Unrest-Driven Distortion: Evidence from Government Intervention in Securities Regulation

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Abstract

This paper investigates the selective enforcement practices of the local agencies of the China Securities Regulatory Commission (CSRC) under the pressures of social stability. Specifically, they tend to reduce the intensity of enforcement in response to worker collective unrest. Our empirical analysis pinpoints a novel mechanism by which local governments, motivated by the imperative to maintain social order, exert influence over the regulatory actions of these agencies. However, this intervention results in significant indirect economic costs, manifesting not only in the erosion of market efficiency but also in the increased prevalence of corporate earnings management practices.

Keywords: Collective Unrest, Local Government Intervention, Securities Regulation, Enforcement Distortion

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1 Introduction

In China's political and economic system, local governments play a pivotal role in market regulation (Li and Zhou, 2005; Xu, 2011). This role becomes especially pronounced under social stability pressures, where local policy decisions significantly impact the regulatory effectiveness of capital markets. This paper examines how local governments influence the China Securities Regulatory Commission (CSRC) in administering punishments for listed firms, and it explores the broader economic implications of such interventions.

Our analysis begins by examining the effect of labor unrest on regulatory penalties for publicly listed companies. Empirical evidence reveals a notable negative correlation between the intensity of labor unrest and the likelihood of administrative penalties for these firms. Specifically, our findings indicate that with each unit increase in labor unrest intensity, the probability of a listed firm facing an administrative penalty decreases by approximately 2.77Bp. This suggests that in regions experiencing higher levels of social turbulence, CSRC offices tend to adopt a more lenient approach in sanctioning listed companies. This regulatory leniency is even more pronounced during periods of heightened social unrest, such as strikes, protests, or petitions, highlighting a strategic adjustment by regulatory authorities when faced with local instability pressures.

One of the primary identification challenges in this analysis is the potential confounding effect of economic downturns, which could lead to declining corporate performance, layoffs, or even bankruptcies, thereby triggering labor unrest(Bernanke, 1983; Gertler and Gilchrist, 1994; Riegel, 2012; Ahmad and Kutan, 2016; Carballo, Handley, and Limão, 2018). To address this challenge, we employ a set of exogenous shocks as instruments: historical occurrences of solar eclipses, the presence of large ancestral temples, and periods of urban renewal or land requisition. Regions with past solar eclipses and a higher density of large ancestral temples exhibit a stronger historical and cultural predisposition for collective action, increasing the likelihood of local government support for lenient regulatory policies. Additionally, during periods of large-scale urban renewal and land requisition, regulatory bodies may adopt a more cautious stance to prevent further social unrest, resulting in reduced penalties for companies in these regions.

We further investigate why CSRC regional offices respond to stability pressures with policies that align with local government objectives. Two key mechanisms emerge from this analysis. First, the stability priorities of local governments create a strong incentive for intervention. Local officials, often motivated by career advancement, may pressure CSRC offices to adopt lenient enforcement strategies that avoid market disruptions, especially under circumstances where strict regulatory actions could fuel social unrest (North, 1990; Shleifer and Vishny, 1994; Boylan and Long, 2001). Second, local governments

possess the administrative capacity to influence CSRC actions. Regional CSRC offices frequently rely on local governments for logistical support, cooperation, and resources, creating an interdependency that allows local authorities to steer regulatory enforcement in favor of stability goals. Additionally, we rule out alternative mechanisms such as firms' tax contributions, political connections, and the information-gathering capacity of CSRC offices, confirming that the leniency effect is not driven by these factors but rather by stability-focused local government intervention.

Finally, we explore the economic consequences of local governments' strategic influence on CSRC enforcement actions. Such regulatory leniency can lead to market deterioration, where "bad money drives out good" as poor governance and reduced accountability proliferate (Black, 1998; Dyck and Zingales, 2003; Leuz et al., 2006). This softer regulatory stance may reduce overall market transparency, distort investment incentives, and encourage a culture of earnings manipulation, ultimately leading to weakened market efficiency and investor trust. In the long term, these dynamics pose significant risks to the integrity and sustainability of China's capital markets, underscoring the broader economic costs of stability-focused regulatory intervention (Johnson et al., 2000; Fan et al., 2011; Stulz, 2005).

The contribution of this paper is threefold. First, this paper contributes to the literature on the stability objectives of government and the incentives of local officials. Existing studies emphasize the critical importance of social stability and the avoidance of unrest, particularly within China's unique political-economic framework. For instance, Cai and Treisman (2005) emphasize that local governments in China, due to their substantial autonomy, often prioritize stability to demonstrate their competence and secure their positions. Similarly, Blanchard and Shleifer (2000) illustrate how the decentralized structure fosters incentives for local officials to pursue stability-oriented policies to align with central expectations and avoid central government intervention.The work by Chen et al. (2021) further explores how stability pressures influence broader governance outcomes, showing that local governments frequently divert resources toward stabilizing efforts, which can sometimes come at the expense of other public goods. Additionally, Gehlbach and Keefer (2018) and Tsai (2007) discuss how the need to maintain social harmony can lead to selective enforcement and regulatory leniency, especially in sectors considered vital for local economic development and employment stability.

Our study builds on these insights by quantifying an additional, often-overlooked cost of stability-driven regulatory leniency within the sphere of financial regulation. Unlike visible stability measures—such as direct subsidies or investment in social welfare—regulatory leniency is a more subtle approach, often manifesting as reduced enforcement or selective penalties. By examining the influence of local governments on the enforcement actions of regional CSRC offices, our study provides a unique perspective on

how these stability-oriented interventions impose hidden costs on capital markets. This approach echoes the findings of Bertrand and Mullainathan (2002), who show that political interference can lead to suboptimal regulatory practices, as well as Qian et al. (2017), who highlight how government interventions driven by non-economic motives can distort market dynamics.

Second, this paper adds to the literature on selective enforcement by government entities. Selective enforcement is a complex phenomenon that often arises from the competing objectives faced by government officials in a multi-tasking environment. For instance, in China's decentralized governance system, local governments frequently juggle between enforcing national regulations and mitigating local social pressures. Studies by Qian and Weingast (1997) and Acemoglu et al. (2001) illustrate how the discretionary enforcement of regulations can emerge when government officials are tasked with balancing regulatory oversight with alternative priorities, such as maintaining social order or protecting local industries from economic shocks.This discretionary approach to regulation can be particularly pronounced in settings where the risk of collective action is high. For example, Oates (2005) argues that in decentralized systems, local authorities may prioritize policies that reduce the risk of social unrest, often leading to a softer regulatory stance. Similarly, Cao et al. (2007) find that when faced with local labor unrest, government officials may adjust their enforcement behaviors to prevent further escalation, illustrating the role of selective enforcement as a tool for social management.

Our contribution extends this literature by examining how selective enforcement manifests within the financial regulatory framework, specifically through the actions of regional offices of the CSRC. Unlike other forms of local government intervention, selective enforcement in financial markets has unique implications for market transparency and investor confidence. By reducing penalties or overlooking certain violations in times of social tension, regional CSRC offices, under the influence of local government, may unintentionally compromise the integrity of the capital markets. This aligns with findings by Fisman and Wang (2017), who demonstrate that regulatory leniency, while politically expedient, can lead to adverse market outcomes by eroding compliance incentives.

Third, this paper contributes to the growing literature on the localization of financial regulation. Existing studies discuss the benefits and drawbacks of decentralized regulatory enforcement, where local regulators can better utilize local information but may also face risks of collusion with local governments. Shleifer and Vishny (1993) illustrate how localized oversight can sometimes compromise regulatory effectiveness due to vested interests, while Besley and Coate (2003) discuss potential agency problems in decentralized governance. Our study highlights a novel channel through which localized financial regulation can become ineffective, namely the collusion between regulatory bodies and local governments under stability pressures, posing significant risks to the transparency

and effectiveness of financial oversight. Our study adds to this discourse by revealing a specific mechanism through which localization in financial regulation can result in regulatory ineffectiveness: collusion between local CSRC offices and local governments driven by stability pressures. Under such conditions, local governments may encourage regulators to adopt a more lenient approach to enforcement, especially toward firms that are significant to local employment and economic stability. This collusion reflects a prioritization of local stability over market integrity, posing severe risks to transparency, investor confidence, and the effective enforcement of financial regulations.

In highlighting this collusion channel, our research underscores the trade-offs involved in decentralized regulation: while localized oversight allows for responsiveness to local conditions, it can also foster environments where local governments exert undue influence, compromising the impartiality and effectiveness of regulatory bodies. This insight deepens our understanding of the complex dynamics at play in decentralized regulatory frameworks and the unintended consequences that may arise from the push for stability in politically sensitive settings.

The remainder of the paper is organized as follows. Section 2 provides the institutional background, detailing the structure and functions of local CSRC offices within China's regulatory framework, especially under stability pressures. Section 3 presents the data sources and summary statistics, offering an overview of the variables and sample characteristics used in the analysis. Section 4 investigates the effect of unrest on local CSRC regulation, examining the relationship between labor unrest intensity and regulatory leniency. Section 5 explores why stability pressure binds the local CSRC, focusing on the channels of local government intervention, including motivation and capacity. Section 6 discusses the broader implications of these findings, particularly on market efficiency and corporate behavior. Finally, Section 7 concludes.

2 Institutional Backgrounds

2.1 Worker Collective Action in China

Collective action offers a vital lens for understanding Chinese society. These incidents reflect deeper societal tensions and provide insight into how the state and the public interact in moments of unrest. In the Chinese context, collective action carries a more neutral tone compared to terms such as riots or disturbances, helping the state avoid antagonizing the public while preserving flexibility in its response. This approach is

further reflected in the adoption of the "ease, don't aggravate" (*keshunbukeji*) principle,[1] indicating a deliberate strategy to manage social unrest with caution.

