated by people who are wealthier, more educated, of higher social status, male, and more politically connected than nonparticipants. Not surprisingly, they find that the poor benefit less from participation, as resulting policies are biased in favor of participants. Our study minimizes this selection bias through our matching strategy, as well as by showing that the effect of participation on compliance is concentrated among SMEs. But, ultimately, carefully designed randomized experiments are necessary to fully eliminate such unobservable influences.

DISCUSSION

Can emerging economy societies benefit from more representative participation by firms in the design of government regulations? Our theoretical framework suggests an affirmative answer based on individual-level theories from political science and organizational behavior, which argue that consultative processes can increase an authority's legitimacy and people's willingness to follow its rules. But this answer is crucially dependent on government being seen by firms as responsive to their input. We argue that when participating firms feel government has acknowledged their perspective, they are more likely to see it as legitimate and therefore to invest in compliance with its regulations. But when government is not seen as responsive, there can be a backlash, whereby participating firms are less likely to comply than if they had not participated at all. We find support for our theory on the contingent role of government responsiveness to firm participation in analysis of an unusual, large-scale firm-level survey data on participation and compliance based on a representative sample of domestic private firms in transitioning, authoritarian-ruled Vietnam.

The Bounded Social Responsibility of Firms

A theoretical framework drawing on existing firm-level management research would paint a more mixed picture of the likely societal effects of increasing the involvement of firms in the political process of rule-making. This is because of significant variation in assumptions about the nature of firms across this work. On the one hand, the corporate political activity (CPA) literature frames business involvement in government policy making as strategic distortion of this process for private gain (Hillman & Hitt, 1999; Hillman, Keim, & Schuler, 2004; Pearce, De Castro, & Guillén, 2008). This framing also pervades non-market strategy work specifically focused on emerging economies (Marquis & Qian, 2013; Marquis & Raynard, 2015). On the other hand, management scholars also have argued that: firms can be paragons of social responsibility (Aupperle, Carroll, & Hatfield, 1985; Carroll, 1979; McGuire, Sundgren, & Schneeweis, 1988; McWilliams & Siegel, 2001); PPPs can facilitate the provision of vital services (Kivleniece & Quelin, 2012; Rangan, Samii, & Van Wassenhove, 2006; Roehrich, Lewis, & George, 2014); and society can even benefit from handing over control of certain government regulatory functions to industry (Christmann & Taylor, 2001; Scherer & Palazzo, 2007). In developing our theory, we take a middle road by conceiving of firms as embodying the boundedly self-interested perspectives of the entrepreneurs that lead them (Bosse & Phillips, 2016). We believe the result is a theoretical lens that is both more hopeful, with respect to broader society, than research on CPA and more realistic—in terms of thinking about the real interests of, and real impact on, the public—than has been the case for past work on CSR, PPP, and private self-regulation.

Our backlash hypothesis has particularly important implications regarding the sustainability of rules and institutions, whether they be in the realm of government regulation of firms or standards within networks of firms. If firms care about reciprocity and fairness, it is clear that

institutions can break down if authorities are seen to behave badly or to not take their responsibilities very seriously. In a similar vein to our analysis of government regulation, there is reason to believe that the behavior of industry associations or global buyers atop global value chains will have similar contingent roles in determining the success of the self-regulation arrangements that they lead. In this way, our work builds on the discussion in Ferraro, Etzion, and Gehman (2015) on the importance, difficulties, and costs involved in building "participation architecture" aimed at fostering sustainable engagement over time.

Bringing SMEs Back In

SMEs account for over 95 percent of firms in both the US and Europe (OECD, 2000) and significantly more in developing countries (ILO, 2015). Nevertheless, leading corporations are the dominant focus in research on business relations with government and society. CPA scholars, for example, typically analyze samples of publically listed firms or even just those in the Forbes 500 (Hillman et al., 2004; Lux, Crook, & Woehr, 2011). But our paper clearly establishes that business-government relations are not the exclusive purview of leading corporations. Similar approaches pervade research on non-market strategies in emerging economies (Marquis & Raynard, 2015), as well as the broader CSR, PPPs, and self-regulation literatures. The distortionary effects of this focus on big, successful firms are visible throughout the management field (Barkema, Chen, George, Luo, & Tsui, 2015; George, McGahan, & Prabhu, 2012).

SMEs are fundamentally different than elite firms. They are generally less likely to operate in oligopolistic industries wherein major rents can be won through small back room changes to policy. They also have less slack resources, so it is not realistic for them to substantially invest in bending government policy to their will. Instead, their activities must be more modest, with

relatively greater focus on enhancing survival rather than enhancing growth and success, compared to the case of leading corporations. Finally, SMEs tend not to be beholden to the same pressures to maximize shareholder profits and to be more socially embedded in their communities than their corporate counterparts (Castka, Balzarova, Bamber, & Sharp, 2004; Werner & Spence, 2004). These differences help to explain why SMEs' political activities could contribute more positively to the strengthening of government institutions and the competitiveness of markets than those of larger firms.