Worker-related incidents constitute a significant part of collective action in China. These actions are primarily driven by disputes over wages, job security, and working conditions—issues that are deeply rooted in China's rapid economic growth, industrial restructuring, and urbanization. Although it is difficult to obtain precise data on the overall proportion of worker collective actions due to the challenges in tracking all mass incidents,[2] previous research suggests that workers account for more than half of the total participants in such events(Qiao, 2010; Feng, 2015). This underscores the dominant role of labor issues within China's broader landscape of collective action.

Building on this understanding of worker collective action, it is important to examine how the modes and strategies of worker movements have adapted in light of the changing socio-economic conditions.

Evolving Forms of Worker Collective Action During the 2010s, China's worker collective actions have shifted from traditional manufacturing protests to a growing prevalence of disputes in emerging service sectors, like healthcare, food delivery, and logistics. This shift mirrors the country's economic transformation, moving from an export-driven manufacturing model to a more service-oriented one, where labor disputes have expanded into new industries shaped by digital platforms and precarious working conditions.

As illustrated in Panel A of Figure 1, this transition is evident in the steady decline of manufacturing protests after 2016, alongside a notable rise in service sector disputes, which by 2019, had overtaken manufacturing in terms of the proportion of collective actions. Panel B of Figure 1 highlights the variety of collective action during this period. Traditional methods such as marches, strikes, and sit-ins remained dominant, with protests/marches accounting for 49.44% of worker movements between 2011-2020, reflecting a clear preference for large-scale collective action. More extreme measures, such as blocking public transportation (3.14%) and threatening suicide by jumping (1.83%), underscore how, when pushed to the brink, workers resort to drastic actions to draw attention to their plight.

[Figure 1 About Here]

[1] An author from the Organization Department of the CPC Central Committee pointed out: "The central government has proposed the 'Three Can's and Three Can't's' (can disperse but not assemble, can resolve but not escalate, can ease but not aggravate) as general requirements and fundamental principles for handling collective action" (Wu, 2001). Additionally, the *Guidelines for Handling Collective Incidents*, released in 2023, reaffirm these principles as key to handling such incidents. For further details, please refer to: http://guoqing.china.com.cn/2023-05/15/content_85325358.htm?f=pada=true.

[2] In 2003, Chinese authorities officially released annual statistics on mass incidents for the first time. However, since 2008, the government has ceased publishing specific data on such incidents.

Regional Shifts in Worker Collective Action In the early 2010s, worker collective action in China were heavily concentrated in southeastern coastal provinces, particularly in Guangdong. However, with the gradual shift of low-cost, export-driven industries abroad and the urbanization of inland areas, the proportion of protests in Guangdong has steadily declined. Rising costs and favorable policies in Southeast Asia have driven many manufacturers to relocate overseas, while others have shifted inland, attracted by infrastructure development and investment incentives. This has led to the growth of labor markets in inland regions, particularly in the service and transportation sectors. As illustrated in Figure 2, the geographic shift in collective actions parallels these economic changes.

[Figure 2 About Here]

Infrequent Use of Force in Local Government Reactions Contrary to many biased media narratives, China's leadership does not respond to labor movements with sweeping repression. While there are instances of strong intervention, most worker protests are not met with heavy-handed crackdowns by authorities.[3] Throughout the 2010s, police intervened in only 14% of the incidents recorded on the Worker Collective Action Map, and just 4.7% of cases resulted in arrests. As illustrated in Figure 3, police involvement was significantly higher during the first half of the decade when large-scale protests were more common. Between January 2011 and December 2015, police intervened in 27.3% of the incidents, with arrests occurring in 7% of cases. As mentioned earlier, larger-scale protests were more frequent during this period. The state's approach, however, is not purely reactive. In many cases, the government acknowledges workers' grievances, and under media pressure, authorities may push companies to settle wages or improve conditions to maintain stability(Yang and Chen, 2020). However,it still views these workers as a source of instability, despite addressing their demands.

[Figure 3 About Here]

2.2 "China-style" Stability Maintenance

Worker collective actions touch upon one of China's most politically sensitive topics, stability maintenance (*weiwen*). It is viewed as a key tool in ensuring the Chinese Communist Party's legitimacy(Wang and Luo, 2015). Broadly speaking, all actions by the

[3] Former Public Security Minister Jianzhu Meng warned against the excessive use of police force, https://china.huanqiu.com/article/9CaKrnJl8v1. The State Bureau for Letters and Calls further stipulated that misuse of police power could result in the dismissal of local leaders, https://www.gjxfj.gov.cn/gjxfj/xxgk/fgwj/flfg/webinfo/2008/07/1541706492397919.htm.

government to maintain its ruling legitimacy and social-political order can be considered part of maintaining social and political stability. Narrowly defined, stability maintenance refers specifically to the institutional systems, mechanisms, and strategic actions the government employs in response to public unrest(Xiao, 2015). Our paper focuses on the latter, exploring the strategic choices the Chinese government has taken to manage worker protests.

Pressure-Based System of Stability Maintenance The operational mechanism of China's stability maintenance functions within a pressure-based system. This system, rooted in China's political framework, works by transmitting pressure down through hierarchical levels of governance. Local party committees and government bodies are required to fulfill mandates from higher authorities by linking administrative directives with material incentives and opportunities for career advancement.

Stability maintenance is central to official performance evaluations, holding local leaders accountable for maintaining social order. Failure to do so, particularly during major unrest, can lead to severe consequences, including disqualification from honors, promotions, or even dismissal under the "one-vote veto" system.[4] In this vertically integrated structure of governance, accountability extends beyond local authorities to higher levels of government when risky events occur. As local governments weigh the trade-off between development and stability, a shift in priorities has emerged. Underperformance in economic development may delay promotion, but mishandling unrest poses a greater risk — removal from office.[5] This dynamic is reinforced by the intricate network of agencies responsible for stability maintenance across all levels of governance, as shown in Figure 4, underscoring the organized control mechanisms that permeate China's political system.

[Figure 4 About Here]

The Distortion of Stability Maintenance Methods Instead of utilizing democratic and legal frameworks to resolve social conflicts, the approach has transformed into a form of campaign-stylized governance(Tang, 2007; Zhou, 2012). This relies on tactics such as "leaders taking direct control," "departmental involvement," and "mass mobilization", which prioritize immediate, short-term results over systemic, sustainable solutions.

[4] On July 12, 2009, the Chinese government released the "Interim Provisions on the Accountability of Party and Government Cadres", identifying seven scenarios where leaders can be held accountable, two of which directly relate to collective incidents.For more details, see https://www.gov.cn/gongbao/content/2009/content$_1$371343.*htm*

[5] For example, Yunqiao Feng, Secretary of the Xiantao Municipal Party Committee(vice-departmental level), was removed from his position for mishandling a major collective incident, leading to significant consequences. His promotion and appointment process was also terminated. For more details, see https://zgjjjc.ccdi.gov.cn/bqml/bqxx/201708/t20170801$_1$03987.*html*

Furthermore, governance methods have shifted, with a clear "de-judicialization" trend, where legal frameworks are increasingly bypassed in favor of administrative or extralegal interventions(Tang, 2012). This erosion of judicial authority weakens the legitimacy of governance and fosters a culture of impunity, as decisions are made without accountability to the legal system.[6]

2.3 Decentralization by CSRC

The "tiao-kuai" system in China refers to the vertical functional departments ("tiao") and the horizontal territorial governments ("kuai"), highlighting the interaction and balance between central authority and local governance.

Among the various "tiao-tiao" systems in China under central vertical management, the vertical securities regulation management system is a typical example, characterized by its verticality, independence, and unity. Specifically, The CSRC fully controls the personnel, operations, and finances of its regional bureaus, including organizational structure and appointments. These bureaus are entirely funded by the central government, preventing local government interference.

In December 1998, the amended *Securities Law of the People's Republic of China* clarified the CSRC's unified regulatory responsibilities. In July 1999, 36 regional securities regulatory offices were officially established, marking the formation of China's two-tier securities market regulatory system. Under this system, the CSRC regulates the national securities market, while its regional offices, authorized by the CSRC, oversee the supervision of listed companies and securities institutions in their respective regions.

Decentralization of Administrative Penalty Authority to CSRC Regional Offices In July 2013, the CSRC issued *the Notice on Issuing Administrative Penalty Work Provisions for CSRC Regional Offices*, giving all regional offices the authority to impose administrative penalties, effective from October 1, 2013. Except for major, complex, or sensitive cases that could significantly impact the parties involved, which remain under the jurisdiction of the CSRC headquarters, the regional offices are authorized to independently handle and adjudicate cases within their respective jurisdictions, imposing administrative penalties accordingly. All penalty decisions are filed with the CSRC's Administrative Penalty Committee for record-keeping.