Furthermore, when we look more closely at SMEs, we see that they not only differ in important ways from larger firms, but they also differ importantly amongst one another. In particular, we see variation in whether firms choose to take up an opportunity to provide comments during the drafting of government regulations, whether they comply with government regulations, and—at the center of this study—whether the opportunity to participate in the regulatory design process influences the way they see government and thereby makes them more likely to invest in compliance. Such variation in behavior among members of a single organizational type is particularly relevant to institutional theory, wherein focus on a macro perspective has resulted in some neglect of organizational agency and discretion (Greenwood & Hinings, 1996; McPherson & Sauder, 2013). There appears to be significant room for further research on what firm characteristics make participation more likely and more impactful and why.

Using Individual-Level Theories to Develop Firm-level Theory on Organizational Legitimacy

Recent years have seen multiple calls for greater integration of micro level theories into firm level theories to help clarify key underlying mechanisms (Foss & Pedersen, 2014), including in institutional theory (Pache & Santos, 2010; Seo & Creed, 2002) and non-market strategy (Mellahi,

Frynas, Sun, & Siegel, 2015). Institutional theory distinguishes between two components of organizational legitimacy, which depend upon who is rendering the evaluative judgement. The first component (propriety) captures the assessment of the individual evaluator regarding the social acceptability of a firm's behavior. The second component (validity) is used to describe the collective consensus around legitimacy that is observed at a more macro level, such as a group or society. When a consensus has not been reached or contradictory views exist in society, individual actors reasonably fall back on their own "propriety" assessments. As Bitektine and Haack (2015), explain: "[i]n the absence of a perceived 'consensus' in the field, evaluators are less trusting of the contradictory validity cues they receive from the environment… and are therefore more likely to rely on their own independent propriety assessment (Bitektine & Haack, 2015: pg. 58)."

This increased importance of propriety assessments in the absence of social consensus means that individual entrepreneurs must often serve as their own guide as to the appropriate decisions for a firm to take. Since lack of consensus or contradictory views at the macro level are must likely in countries with nascent or weak government institutions, the increased salience of propriety assessments provides further support for our claim in the Introduction that the participation-compliance relationship is easier to examine in emerging economies. This is because, much as is the case for the frontier innovation space that is the focus of Webb et al. (2009), emerging economies are defined by institutional change and uncertainty. It is vital to recognize that in these settings where what is legal and what firms see as legitimate are not the same, firms and government are both simultaneously engaged in interrelated searches for how to maximize their own organizational legitimacy. When a firms sees government as unsuccessful in building up its legitimacy in society, it is likely to look to other institutional sources for the legitimization it needs.

The theory we develop in this paper sheds increased light on the mechanism by which firms make their independent propriety assessments regarding government regulation by moving down yet another level from that of the firm to that of the entrepreneur. Together, our two individual-level anchor theories, deliberative democracy and procedural justice, contribute to institutional theory the idea that assessments of government by entrepreneur-led firms can be influenced by direct experience with government during the regulatory design process. By bringing attention to the importance of these experiences, it becomes clear that assessments of government legitimacy can be crucially shaped by the way in which entrepreneurs view government behavior within these interactions. This allows us to also contribute to a nascent stream within institutional theory on how firm behavior is dependent on both decisions of institutional actors and the nature of direct interactions between firms and those external actors (Crilly, Zollo, & Hansen, 2012).

It is worth noting that our focus in this study on firms responding to institutional voids in emerging economies with socially irresponsible behavior contrasts with previous work on more constructive firm responses (Fisman & Khanna, 2004; Mair, Martí, & Ventresca, 2012). Further to this point, there has been limited work to date in the management literature on how firms and government can both contribute to the unravelling of institutions. In fact, our backlash hypothesis contrasts substantially with the stronger form of work on procedural justice, which implies that—by allowing actors to let off steam—providing voice without influence may be enough.

Theoretical Limitations and Future Research

Our study's main theoretical limitation is that, in practice, the costs to society (via government) of soliciting participation and responding to firms may outweigh the societal benefits of greater compliance. Our approach in this paper suggests that the ideal government system would involve canvassing the opinion of every single firm for which a particular draft regulation is relevant, and

then responding faithfully to every firm's suggestion. Given pre-existing cynicism towards government, this would probably require significant outreach work. Furthermore, the volume of work involved in constructively responding to all participants would threaten to paralyze already greatly strained emerging economy government bureaucracies. Simply put, a full-fledged consultation and response system, like the one implied by our empirical design, may not be feasible.

Focusing on the direct benefits of participation for participants is a good first cut to identify the theoretical mechanism, but future work must consider how to construct optimal government policy. We believe this avenue of research is promising, because of the potential for spillover benefits, whereby a firm's likelihood of compliance might increase through awareness of participation by similarly situated firms. The driving hypothesis would be that government could reap legitimizing benefits from consultation of only a representative sample of firms. In short, there may be benefits to indirect participation. Future research in the area of the benefits of indirect participation will also help policy makers better understand the degree of resources they should dedicate to participation programs.

Research on strategies for firm engagement and government response through different low cost participation platforms, such as online comment systems and workshops, will also be useful. In the United States, for example, the government tends to conclude the regulatory design process by publicly posting an aggregated report that aims to address all major views, rather than with individualized reports. Through interviews with a range of commenters on food safety regulations, Larson (2011) finds that this may be sufficient for government to be seen as responsive. There is also potential for cost savings by entering into partnerships with, and leveraging the resources of, non-governmental organizations (NGOs) that have already developed strong legitimacy in local

communities in areas relevant to new draft regulations. This would relate to a nascent stream of research on the role of intermediaries in multi-stakeholder regulation (Mena & Palazzo, 2012).

The theoretical argument in this paper is also limited to just one mechanism, legitimacy, by which participation may influence compliance.[16] A particularly important alternative that we do not explore either theoretically or empirically is the possibility that participation can affect compliance by changing the actual substance of regulations. While it did not appear to have been the case for the Labor Code in Vietnam studied in this paper, there is evidence that public comments can shape the substance of regulations (Cuéllar, 2005; McKay & Yackee, 2007; Yackee, 2006). There are two main ways in which such change could influence compliance. First, and most positively for society, participation can help better inform the designers of regulations on the full range of realities across factory floors, resulting in better conceived laws that achieve social protection goals in more efficient ways. Second, and more in line with the negative social impact associations of participation in the CPA literature, it can lead to a watering down of regulations. Our expectation is that the additional information provided to government regulators by a broader based, representative sample of firms should help more than it hurts, but this does involve an assumption about the competence and good intentions of government. As such, exploring the conditions under which participation either positively or negatively influences the quality of government regulations is a great area for future research.

We are also unable to address the degree to which the social benefits of the relatively modest participation method of providing comments on draft regulations are sustainable. Formal government participation programs are clearly very difficult to implement and are always

[16] Earlier versions of this paper did explore an alternative mechanism: participation may increase compliance by increasing the degree to which firms are aware of and understand regulations. We, however, did not find any evidence consistent with such a mechanism. For more on this, see Online Appendix D (all of our online appendices for this paper are at: https://dataverse.harvard.edu/dataverse/emalesky.

vulnerable to capture by organized and strategically acting interest groups (Turner & Weninger, 2005). Such interest groups include not only big business, with all of its slack resources, but also bureaucrats and leading politicians within government. The outcome of efforts by almost all of these groups is most likely to show up in terms of reduced government responsiveness within any government participation program. There is also reason to believe that sustainable gains in levels of regulatory compliance through participation in the regulatory design process eventually require transition to a deeper inclusion with regard to influence over actual regulatory content. As we note in the Introduction, participation programs appear to no longer have much impact in China. This is, of course, consistent with our argument and empirical findings regarding the importance of government acknowledgement of participation, but involves a dynamic time dimension that we are unable to explore in the current study.

A final area of research that we think can build on our work and improve on its shortcomings relates to the unfortunate reality that many emerging economy governments will respond to the challenges of implementing effective participation programs with inaction. This reality has already spawned a great deal of interest in management in the potential of global regulatory systems, created and managed by multinational enterprises and other non-governmental stakeholder organizations (Christmann & Taylor, 2001; Scherer, Palazzo, & Matten, 2014). Motivations range from the desire to reduce vulnerability to punishment by key stakeholders to a desire to be a driver of change that makes the world a better place (Büthe, 2010; Ferraro et al., 2015; King & Lenox, 2000).

Unfortunately, evidence to date on the effectiveness of such private regulation strategies in constraining firms and protecting society is limited in both emerging economies (Graham & Woods, 2006) and advanced economies (Barnett & King, 2008; King & Lenox, 2000). Short and

Toffel (2010) show that firms are most likely to follow through on their own self-regulation policies under the watchful eye of a high capacity state, which clearly does not bode well for application in emerging economies. Furthermore, firms connected to global production networks constitute a relatively small, elite, and actually shrinking share of firms in emerging economies (Gereffi, Regini, & Sabel, 2013). Nevertheless, it is surely worthwhile—given the urgency of the dangers to society—to simultaneously explore and promote means for improving both host country government and overlapping global private regulatory systems.

We hope to see research on whether the procedural justice-based mechanism of participation, legitimacy, and compliance that we explore in this study could be transferred to the context of global value chains. In particular, we imagine this mechanism to be relevant to relations between powerful global buyers like Nike and IKEA and their emerging economy suppliers, as well as powerful global consumer goods multinational enterprises (MNEs) like Unilever and their emerging economy retailers. In both types of cases, the MNEs are today facing significant pressures and threats from their key stakeholders in advanced economies to ensure that their business partners live up to much higher standards of social acceptability than are the norm in most emerging economies. But, despite their vast resources, these MNEs still encounter significant challenges when seeking to enforce consistent compliance from the firms they work with in emerging economies. In fact, even more so than emerging economy governments seeking legitimacy as authorities on what is socially acceptable in the host country, the MNEs face the additional challenge of getting firms to accede to standards that were conceived in foreign and far more economically developed countries. As such, the benefits and challenges of participatory rule design may be even greater in this setting.