Dilemmas in the Relationship Between CSRC and Local Governments On the one hand, there is fiscal dependency. The funding for regional securities regulatory bureaus is included in the central government budget along with that of the CSRC

[6] Many studies (see, among others, Cheng, 2013; Qian and Tang, 2023; Yang, 2024) have conducted case analyses on campaign-style governance, particularly in the context of stability maintenance.

headquarters. After receiving annual appropriations, the CSRC allocates resources to its regional offices. As shown in Table 1, over the past decade, with increasing regulatory responsibilities, the shortfall in central government funding has widened in recent years. By 2023, the share of fiscal appropriations dropped to 69.20%, with a funding gap reaching 758 million RMB. To cover this shortfall, regional bureaus have had to rely on local government support through subsidies, sponsorships, and rewards, which help improve staff compensation.[7]

[Table 1 About Here]

On the other hand, there is operational dependency. In recent years, as capital market reforms have deepened, the CSRC has gradually delegated many tasks to its regional bureaus, significantly increasing their regulatory responsibilities. Along with more detailed performance assessments from the CSRC, regional bureaus have been compelled to seek local government support to meet their evaluation targets. [8]

2.4 Securities Market Regulation

Retrospective on the Development of Securities Market Regulation The development of China's securities market administrative regulatory system can be divided into four stages. *The first stage (1986-1992)* featured a disorganized regulatory framework with overlapping bodies and no clear laws. *The second stage (1992-1998)* saw the creation of national institutions, though penalties remained low. *The third stage (1998-2019)* marked the centralization of power under the CSRC, the enactment of the Securities Law, and increased penalties. *The fourth stage (2019-present)* introduced the registration-based system and new laws, with the CSRC focusing on post-issuance disclosure and strict enforcement with a "zero tolerance" approach.

In China's securities market, regulatory actions are generally categorized into two types: administrative penalties and administrative regulatory measures. Administrative penalties are more stringent and can involve actions such as warnings, fines, confiscation of illegal gains, and suspension or revocation of licenses. In contrast, administrative regulatory measures are less severe supervisory actions aimed at addressing securities

[7] Funds such as *capital market and tech innovation financing projects*, *supporting poverty alleviation through capital market synergy*, and *mitigating key financial risks and supporting high-quality development of listed companies* were used to cover the bureau's fiscal shortfall and ensure staff compensation.

[8] For example, in some provinces, fewer than 60 staff members are available to handle business regulation, including overseeing IPO guidance and approval, supervising listed companies, securities and futures firms, accounting firms, conducting on-site inspections and promoting investor education and protection. These bureaus face serious staffing shortages, and given the nature of their work, many tasks require two-person teams, further straining their limited resources.

violations without imposing formal penalties. These measures include corrective orders, regulatory meetings, warning letters, or requirements for public disclosures.[9]

Rising Trends in CSRC and Regional Office Administrative Penalties See Figure 5. Panel A illustrates that in 2023, the China Securities Regulatory Commission (CSRC) and its 36 regional offices issued a total of 449 administrative penalty decisions, according to public data.[10] This marks a continued increase compared to 381 cases in 2022 and 371 cases in 2021. Panel B highlights that the CSRC issued the highest number of penalties, totaling 76, while the regional offices collectively issued 374 penalties. Notably, the Shanghai, Zhejiang, Guangdong, and Beijing offices were the primary forces in enforcement, handling 171 cases, which accounted for 38% of all cases and 45.7% of those handled by regional offices. The trend of regional offices conducting independent investigations and issuing penalties has further strengthened.

[Figure 5 About Here]

3 Data and Summary Statistics

3.1 Workers Movements

The Chinese government has not publicly released statistics on strikes or worker protests. In this context, the China Labor Bulletin's (CLB) *Workers' Collective Action Map* is the only publicly accessible database. Since 2011, this map has recorded over 1,000 worker collective actions annually, drawing primarily from Chinese social media platforms like Weibo, WeChat, Douyin, and Kuaishou. CLB regularly searches these platforms for worker-posted protest and strike information and compiles it into the database.

Our study uses data from this map, covering 15,109 observations from 2011 to 2023, detailing the time, location, industry, number of participants, type of action, demands, and government responses. These data provide a strong foundation for analyzing labor movements and the social stability pressures they create. Figure 6 shows an example of a recorded workers' collective action, demonstrating how the dataset captures the essential aspects of labor protests in China.

[9] Administrative penalties are actions enforced by authorized agencies within their legal scope, including CSRC market bans or penalties from other regulatory bodies like environmental or tax authorities. In contrast, administrative regulatory measures are tools used by the CSRC to address violations without imposing formal penalties, as seen in previous CSRC cases.

[10] The data is compiled based on administrative penalty decisions published on the official websites of the China Securities Regulatory Commission (CSRC) and its regional offices. For more details, see http://www.csrc.gov.cn

[Figure 6 About Here]

It's important to note that the Workers' Collective Action Map does not cover all protests in China, as it relies on publicly available information, such as social media posts and limited official reports. Based on the few official data available, we estimate that the map captures only 5% to 10% of all worker protests. Despite their limited scope, the data offer valuable insights into the intensity of labor movements and help to assess the stability pressures faced by local governments. While not comprehensive, the map effectively reflects the frequency and scale of worker actions across regions, making it a critical tool for studying labor movements and the stability challenges faced by local governments in China.

To more accurately identify the causal relationship between penalties imposed by CSRC regional offices and labor protests, while minimizing the influence of other confounding factors, we reorganized the labor protest data into a city-level quarterly panel format. Specifically, we defined the variable "*Protest Event Intensity*", which represents the number of labor protests occurring within a given city each quarter, and standardized it relative to the historical average for that city (calculated as the average over the preceding four quarters).

In our empirical analysis, we particularly selected the labor protest intensity from the previous quarter as the primary explanatory variable, rather than the intensity from the current quarter. This choice is grounded in the consideration that the number of labor protests occurring within the current quarter may not accurately reflect the underlying context and motivations linked to the CSRC's penalty decisions. Notably, if a company had already been penalized early in the current quarter, using the entire quarter's protest data as an explanatory variable could introduce significant bias(forward bias). Therefore, employing the prior quarter's protest intensity better captures the social environment preceding regulatory decisions, enhancing the robustness of the analysis.

Additionally, the penalty process in CSRC regional offices is relatively lengthy, typically involving several stages such as investigation, deliberation, and decision-making. Therefore, penalties are not immediate but occur after a considerable delay.

3.2 Listed Companies Subject to Securities Regulation

We scraped all the penalty documents published on the official websites of the 36 regional offices of the China Securities Regulatory Commission (CSRC). We then cross-referenced and supplemented this data with the violations and penalties disclosed in the public filings of listed companies. As a result, we compiled a total of 1,615 penalty cases between 2011 and 2023.

As introduced in the previous section on securities market regulatory measures, Figure 7 illustrates the distribution of two types of penalties—administrative penalty decisions and administrative regulatory measures—over different periods, highlighting their trends under varying regulatory environments. Among these, administrative penalty decisions tend to have the greatest impact on listed companies, not only because of their direct financial costs but also due to the potential legal and reputational risks. In the CSRC's regulatory practice, however, such severe penalties are relatively rare; data shows that only 10.9% of cases involved administrative penalty decisions. This suggests that CSRC regional offices tend to favor milder regulatory measures when addressing violations, aiming to correct market behavior while minimizing direct shocks to the market.

[Figure 7 About Here]

3.3 Sample Selection and Summary Statistics

We focus on A-share listed companies on the Shanghai and Shenzhen Stock Exchanges over the period from 2011 to 2023. The primary data sources include the CSMAR (China Stock Market Accounting Research) database for financial and firm-level data.

To ensure the accuracy and consistency of our dataset, we implement several filters. First, we exclude firms in the financial sector (such as banks, insurance companies, and securities firms), as these entities typically have distinct financial structures and regulatory requirements that may introduce bias into the analysis. Second, we remove observations with missing financial data that are essential for our analysis, such as total assets, net income, and other core variables that contribute to evaluating firm performance and financial health.

We adopt a quarterly data frequency in our sample to better align the timing of administrative penalties with periods of labor unrest. Using quarterly observations allows for a more precise matching of enforcement actions and labor unrest incidents, capturing the lagged effects of labor unrest on regulatory decisions with greater temporal accuracy. This approach provides a finer-grained analysis than annual data, ensuring that both the penalties and labor events are assessed within closely corresponding timeframes, thereby enhancing the robustness of our empirical findings.

After applying these criteria, our final sample consists of 116,624 firm-quarter observations. The descriptive statistics for the main variables are presented in Table 2.

[Table 2 About Here]

4 The Effect of Unrest on Local CSRC Regulation

In this section, we examine whether the occurrence of local unrest may influence the enforcement decisions made by regional offices of the CSRC. As discussed, these regional offices, established by the CSRC to carry out regulatory oversight based on the principle of local jurisdiction, play a critical role in enforcing financial regulatory authority at the local level. This decentralized structure allows the CSRC to extend its reach across various regions while adapting to local conditions.

The relationship between CSRC regional offices and local governments mirrors broader central-local dynamics within China's "striped" governance structure, where shared interests and unique tensions coexist. During periods of local unrest, this relationship may pressure regional offices to prioritize stability, potentially leading to a more lenient enforcement approach in response to local government interests.

4.1 Empirical Framework

Using a half-life regression model, we analyze the effect of local labor unrest on the likelihood of administrative penalties imposed on listed firms. Specifically, we examine if labor unrest incidents in the current and previous quarters influence enforcement decisions made by regional offices of the CSRC. The estimation specification is as follows:

$$\text{AdminPunishment}_{i,t} = \alpha + \sum_{k=0}^{4} \beta_k \, \text{EventCount}_{i,t-k} + \gamma \, \text{Control}_{i,t} + \delta_{\text{city}} + \delta_{\text{year}} + \epsilon_{i,t} \quad (1)$$

where i, t, and δ represent the firm, time (quarter), and fixed effects, respectively. The dependent variable, AdminPunishment, is a binary indicator of whether a firm received an administrative penalty in a given quarter.[11] The key explanatory variables, $\text{EventCount}_{i,t-k}$, represent the standardized counts of labor unrest incidents in the firm's city for the current quarter ($k = 0$) and the previous four quarters ($k = 1$ to $k = 4$), respectively.[12] Including these lagged event counts, we aim to capture the delayed impact of labor unrest on regulatory enforcement actions.

Table 3 summarizes the regression results, highlighting the lagged effect of labor unrest on administrative penalties. The coefficients indicate that labor unrest in the

[11] We use administrative penalties, rather than broader regulatory measures, because penalties provide a clearer signal of enforcement intensity and have greater legal and financial implications for firms.

[12] By standardizing these counts based on historical levels, we control for regional differences in the baseline frequency of labor unrest.

previous quarter (t-1) has a statistically significant negative effect on the likelihood of penalties, while the effect of unrest in the current quarter (t) and earlier quarters (t-2 to t-4) is smaller and less significant. This lagged pattern aligns with the procedural nature of penalty enforcement, where authorities require time to follow established processes before issuing penalties. Consequently, labor unrest exerts its strongest influence on penalties with a one-quarter delay, while the impact of unrest from the current and earlier quarters diminishes over time.

[Table 3 About Here]

This delay is intuitive, as regulatory authorities typically follow a procedural timeline for penalties, which involves several stages before enforcement decisions are finalized. Consequently, penalties are not issued immediately but reflect a structured response to prior unrest, aligning with the systematic nature of regulatory enforcement.

Based on this analysis, we select the intensity of labor unrest incidents in the previous quarter, represented as $EventCount_{i,t-1}$, as the primary explanatory variable for the subsequent empirical analysis.

Bivariate Probit Model: Impact of Labor Unrest on Administrative Penalties In our first main regression, the dependent variable is a binary indicator of whether a firm received an administrative penalty. However, when estimating a firm's probability of receiving a penalty, an identification issue arises because this probability is not directly observable. Instead, we only observe instances of administrative penalties issued.

This issue has two implications. First, the observed outcome depends on the interaction of two distinct but latent economic processes: the occurrence of a regulatory violation and the subsequent detection of that violation by the authorities. Second, if the detection process is imperfect (i.e., the probability of detecting a violation is less than one), then the observed probability of penalties (detected violations) will differ from the underlying probability of violations (actual regulatory breaches), which is our target for estimation. Consequently, a standard probit model cannot effectively address this issue of partial observability, as it does not account for the possibility that some violations remain undetected.

To address this, alternative modeling approaches are required to more accurately estimate the relationship between labor unrest and the likelihood of penalties while accounting for the incomplete observability of regulatory violations.

Following Wang(2013), we employ a bivariate probit model to address the issue of partial observability in detecting regulatory violations. For each firm i, we denote F_i^* as the firm's incentive to commit a violation and D_i^* as the likelihood of being penalized,

conditional on a violation having occurred. This model allows us to separate the probability of committing a violation from the probability of detection, providing a clearer estimation framework.

The reduced form of the model is specified as follows:

$$F_i^* = x_{F,i}\beta + u_i$$

$$D_i^* = x_{D,i}\gamma + v_i$$

where $x_{F,i}$ is a row vector containing factors that influence firm i's incentive to commit a violation, including $\text{EventCount}_{i,t-1}$, and $x_{D,i}$ contains variables that affect the probability of detection. The error terms u_i and v_i follow a bivariate normal distribution with a correlation coefficient ρ, capturing the possible dependence between the two processes.

For the occurrence of a violation, we define F_i as a binary variable where $F_i = 1$ if $F_i^* > 0$ and $F_i = 0$ otherwise. For the detection of the violation (conditional on occurrence), we transform D_i^* into the binary variable D_i, where $D_i = 1$ if $D_i^* > 0$, and $D_i = 0$ otherwise.

Instead of directly observing F_i and D_i, we observe $Z_i = F_i D_i$, where $Z_i = 1$ if firm i has committed a violation and has been detected, and $Z_i = 0$ if firm i has not committed a violation or has committed one but has not been detected. Let Φ denote the bivariate standard normal cumulative distribution function. The empirical model for Z_i is given by:

$$P(Z_i = 1) = P(F_i D_i = 1) = \Phi(x_{F,i}\beta, x_{D,i}\gamma, \rho)$$

$$P(Z_i = 0) = P(F_i D_i = 0) = 1 - \Phi(x_{F,i}\beta, x_{D,i}\gamma, \rho)$$

Thus, the log-likelihood function for the model is:

$$L(\beta, \gamma, \rho) = \sum_{z_i=1} \log(P(Z_i = 1)) + \sum_{z_i=0} \log(P(Z_i = 0))$$

$$= \sum_{i=1}^{N} [z_i \log(\Phi(x_{F,i}\beta, x_{D,i}\gamma, \rho)) + (1 - z_i) \log(1 - \Phi(x_{F,i}\beta, x_{D,i}\gamma, \rho))]$$

By including $\textit{EventCount}_{i,t-1}$ in $x_{F,i}$, we specifically examine the impact of labor unrest on the probability that a firm receives an administrative penalty. This approach allows us to isolate the effect of local labor unrest on regulatory outcomes while accounting for the imperfect observability of violations.

The model can be estimated using the maximum likelihood method, with identification conditions that (1) $x_{F,i}$ and $x_{D,i}$ do not contain identical variables, and (2) the explanatory variables exhibit sufficient variation across the sample. In the following sections, we specify the dependent variable (Z_i) and the independent variables in each of the two probit equations (vectors x_F and x_D, respectively).

Additionally, we investigate whether stability pressure affects the likelihood of a firm receiving an administrative penalty rather than a more lenient measure, such as administrative supervision, once a violation has been detected. Specifically, we analyze whether higher local stability pressure influences the regulatory authority's decision to impose lighter penalties. This model is conditional on the occurrence of a violation and focuses on the discretionary aspects of enforcement intensity.

where $ViolationControls_{i,t}$ capturing specific characteristics of the case, including factors such as executive involvement (InvolPervio), related-party transactions (RelatedTrans), and issues with information disclosure (InfoDisclosure). These controls help account for the nuanced details of each case that could influence the severity of the penalty.

4.2 Baseline Results

We perform our baseline analysis to examine the effect of local unrest on both the likelihood of firms receiving an administrative penalty and the severity of such penalties. The results of our first and second regressions are presented in Table 4.

Table 4 is divided into two panels. Panel A reports the results of the first stage in our bivariate probit model, assessing the likelihood that a firm commits a regulatory violation (P(V = 1)). Panel B reports the results of the second stage, examining the severity of penalties conditional on a violation having been detected (P(D = 1 | $V = 1$)).

[Table 4 About Here]

In both panels, the variable $EventCount_{i,t-1}$ captures the intensity of local unrest in the previous quarter, which serves as a proxy for the local stability pressure. We hypothesize that higher levels of local unrest would lead to regulatory leniency, resulting in a lower probability of both penalty issuance and penalty severity.

In panel A, we observe that the coefficient of $EventCount_{i,t-1}$ is negative and statistically significant across all specifications, suggesting that higher levels of local unrest reduce the likelihood of a firm receiving an administrative penalty. This finding indicates that regulators may be less inclined to pursue enforcement actions in unstable regions, likely due to political pressures to maintain local stability.

Panel B examines the effect of local unrest on the severity of penalties for firms with detected violations. Here, $EventCount_{i,t-1}$ also has a negative and significant coefficient, reinforcing the idea that stability pressure can lead to lighter penalties. Column (1) shows results without any control variables, Column (2) includes firm and year fixed effects, and Column (3) further adds controls at the regional, firm, and case levels. The consistency of the negative coefficient on $EventCount_{i,t-1}$ across all specifications supports the hypothesis that higher stability pressure reduces both the likelihood of penalties and their severity.

The baseline results indicate that local unrest significantly reduces the likelihood and severity of administrative penalties across all specifications. In both regressions, the coefficient for Unrest (*EventCount*) is negative and statistically significant, suggesting that higher levels of local stability pressure lead to a reduction in penalty likelihood and intensity. This finding supports the hypothesis that local stability concerns may influence regulatory enforcement leniency, with regulators opting for lighter penalties in areas experiencing heightened unrest.

4.3 Identification Challenges

One key challenge in identifying the causal impact of stability pressure on regulatory enforcement is the potential presence of confounding factors. For instance, deteriorating economic conditions may lead to poor firm performance, layoffs, or even bankruptcies, which in turn could trigger labor unrest events such as worker protests. In such cases, both the occurrence of labor unrest and the reduction in regulatory penalties may stem from the same underlying economic stress rather than from stability pressure per se. To address these endogeneity concerns, we employ a set of instrumental variables (IVs) to ensure the robustness of our identification strategy.

Our baseline regression demonstrates that under stability pressure, regulatory authorities tend to reduce the severity of penalties imposed on listed companies. However, to mitigate potential endogeneity issues, we construct a series of IVs aimed at isolating the effect of labor unrest on CSRC behavior.

Specifically, we incorporate three instrumental variables as exogenous sources of variation in stability pressure. First, we use the occurrence of solar eclipses, based on the findings of Miao et al. (2021), which show that solar eclipses increase the likelihood of collective protests and rebellions. Solar eclipses are exogenous events, determined by the relative positions of the Sun, Earth, and Moon, and unrelated to geographic, economic, or cultural characteristics of any given city. Second, we consider the number of large ancestral halls as an indicator of regions with strong Confucian and clan culture influences, which may foster a greater propensity for collective action in response to economic

or social conflicts. Finally, we utilize periods of major urban renewal and land expropriation, where forced relocations by the government can lead to public dissatisfaction and increased labor unrest. While these exogenous events create social instability, they are unlikely to directly impact CSRC's enforcement decisions, making them suitable as instruments for labor unrest.