Concluding Policy Implications

This study does not offer a simple path to eliminating the scourge of regulatory non-compliance by firms in emerging economies. Broader participation by firms in government's regulatory design process alone will not be successful. Its potential to contribute constructively to improving a dire situation hinges critically on the responsiveness of government agencies faced with severe resource constraints. Among people who have substantial real world experience in this realm, there is understandably great skepticism about the prospects for bureaucrats to take such positive action. As such, it is crucial to clearly recognize that translating the theorized mechanism we develop in this study into implementable public policy is no small task. It is in this context, that we believe that the core public policy takeaway from our study is that an ambitious, but still realistic goal is for governments in resource-constrained emerging economies to be "administratively weak, but normatively strong" (Dobbin & Sutton, 1998: p. 441). That is, as emerging economies lack sufficient enforcement capacity, they must follow a set of practices that cultivate legitimacy among their stakeholders in order to achieve regulatory compliance.

Flowing out of our study, we see three main components of a successful path forward for participation and regulatory design programs in emerging economies. First, it is critical that emerging economy governments recognize the critical importance of regulating, and therefore also consulting all types of firms, not just the largest. As noted, a practical approach will certainly require some form of representative consultation. Second, governments must invest into genuinely and systematically listening to firms. The ultimate goal is movement towards a sense among members of the business community that government respects the challenges they face and is seriously weighing their interests as it does its job of clarifying and enforcing broadly supported and well informed social protections. Third, governments must build more participatory regulatory

design processes in a very modest and deliberate manner that assiduously avoids overreach. We see a pairing of policy experimentation and rigorous policy evaluation as central to this final component. This clearly represents a chance for our community to contribute.

We also see three core threats to the prospects of government participation programs fulfilling their promise for increasing the social responsibility of business in emerging economies. First is the danger that any new government program is vulnerable to, and so must guard against, capture by organized and well-resourced interest groups. Second is the danger of poor and unstable leadership and more generalized incompetence in emerging economy governments characterized by weak institutions and limited resources. Third and finally, there is the danger of intransigent cynicism among firms about the nature and capacity of government in countries where corruption and regulatory capture have long been the norm. Here again there is a role for scholarship to work with willing governments and other stakeholders to build evidence of what really works.

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Figure 1: Distribution of Key Dependent Variables