Using these exogenous instruments as proxies for stability pressure allows us to better isolate the impact of labor unrest on regulatory enforcement. The regression results, shown in Table 5, align with our baseline findings. Specifically, cities with a history of solar eclipses or a higher number of large ancestral halls are more prone to labor unrest. This social instability, in turn, prompts the CSRC to adopt a more cautious approach in its regulatory actions, leading to reduced penalties for listed firms to avoid exacerbating social tensions. These effects are particularly pronounced during periods of major urban renewal and land expropriation, illustrating that regulatory authorities tend to employ milder enforcement strategies under heightened stability pressures.

[Table 5 About Here]

An alternative approach involves expanding the sample to include penalties imposed by both the central CSRC and its regional offices. We construct a Difference-in-Differences (DiD) model based on the 2014 reform, when the CSRC delegated administrative penalty powers to its regional offices. In this model, regions experiencing labor unrest (indicated by the occurrence of worker protest events) are assigned a treatment value of 1. By comparing the changes in regulatory enforcement before and after the reform between regions with and without labor unrest, this approach allows us to isolate the effect of stability pressure on enforcement intensity. Leveraging the exogenous timing of the reform helps control for potential confounding factors and provides robust estimates of how local labor unrest influences both central and regional CSRC regulatory behavior.

$$\text{AdminPunish}_{i,t} = \alpha + \beta_1(\text{Post}_t \times \text{Unrest}_i) + \beta_2\text{Post}_t + \beta_3\text{Unrest}_i + \gamma X_{i,t} + \lambda_t + \mu_i + \epsilon_{i,t}$$

In our DiD analysis, we present four key regression specifications to evaluate the impact of labor unrest on CSRC penalty severity post-reform. Columns (1) and (2) provide results with basic and city-level controls, respectively, while Columns (3) and (4) include additional case-specific characteristics to account for variations in individual cases.

The results show that the interaction term, *Post* × *Unrest*, remains statistically significant and negative across all specifications, indicating that the effect of labor unrest on regulatory leniency is robust to different model adjustments. Specifically, the consistent

significance and negative sign of the interaction term suggest that, in regions experiencing labor unrest, CSRC and its regional offices tend to reduce the severity of penalties after the 2014 reform. This pattern supports the hypothesis that stability pressure influences regulatory behavior, leading to a more cautious enforcement approach in times of social tension.

5 Why stability pressure binds the local CSRC?

In our baseline regression analysis, we observed that when local worker protests are frequent, regional CSRC offices indeed tend to reduce the severity of penalties imposed on listed companies. But what underlies this phenomenon? To explore this question further, we need to incorporate the stability motives of local governments into our analytical framework and investigate potential collusion between local governments and CSRC offices. To better understand these mechanisms, we constructed the following regression model:

$$\begin{aligned}\text{AdminPunish}_{i,t} = \alpha + \beta_1 \text{EventCount}_{i,t-1} + \beta_2 \text{KeyVar}_{i,t-1} + \beta_3 (\text{EventCount}_{i,t-1} \times \text{KeyVar}_{i,t-1}) \\ + \gamma X_{i,t} + \lambda_t + \mu_i + \epsilon_{i,t}\end{aligned}$$

where $\text{KeyVar}_{i,t}$ represents the critical factors we aim to investigate. Consistent with previous analyses, we control for variables related to the case, listed companies, and city-level characteristics, as well as firm and time fixed effects.

5.1 Aiming for Stability: The Local Government Motivation Behind Security Regulation

In this section, we delve into the underlying motivations that drive local governments to influence CSRC regional offices, especially when stability pressures are high. One key incentive is tied to the career advancement structure of local officials, which often hinges on regional economic stability and social harmony. In China's governance structure, local government leaders are evaluated not just on economic performance metrics, but also on their ability to maintain social order. Stability is seen as a crucial indicator of successful governance, and any unrest—such as labor protests or market instability due to regulatory penalties on major firms—could be viewed as a failure to uphold these standards.

Thus, local officials are motivated to intervene in CSRC enforcement decisions as a means of preventing market turbulence that might destabilize social conditions and,

in turn, their career prospects. Studies such as those by Li and Zhou (2005) and Chen and Kung (2019) have documented how local officials prioritize stability in economic policies, often seeking to suppress negative impacts that could trigger unrest. By softening penalties on listed companies during periods of labor unrest, local officials may aim to mitigate potential fallout, ensuring a smooth path to career advancement. These motivations underscore the strong alignment between local government priorities and stability-focused regulatory interventions in financial markets.

We focus on understanding the impact of local government stability motives on CSRC enforcement intensity. To capture this effect, we define two key variables: *TurnoverPressure* and *OfficialCharacteristics*. This variable captures specific traits of local officials that have been linked to promotion likelihood, including age, political connections, and past performance. For example, older officials nearing retirement age may be less incentivized to prioritize long-term stability compared to younger officials with more career growth opportunities. Political connections are also significant; officials with strong ties to higher levels of government may have more leeway to influence regulatory outcomes without fearing negative repercussions.

This framework enables us to empirically assess the channels through which career incentives drive regulatory leniency. Our models suggest that both *TurnoverPressure* and *OfficialCharacteristics* play significant roles in shaping enforcement intensity. When turnover pressure is high, officials are incentivized to suppress strict penalties to avoid destabilizing market conditions that might undermine social stability. Similarly, characteristics like political connections and age impact how likely officials are to intervene in CSRC decisions, as these factors influence their career trajectories and the benefits of prioritizing stability.

Expanding upon our findings, we conduct a heterogeneity analysis to investigate further into how stability pressures shape regulatory leniency, examining the specific conditions that amplify local government influence. The results indicate that local officials' tendency to intervene in CSRC enforcement intensifies significantly when stability concerns are at their peak—during large-scale labor unrest or incidents involving mass petitions. In these high-tension contexts, the reduction in penalties for listed firms becomes even more apparent, underscoring the strategic priority to maintain social order and prevent further disruptions.

This analysis illuminates the nuanced ways in which stability pressures drive regulatory discretion. In regions or periods with heightened social instability, local officials are particularly motivated to temper CSRC decisions, aiming to prevent financial sanctions from exacerbating already delicate social conditions. These insights offer a layered understanding of how local stability concerns shape targeted leniency within China's regulatory

landscape.

5.2 Pulling the Strings: How Local Governments Leverage Influence Over the CSRC

While motivation explains the 'why,' local governments' ability to influence CSRC regional offices reveals the 'how.' Despite the CSRC's centralized oversight, its regional offices rely on local resources and support to carry out effective enforcement. This reliance forms the basis for local governments' ability to intervene in regulatory actions, especially on sensitive issues related to stability.

Regional CSRC offices often depend on local governments for logistical support, cooperation in investigations, and even administrative resources, creating an interdependent relationship. This dependency allows local governments to subtly or directly steer CSRC enforcement outcomes to favor stability objectives. For instance, regional officials who prioritize strict regulatory action without considering local stability concerns may find it difficult to secure essential cooperation or resources from local government counterparts. This dynamic creates an implicit pressure for CSRC regional offices to adjust their enforcement practices, especially when local stability pressures are high.

Moreover, this capacity to influence CSRC decisions is bolstered by the authority local governments hold over regional administrative processes. In situations where local governments prioritize stability, they are equipped to influence CSRC regional offices through mechanisms such as limited administrative cooperation or preferential support for lenient enforcement approaches. This capacity to guide regulatory outcomes effectively empowers local governments to align CSRC actions with their stability goals, particularly during periods of social tension.

To empirically examine the channels through which local governments influence regional CSRC offices, we can leverage various indicators that capture the dependency of CSRC regional offices on local government resources and support. One useful indicator is the *financial shortfall* faced by regional CSRC offices, which could signal their reliance on local government funding or resources. If local governments contribute supplementary financial support, CSRC offices may feel pressured to align their enforcement actions with local stability objectives to maintain these financial flows.

Additionally, *cooperation levels* between CSRC regional offices and local governments can serve as a proxy for interdependency. For example, data on the frequency of joint inspections or investigations, or reliance on local government offices for administrative support, could indicate the extent to which CSRC offices depend on local administrative resources. In regions where this cooperation is high, we might expect more lenient en-

forcement during periods of labor unrest, as CSRC officials may adjust their actions in response to implicit or explicit local stability priorities.

Another indicator is *the presence of local government-appointed liaisons or representatives within CSRC offices*, which could directly reflect the influence of local governments on CSRC activities. The presence of such liaisons may facilitate information flow and coordination between the CSRC and local government but could also introduce a channel through which stability pressures are communicated to CSRC officials.

Together, above two sections explain the dual channels—motivation and ability—through which local governments exert influence over CSRC regulatory actions, particularly in response to social stability pressures.

In Table 7, columns (1) to (3) present results using Financial Dependency as the key variable, while columns (4) to (6) report findings with Logistical Cooperation as the key variable. The significant negative coefficients on the interaction terms across these specifications indicate that higher dependency on local government resources (financial or logistical) correlates with reduced penalty severity in response to labor unrest. This suggests that when CSRC regional offices are more reliant on local government resources, they may be inclined to mitigate enforcement actions to align with local stability priorities.

[Table 7 About Here]

In Table 8, columns (1) and (2) present results using Financial Shortfall as the key variable, columns (3) and (4) report findings with Cooperation Levels, and columns (5) and (6) use Local Government Liaisons. The significant negative coefficients on the interaction terms indicate that higher dependency on local government resources correlates with reduced penalty severity in response to labor unrest, supporting the Ability channel of influence.