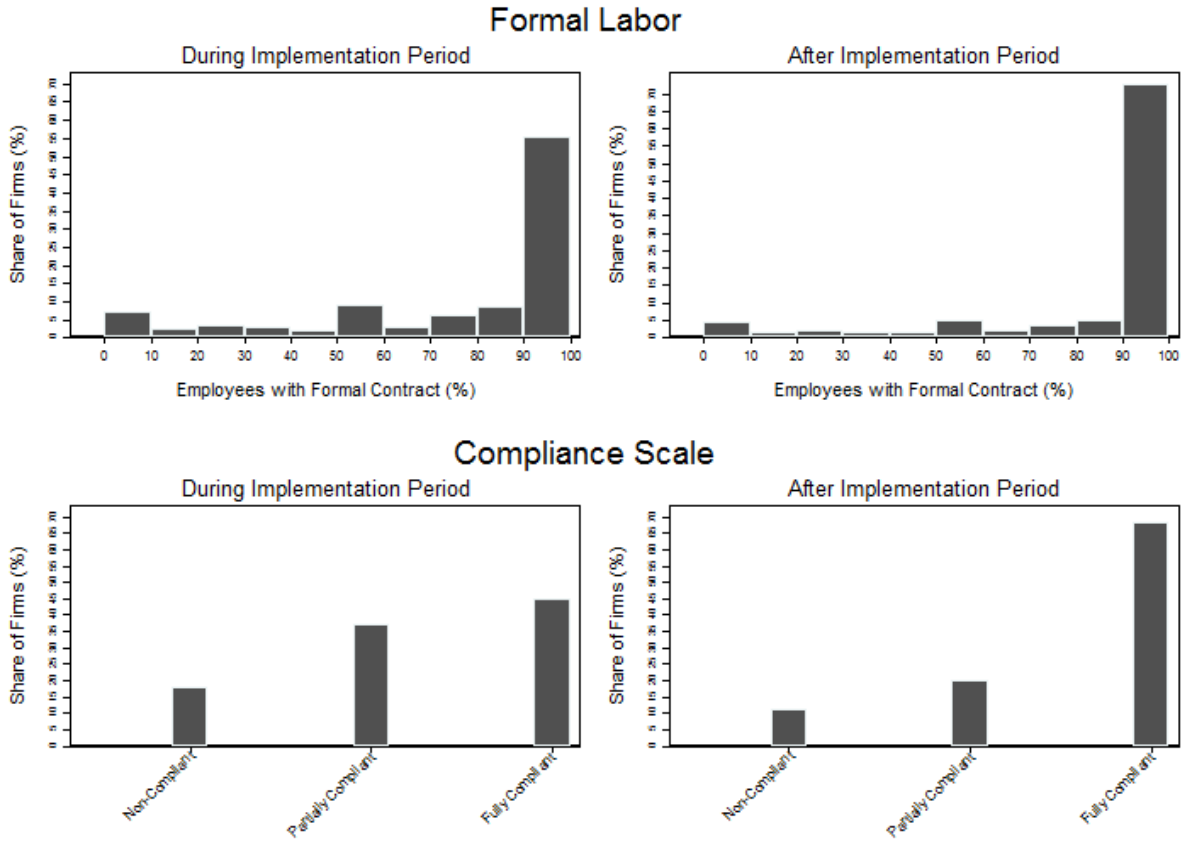

Figure 2: Compliance by Firm Size

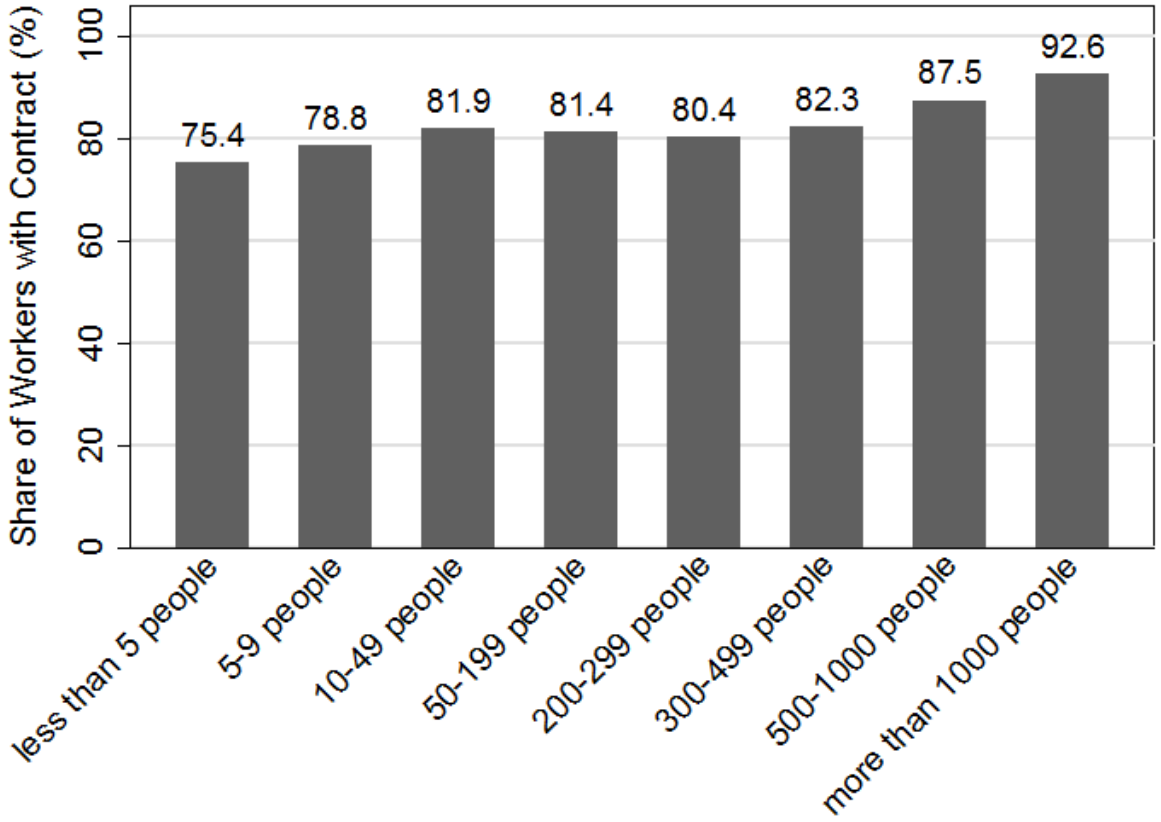

Table 1: Factor Analysis to Generate Mediating Variable

Indicators	Mean	SD	Min	Max	Factor1 (Legitimacy)	Uniqueness
Gov't attitude toward private sector	3.46	0.83	1	5	0.722	0.479
Gov't officials use regulations to extract bribes	2.58	0.67	1	4	0.731	0.466
Gov't attitude doesn't depend on contribution	2.70	0.64	1	4	0.788	0.379
Eigenvalue					1.676	
Variance Explained					0.560	
Mean					0.000	
SD					1.000	
Min					-3.561	
Max					2.691	

The table presents the rotated factor loadings (pattern matrix) and unique variances from a factor analysis using a varimax rotation procedure. Three variables were used which load on to one unique factor (based on eigenvalues>1), which corresponds to our theoretical distinction of legitimacy. Shading highlights which variables are correlated with the underlying factors.

Table 2: Correlations and Descriptive Statistics

Variable		1	2	3	4	5	6	7	8	L1	L2	L3	N	Mean	Std. Dev.	Min	Max
1	Formal Labor (%)	1.00											5633	80.30	30.41	0.00	100.00
2	Compliance Scale (0-2)	0.92*	1.00										5633	1.43	0.73	0.00	2.00
3	Trade Union=1	0.12*	0.04*	1.00									5633	0.19	0.39	0.00	1.00
4	Budget Spent on Recruitment (%, ln)	-0.12*	-0.17*	0.05*	1.00								4578	0.53	0.89	0.00	4.62
5	Provided Comment	0.01	-0.03*	0.20*	0.07*	1.00							5633	0.21	0.41	0.00	1.00
6	Government Responded	0.03*	-0.01	0.20*	0.08*	0.76*	1.00						5633	0.14	0.34	0.00	1.00
7	Comment Used in Revision	0.03*	0.00	0.16*	0.06*	0.55*	0.69*	1.00					5633	0.08	0.26	0.00	1.00
8	Factor 1: Legitimacy	0.10*	0.14*	-0.05*	-0.18*	-0.01	0.04*	0.07*	1.00				4731	-0.05	0.98	0.56	2.69
L1	*Gov't attitude toward private sector*	0.11*	0.12*	0.01	-0.08*	0.02	0.07*	0.09*	0.72*	1.00			5444	3.45	0.81	1.00	5.00
L2	*Gov't officials use regulations to extract bribes*	0.08*	0.11*	-0.08*	-0.20*	-0.05*	-0.01	0.01	0.72*	0.26*	1.00		5071	2.55	0.66	1.00	4.00
L3	*Gov't attitude doesn't depend on contribution*	0.05*	0.10*	-0.05*	-0.13*	-0.01	0.03	0.04*	0.79*	0.34*	0.36*	1.00	5280	2.66	0.63	1.00	4.00

*** p<0.01, ** p<0.05, t p<0.1.

Table 3: Matching Commenting and Non-Commenting Firms

	1. Before Entropy Balancing					
	Treatment (Participation)			Control (Did Not Comment)		
Confounder	**Mean**	**Variance**	**Skew**	**Mean**	**Variance**	**Skew**
Employment Size Scale (1-8)	3.11	1.93	1.05	2.57	1.18	0.73
Equity Size Scale (1-8)	3.58	2.16	0.39	3.05	1.45	0.49
State Owns Shares=1	5.9%	0.06	3.74	1.5%	0.01	7.95
Equitized State Owned Enterprises=1	12.0%	0.11	2.35	4.0%	0.04	4.69
Owner w/Gov. Connections =1	24.7%	0.19	1.18	11.0%	0.10	2.50
Former Household Enterprise=1	47.2%	0.25	0.11	54.2%	0.25	-0.17
Partnership=1	0.4%	0.00	16.17	0.1%	0.00	36.81
Limited Liability Co.=1	48.7%	0.25	0.05	54.2%	0.25	-0.17
Joint Stock Company =1	27.9%	0.20	0.98	18.7%	0.15	1.61
Other Company Form=1	0.3%	0.00	18.10	0.1%	0.00	27.81
Main Customer is Foreign Company=1	8.5%	0.08	2.97	6.6%	0.06	3.51
Direct Exporter=1	6.9%	0.06	3.41	3.6%	0.03	4.98
Indirect Exporter=1	3.9%	0.04	4.74	2.1%	0.02	6.68
	2. After Entropy Balancing					
Confounder	**Mean**	**Variance**	**Skew**	**Mean**	**Variance**	**Skew**
Employment Size Scale (1-8)	3.11	1.93	1.05	3.11	1.89	1.07
Equity Size Scale (1-8)	3.58	2.16	0.39	3.57	1.90	0.51
State Owns Shares=1	5.9%	0.06	3.74	5.9%	0.06	3.75
Equitized State Owned Enterprises=1	12.0%	0.11	2.35	11.9%	0.11	2.35
Owner w/Gov. Connections =1	24.7%	0.19	1.18	24.6%	0.19	1.18
Former Household Enterprise=1	47.2%	0.25	0.11	47.2%	0.25	0.11
Partnership=1	0.4%	0.00	16.17	0.4%	0.00	16.18
Limited Liability Co.=1	48.7%	0.25	0.05	48.7%	0.25	0.05
Joint Stock Company =1	27.9%	0.20	0.98	27.9%	0.20	0.99
Other Company Form=1	0.3%	0.00	18.10	0.3%	0.00	18.11
Main Customer is Foreign Company=1	8.5%	0.08	2.97	8.5%	0.08	2.97
Direct Exporter=1	6.9%	0.06	3.41	6.9%	0.06	3.41
Indirect Exporter=1	3.9%	0.04	4.74	3.9%	0.04	4.74

This table describes the Entropy Balancing Procedure (Hainmueller 2012) to address observed differences between firms that provided comments and those that did not. The first panel shows mean, variance, and skew between commenting firms and control firms before balancing. The second panel shows the same statistics afterwards. The second panel demonstrates much more balance on confounders.