[Table 8 About Here]

5.3 Alternative Channel

To strengthen our analysis and isolate the primary mechanism of local government influence on CSRC regional offices, we need to rule out alternative channels that could potentially explain the relationship between stability pressure and regulatory leniency. Specifically, we consider three possible alternative channels—*Tax Income*, *Firm Political Connections*, and *Local Information Gathering*—which may theoretically impact CSRC

decisions, but we argue are not central to our findings. By empirically testing these alternative explanations, we aim to demonstrate that they are not the driving forces behind the observed leniency.

Tax Income A potential explanation could be that the leniency in penalties is motivated by the desire to protect local tax revenue, particularly if a penalized firm is a significant contributor to the local tax base. In this scenario, local governments may pressure CSRC offices to reduce penalties to maintain steady tax income. However, we argue that tax revenue concerns are not critical to our framework, as the regulatory leniency we observe aligns more closely with stability pressures than with purely economic motivations. In the empirical analysis, we will include measures of each firm's contribution to local tax income to show that this factor does not significantly influence the enforcement actions of the CSRC.

Firm Political Connections Another possible channel is the political connections of the firm itself. Firms with strong ties to government officials might receive preferential treatment, as officials could intervene to reduce penalties as a favor to these firms. To address this, we will control for indicators of a firm's political connections, such as board members with government backgrounds or ties to influential political figures, to test whether political connections drive the leniency effect. By showing that the leniency effect remains significant after controlling for political connections, we can attribute the leniency more confidently to local stability pressures.

Local Information Gathering (CSRC's Information Capacity) The CSRC's regional offices may vary in their capacity to gather local information, which could theoretically influence enforcement actions. For instance, if a CSRC office has strong local information networks, it may be better equipped to assess the risks associated with imposing penalties that could destabilize the region. However, we hypothesize that the observed leniency is not due to differences in information-gathering capacity. To test this, we include proxies for information capacity, such as the number of inspections or investigations conducted by the CSRC office, and the ratio of listed companies to CSRC staff in each region, to determine if information asymmetry is a significant factor. If the leniency effect persists after controlling for local information capacity, it would suggest that information gathering is not the primary mechanism driving the CSRC's actions.

As shown in Table 9, the coefficients on Tax Income, Political Connections, and Local Information Capacity are all close to zero and statistically insignificant, suggesting that these factors do not significantly influence CSRC penalty severity. Specifically, the tax contributions of firms, their political ties, and differences in the information-gathering capacity of CSRC offices do not account for the observed regulatory leniency. This implies that the leniency is driven primarily by local stability pressures rather than by local tax

protection, favoritism toward politically connected firms, or variations in information capacity.

[Table 9 About Here]

6 Discussion and Implication

The empirical analysis suggests that lenient enforcement by CSRC regional offices, particularly in times of heightened social pressure, could indeed contribute to maintaining local stability.

This connection between lenient penalties and stability goals is not just theoretical but is underscored by real-world examples. For instance, in the case of Kangmei Pharmaceutical, despite its significant financial misconduct, local government officials were reportedly cautious about imposing severe sanctions, likely due to the company's substantial impact on local employment and economic stability. Support from Guangdong's provincial authorities helped Kangmei avoid harsher outcomes, effectively allowing the company to "reborn" rather than face financial ruin. This case illustrates how financial and regulatory interventions, when strategically modulated, may mitigate the potential social unrest that could follow a severe corporate fallout.[13]

Similarly, during the Changsheng Biotech vaccine scandal, the initial response by local authorities seemed tempered, likely due to concerns over public panic and social stability. Though the scandal ultimately led to strict penalties, the cautious initial approach highlights how, in sensitive sectors, regulatory bodies may face pressure to prioritize stability, even if it risks undermining robust enforcement. These cases reinforce the hypothesis that local stability concerns may influence regulatory actions. However, our empirical analysis, while suggesting a significant relationship between stability pressures and regulatory leniency, requires further investigation to explicitly connect leniency with stability outcomes. By linking the regulatory decisions of CSRC offices with observed stability effects, we can clarify whether and to what extent lenient enforcement aligns with the objective of social harmony—a dynamic that warrants closer attention in further studies.[14]

[13] For more details on the Kangmei Pharmaceutical case and the support it received from Guangdong authorities, see the report at https://finance.sina.com.cn/wm/2024-07-04/doc-incaxxfm8608716.shtml.

[14] For an overview of the initial response in the Changsheng Biotech vaccine scandal, refer to the report at https://finance.sina.com.cn/china/2019-01-25/doc-ihrfqzka0939684.shtml.

6.1 The Hidden Cost of Stability: Market Inefficiencies under Regulatory Leniency

Building on our earlier findings regarding regulatory leniency under stability pressures, we now turn our attention to examining the broader implications of such interventions on stock market efficiency. We seek to understand whether local government pressures that result in more lenient CSRC penalties may inadvertently disrupt market efficiency by introducing uncertainty or reducing transparency for investors. Our model investigates this by analyzing key indicators of market efficiency—such as stock price volatility, trading volume, and the bid-ask spread—each of which can signal changes in how well the market reflects available information in the presence of regulatory leniency.

To operationalize this, we define our dependent variable, $MarketEfficiency_{i,t}$, as a set of metrics that capture various aspects of market dynamics for firm i in period t. First, price volatility serves as a gauge of market instability, where greater volatility may reflect increased uncertainty following lenient enforcement actions. Trading volume, another metric, measures investor engagement and confidence; lower trading volumes might indicate that lenient enforcement dampens market participation due to reduced confidence in regulatory rigor. Finally, the bid-ask spread is included as a proxy for information asymmetry, as wider spreads suggest greater uncertainty and potentially impaired information flow among market participants.

The primary explanatory variable, $LenientEnforcement_{i,t-1}$, represents the degree of regulatory leniency in penalties imposed on firms, with lower values indicating less severe penalties. If leniency in enforcement indeed undermines market efficiency, we would expect positive relationships between $LenientEnforcement_{i,t-1}$ and metrics like volatility and bid-ask spread, and a negative relationship with trading volume, as investors adjust to the perceived risks of a less stringent regulatory environment.

Our model also includes a variety of control variables and accounts for firm and time fixed effects to control for unobserved heterogeneity that might otherwise skew our results.

In Table 10, each column provides the estimated coefficients for different market efficiency metrics as the dependent variable. Columns (1)(2) report the results for volatility, showing a positive and significant relationship with $LenientEnforcement_{i,t-1}$, suggesting that lenient enforcement is associated with higher market volatility. Columns (3)(4) examine trading volume, where we find a negative coefficient, implying that lenient enforcement correlates with decreased trading activity, perhaps due to diminished investor confidence. Finally, Columns (5)(6) show results for the bid-ask spread, with a positive and significant coefficient on $LenientEnforcement_{i,t-1}$, which indicates increased informa-

tion asymmetry.

[Table 10 About Here]

These findings suggest that regulatory leniency, while potentially beneficial for short-term stability, may compromise stock market efficiency. In other words, while leniency might serve as a tool for maintaining social stability, it seems to come at the cost of a less efficient market, highlighting a trade-off that policymakers may need to consider.

6.2 Shadows in the Books: How Stability-Driven Leniency Fuels Earnings Manipulation

While regulatory leniency under stability pressures may help maintain short-term social harmony, it has unintended consequences that extend to the financial practices within firms, particularly through encouraging corporate earnings management. In an environment where regulatory oversight is softened to prioritize stability, firms may anticipate less stringent enforcement of violations. This expectation allows management to take advantage of accounting practices to smooth earnings, inflate revenues, or obscure financial difficulties, aligning reported results with short-term performance targets or avoiding fluctuations in financial statements.

As shown in Table 11, firms in regions experiencing stability-driven regulatory leniency exhibit a statistically significant increase in earnings management indicators, such as discretionary accruals or income smoothing. This finding underscores the link between leniency and an increased prevalence of financial manipulation practices. The tendency toward earnings management not only reduces the transparency of financial reporting but also distorts the true economic condition of firms. Investors and analysts, relying on these manipulated figures, may be misled about a company's profitability, growth potential, and risk, leading to misguided investment decisions and inflated valuations. Over time, this erosion of financial reporting quality weakens the integrity of information in the market, making it harder for investors to assess real firm performance.

[Table 11 About Here]

While stability-driven leniency may superficially maintain short-term market calm, it also allows hidden risks to accumulate, potentially triggering greater market disruptions when the true financial situation is eventually revealed.

7 Conclusion

In conclusion, this paper sheds light on an often-overlooked facet of China's regulatory landscape: the delicate balance between market discipline and social stability. As local governments, driven by stability pressures, subtly steer regulatory actions, we witness a complex interplay where capital market oversight bends under the weight of political incentives. While this alignment with local stability goals may prevent immediate unrest, it comes with hidden costs — erosion of market transparency, encouragement of lenient enforcement, and, ultimately, a potential drift toward a less accountable corporate environment. The insights offered here serve as a reminder that the path to stability, though paved with good intentions, may inadvertently lead to vulnerabilities in market integrity. As China's capital markets continue to grow, understanding and addressing these trade-offs will be crucial to fostering a sustainable regulatory framework that not only maintains stability but also promotes transparency and fairness.

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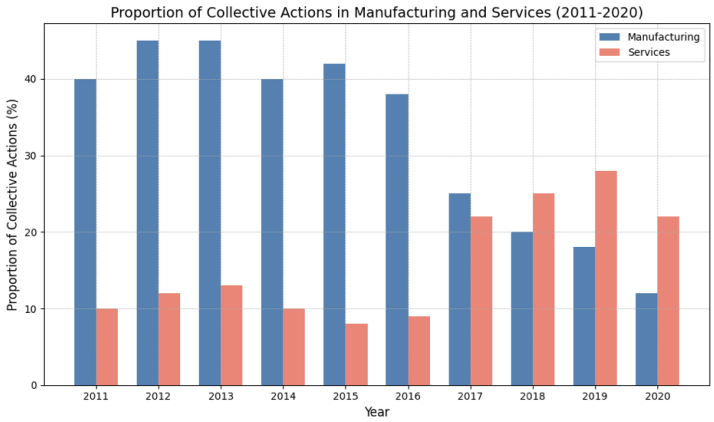
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Tables and Figures

Panel A. Proportion of Collective Actions



Panel B. Types of Collective Actions

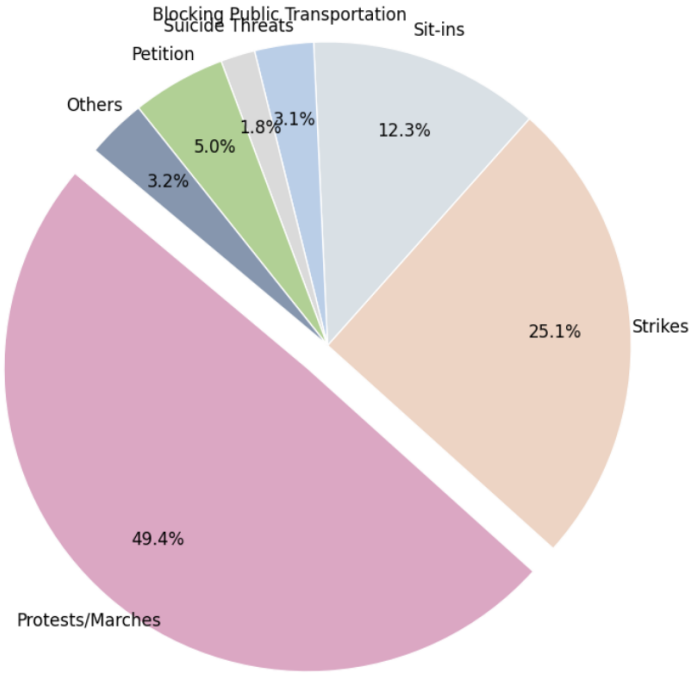


Figure 1. Evolving Forms of Worker Collective Action(2011-2020)

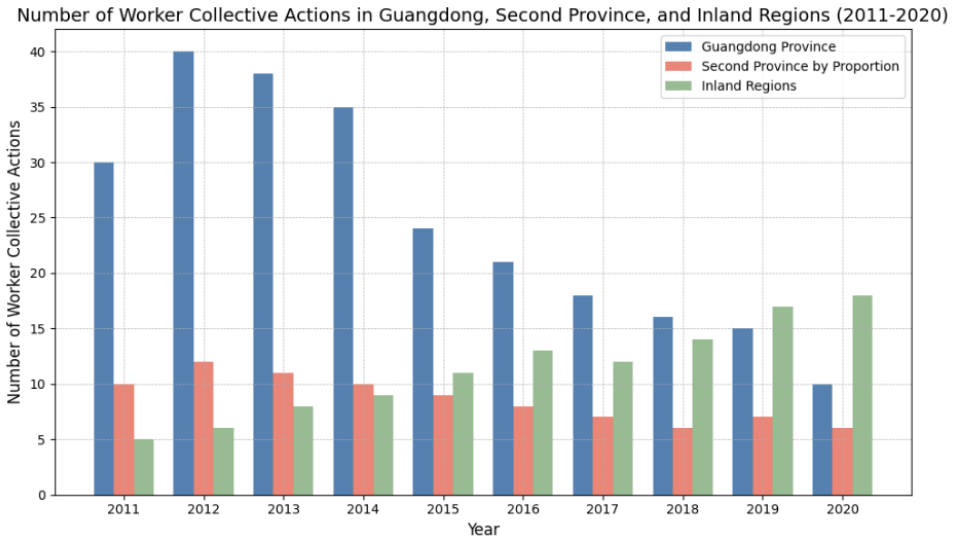


Figure 2. Regional Distribution of Worker Collective Actions (2011-2020)

Notes: For example, in 2010, electronics manufacturing giant Foxconn moved its primary production base from Shenzhen to a new factory outside Zhengzhou, Henan. At its peak in 2018, this facility employed around 300,000 workers—matching the peak workforce at Foxconn's Shenzhen plant in the early 2000s. Half of the world's iPhones are produced by these workers.

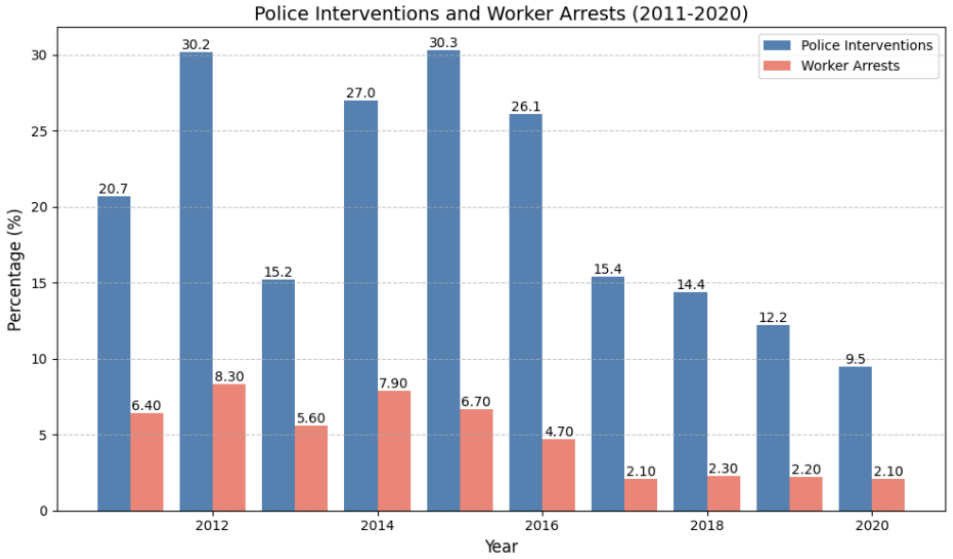


Figure 3. Government's Coercive Response (2011-2020)

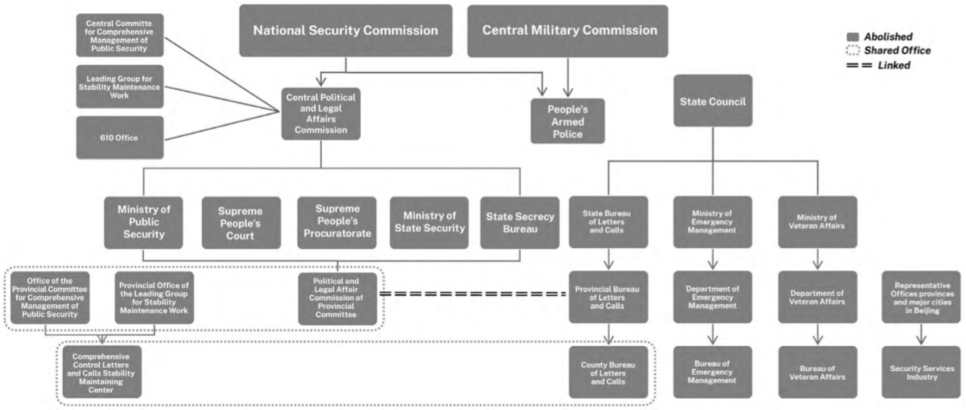
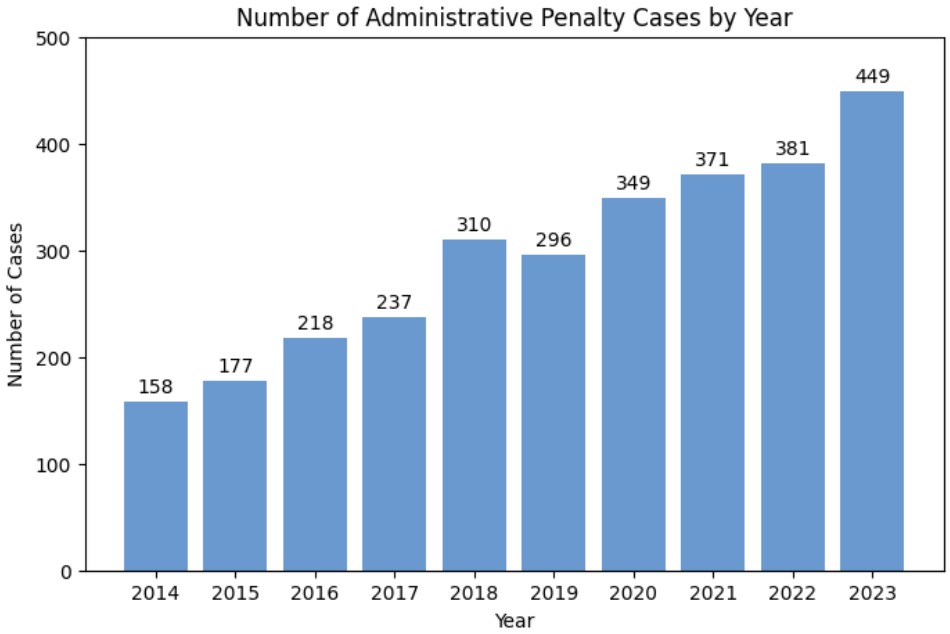


Figure 4. A System of Organized Control

Notes: The diagram illustrates the hierarchical and interconnected nature of China's stability maintenance system. At the top are national bodies like the National Security Commission and the Central Military Commission, overseeing national security and military affairs. These commissions are linked to the Central Political and Legal Affairs Commission, which coordinates stability efforts across various government branches, including the Ministry of Public Security, Ministry of State Security, and Supreme People's Court. At the provincial and county levels, the stability maintenance system involves a network of offices tasked with handling social unrest and managing public complaints. This decentralized network ensures that local governments are responsible for managing stability within their jurisdictions, all while reporting to higher provincial bodies.