Table 4: Correlation between Providing Comments on Draft Regulation and Compliance

	1. Formal Labor (%)						2. Compliance Scale (0-2)					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Participation	1.687ŧ	-0.351	0.077	0.057			-0.058	-0.071*	-0.057	-0.061		
	(0.922)	(0.968)	(0.964)	(0.956)			(0.037)	(0.041)	(0.042)	(0.042)		
Participation with Government Response					3.195***						0.092ŧ	
					(1.099)						(0.049)	
Effective Participation						3.739***						0.109**
						(1.339)						(0.043)
After Implementation Period	9.634***	6.529***	5.890***	6.030***	6.189***	6.271***	0.507***	0.420***	0.415***	0.416***	0.421***	0.424***
	(0.791)	(0.977)	(1.036)	(1.046)	(1.049)	(1.052)	(0.031)	(0.043)	(0.045)	(0.046)	(0.046)	(0.034)
Constant/Cut Point 1	74.613***	78.353***	78.433***	76.226***	75.425***	75.621***	-0.843***	-0.993***	-1.058***	-1.069***	-1.038***	-1.039***
	(0.651)	(0.750)	(0.773)	(2.911)	(2.886)	(2.909)	(0.026)	(0.035)	(0.124)	(0.168)	(0.170)	(0.132)
Cut Point 2							0.063***	0.053	0.024	0.033	0.065	0.064
							(0.024)	(0.034)	(0.124)	(0.168)	(0.169)	(0.131)
Ebalance	No	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Province FE	No	No	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes	Yes
Sector FE	No	No	No	Yes	Yes	Yes	No	No	No	Yes	Yes	Yes
Observations	6,012	5,585	5,585	5,550	5,550	5,550	6,012	5,585	5,585	5,550	5,550	5,550
Provinces	63	63	63	63	63	63	63	63	63	63	63	63
R-squared	0.025	0.013	0.060	0.084	0.086	0.086						
RMSE	30.39	28.47	27.93	27.65	27.61	27.61						
Log Likelihood	-29055	-26626	-26488	-26257	-26249	-26250	-5623	-5286	-5151	-5041	-5040	-5040

The table is divided into two panels with different constructions of our dependent variable. Panel 1 uses the share of workers with formal contracts and employs OLS. Panel 2 uses a three point scale of (0: Non-Compliant; 1) Partially Compliant; 2) Fully Compliant) and utilizes an ordered probit (oprobit) procedure. Robust standard errors are in parentheses in both models (*** p<0.01, ** p<0.05, ŧ p<0.1); Each panel shows six models. The first model (1 & 5) provides the unadjusted bivariate correlation. The second model (2&6) presents estimates using the Hainmueller (2012) entropy balancing procedure to address confounding variables. The third model (3&7) adds provincial fixed effects to deal with the fact that firms are nested within in different regulatory jurisdictions. The fourth model (4&8) employs two-digit ISIC sector fixed effects. Models 5, 6, 7 & 8 use the same full specification as the previous model, but replace the key causal variable (Participation) with government responded and comment used in revision respectively.

Table 5: Testing the Backlash Hypothesis 2 (Does the Government Need to Respond to Firms Comments to Motivate Compliance?)

	1. Formal Labor (%)			2. Compliance Scale			3. Alternative DVs	
Dependent Variable	**No Response**	**Only Comments**	**Joint**	**No Response**	**Only Comments**	**Joint**	**Trade Union**	**Recruitment Budget**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Participation	-3.461**		-3.524**	-0.211***		-0.213***	0.012	-0.015
	(1.475)		(1.478)	(0.061)		(0.061)	(0.020)	(0.042)
Participation with Government Response		5.583***	5.723***		0.240***	0.244***	0.136***	0.197***
		(1.739)	(1.675)		(0.076)	(0.071)	(0.024)	(0.053)
After Implementation Period	7.596***	4.442**	6.195***	0.495***	0.361***	0.422***	-0.099***	-0.388***
	(1.111)	(1.896)	(1.046)	(0.050)	(0.081)	(0.046)	(0.015)	(0.033)
Constant/Cut Point 1	75.569***	74.139***	76.542***	-1.134***	-0.625**	-1.107***	0.258***	0.816***
	(3.065)	(5.072)	(2.884)	(0.169)	(0.307)	(0.168)	(0.039)	(0.103)
Cut Point 2				-0.058	0.575*	-0.000		
				(0.169)	(0.308)	(0.167)		
Ebalance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,793	1,187	5,550	4,793	1,187	5,550	7,043	5,476
Provinces	63	63	63	63	63	63	63	63
R-squared	0.089	0.151	0.088				0.128	0.110
RMSE	28.20	27.10	27.58	.	.	.	0.420	0.856
Log Likelihood	-22765	-5558	-26243	-4325	-1053	-5028	-3841	-6879

The table is divided into three panels. Panel 1 uses the share of workers with formal contracts and employs OLS. Panel 2 uses a three-point scale of (0: Non-Compliant; 1) Partially Compliant; 2) Fully Compliant) and utilizes an ordered probit (oprobit) procedure. Panel 3 tests the robustness of our theory to alternative DVs. Robust standard errors are in parentheses in both models (*** p<0.01, ** p<0.05, ŧ p<0.1). For the alternative dependent variables, Model 7 studies whether a firm has a trade union as required by the Labor Code. Model 8 studies the natural log of the budget share spent on personnel recruitment in the year of Labor Code implementation.

Table 6: Disaggregating Main Effects by Size

Dependent Variable	1. Formal Labor (%)		2. Compliance Scale		3.Trade Union		4. Recruitment Budget	
	SME	**Large Ent.**	**SME**	**Large Ent.**	**SME**	**Large Ent.**	**SME**	**Large Ent.**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Provided Comment	-2.573ŧ	8.242**	-0.194***	0.307	0.040**	-0.007	-0.031	0.344ŧ
	(1.532)	(3.429)	(0.061)	(0.207)	(0.019)	(0.070)	(0.043)	(0.177)
Government Responded	4.858***	-5.938	0.216***	-0.282	0.101***	0.235***	0.222***	-0.265
	(1.770)	(4.136)	(0.072)	(0.227)	(0.024)	(0.074)	(0.056)	(0.195)
After Implementation Period	7.010***	4.236	0.441***	0.334**	-0.087***	0.060	-0.428***	-0.243**
	(1.122)	(3.249)	(0.046)	(0.169)	(0.014)	(0.049)	(0.034)	(0.095)
Constant/Cut Point 1	74.182***	89.116***	-0.937***	-2.198***	0.169***	0.494***	0.830***	0.887***
	(3.172)	(4.887)	(0.173)	(0.582)	(0.034)	(0.128)	(0.110)	(0.170)
Cut Point 2			0.081	-0.651				
			(0.172)	(0.582)				
Ebalance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	5,485	428	5,485	428	6,709	601	5,212	427
Provinces	63	63	63	63	63	63	63	63
R-squared	0.085	0.305			0.106	0.297	0.115	0.249
RMSE	29.03	24.76	.	.	0.383	0.439	0.876	0.794
Log Likelihood	-26216	-1937	-5009	-346.8	-3046	-315.3	-6666	-463.6

The table is divided into four panels. Panel 1 uses the share of workers with formal contracts and employs OLS. Panel 2 uses a three-point scale of (0: Non-Compliant; 1) Partially Compliant; 2) Fully Compliant) and utilizes an ordered probit (oprobit) procedure. Panel 3 studies the presence of a union and uses OLS. Panel 4 measures the natural log of the share of budget on recruitment and uses OLS. Panel 3 studies whether a firm has a trade union as required by the Labor Code. Panel 4 studies the natural log of the budget share spent on personnel recruitment in the year of Labor Code implementation. Both use OLS. Each panel is divided into two models. The first limits analysis to firms with less than or equal to 200 employees. The second looks at firms with more than 200 employees. Robust standard errors are in parentheses (*** p<0.01, ** p<0.05, ŧ p<0.1).

Table 7: Mediation Models

Dependent Variables	**1. Formal Labor (%)**		**2. Compliance Scale (0-2)**	
	Mediation Equations	Final Model	Mediation Equations	Final Model
	Legitimacy	Labor (ln)	Legitimacy	Compliance
	(1)	(3)	(5)	(7)
Legitimacy		2.750***		0.098***
		(0.559)		(0.013)
Participation with Government Response	0.196***	1.813	0.196***	0.015
	(0.046)	(1.246)	(0.046)	(0.031)
Constant	-0.151***	80.054***	-0.151***	1.390***
	(0.024)	(0.636)	(0.024)	(0.016)
e.Variance	1.026***	828.575***	1.026***	0.499***
	(0.031)	(26.716)	(0.031)	(0.011)
Control for After	Yes	Yes	Yes	Yes
Ebalance	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes
Sector FE	Yes	Yes	Yes	Yes
Observations	4,670	4,670	4,670	4,670
Provinces	63	63	63	63
Log Likelihood	-13490	-13490	-6222	-6222

This table presents the results of our mediation models. The mediation involves two equations implemented using STATA's SEM procedure. In the first model we assess the intermediate relationship between receiving a government response and our measure of legitimacy (derived from Table 7). The second model captures the direct effect of government response as well the indirect effect mediated by legitimacy. The table is divided into two panels with different constructions of our final dependent variable. Panel 1 uses share of workers with formal contracts and employs OLS. Panel 2 uses a three-point scale of (0: Non-Compliant; 1) Partially Compliant; 2) Fully Compliant) and utilizes an ordered probit (oprobit) procedure. We also replicate the operation using the Imai et al. (2012) procedure MEDEFF (available upon request). All models use entropy balancing, control for before/after implementation period, and employ provincial and two-digit sector fixed effects. Robust standard errors, clustered at province level, are in parentheses in both models (*** p<0.01, ** p<0.05, ŧ p<0.1).

Table 8: Quantities of Interest from Mediation Analysis

Overall Effects of Government Response to Firm Comments	Formal Labor (%, ln)	Compliance Scale
Total Effect (Indirect + Direct)	2.351	0.053
Direct Effect	1.813	0.034
Indirect Effect of Legitimacy	0.538	0.019
Proportion of Total Response Effect Mediated by Legitimacy	22.9%	35.8%
Ratio of Indirect to Direct Effect	0.297	0.559

This table presents the derivations of the quantities of interest derived from Table 8. The columns correspond to the two different dependent variables.