Panel A. Number of Administrative Penalty Cases by Year



Panel B. Number of Administrative Penalty Cases by Region

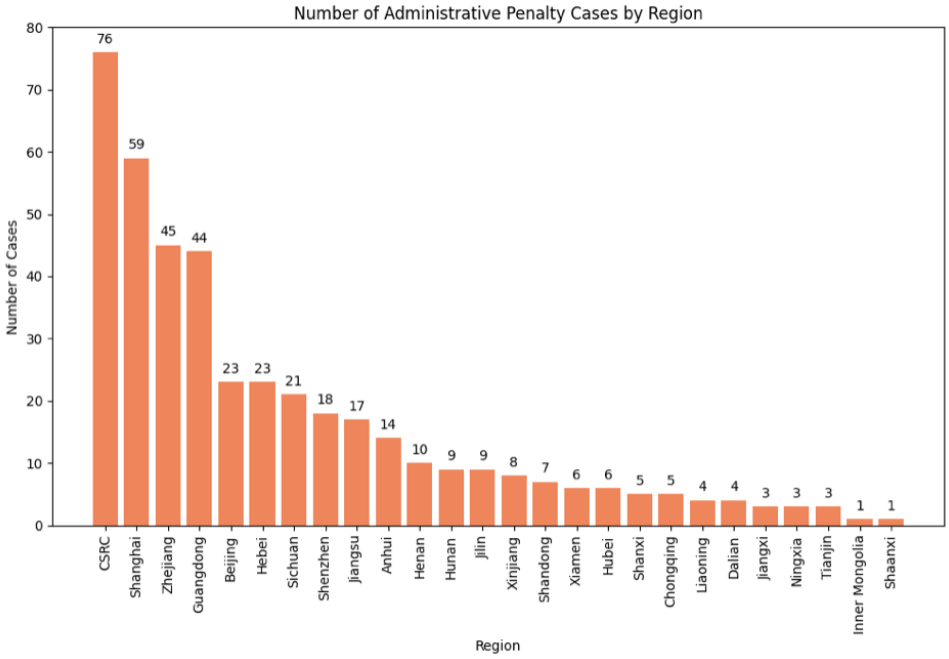


Figure 5. Overview of Administrative Penalties

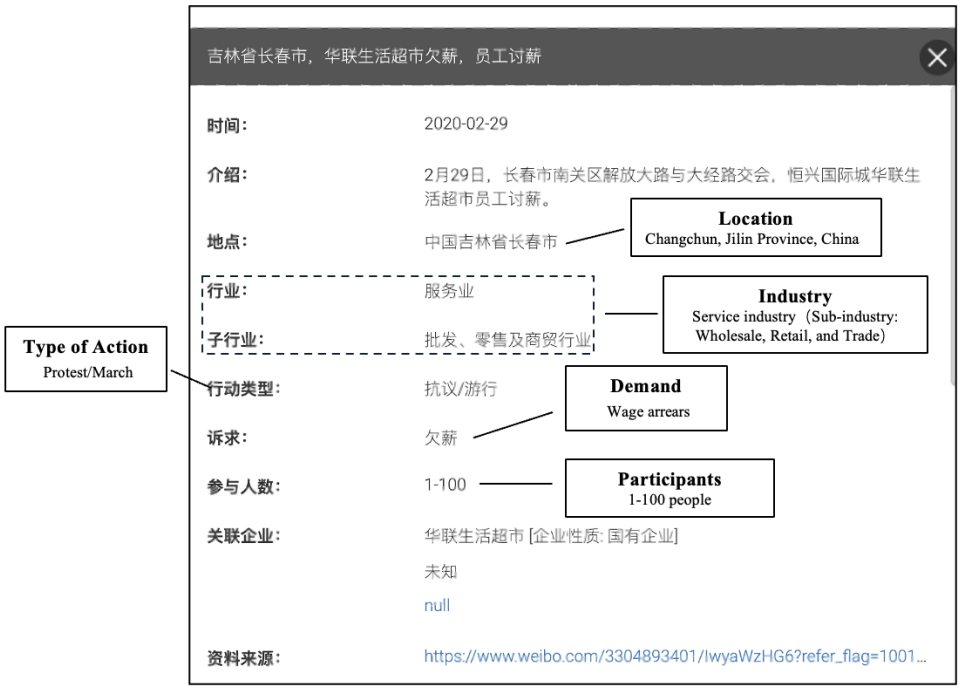


Figure 6. Detailed Example of a Workers' Collective Action

Notes: This case involves a protest that occurred on February 29, 2020, in Changchun, Jilin Province, China. The action was a protest/march involving 1-100 participants from the service industry (sub-industry: wholesale, retail, and trade), demanding wage arrears. The associated company, Huaxing Supermarket, is identified as a state-owned enterprise. This figure illustrates the detailed information captured in the dataset, which includes the time, location, industry, number of participants, type of action, and the workers' demands.

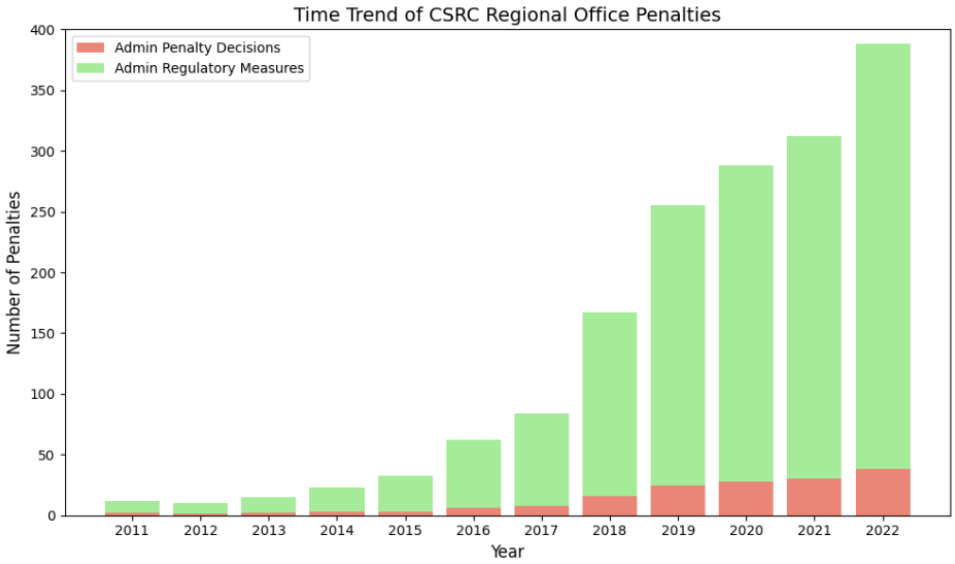


Figure 7. Time Trend of CSRC Regional Office Regulatory Actions

Table 1. Final Accounts of CSRC Departments in China (Unit: 10,000 RMB)

Notes: The data is sourced from the official website of the China Securities Regulatory Commission (CSRC). The CSRC's revenue sources are relatively stable, primarily consisting of fiscal appropriations and other income (such as local government financial support and bank interest income). A total of 39 entities are included in the CSRC's final accounts, comprising 1 headquarters and 38 regional offices.

Year	Grant Revenue	Other Revenue	Total Revenue	Grant Share (%)	Other Share (%)
2023	170,346.36	75,808.99	246,155.35	69.20	30.80
2022	128,452.89	56,482.31	184,935.20	69.46	30.54
2021	101,774.82	19,738.95	121,513.77	83.74	16.26
2020	139,846.61	49,100.15	188,946.76	74.01	25.99
2019	140,850.34	48,141.33	188,991.68	74.52	25.48
2018	129,412.35	45,431.23	174,843.58	73.98	26.02
2017	118,266.85	31,689.54	149,956.39	78.88	21.12
2016	115,726.15	23,137.85	138,864.00	83.34	16.66
2015	110,810.12	18,227.57	129,037.69	85.88	14.12
2014	105,777.86	15,758.23	121,536.21	87.04	12.96
2013	101,189.96	12,847.44	114,037.40	88.74	11.26
2012	97,007.90	13,638.07	110,715.97	87.68	12.32
2011	97,683.59	8,940.89	106,624.48	91.61	8.39

Table 2. Summary Statistics

Variable	Mean	Std. Dev.	Observations
Variable 1	10.5	2.3	100
Variable 2	15.2	3.7	100
Variable 3	20.1	5.1	100

Table 3. Half-life regression Regression Results

Lagged Quarter	Coefficient	Significance Level
Current Quarter	-0.0279	
Previous Quarter (t-1)	-0.1281	***
Two Quarters Ago (t-2)	-0.0147	
Three Quarters Ago (t-3)	0.0003	
Four Quarters Ago (t-4)	0.0988	

Table 4. Impact of Local Unrest on the Likelihood and Severity of Administrative Penalties

	Bivariate Probit Model		
Variables	**(1)**	**(2)**	**(3)**
Panel A: Likelihood of Violation (P(V = 1))			
$\text{EventCount}_{i,t-1}$	-3.752**	-3.891**	-3.763**
	[1.096]	[1.020]	[1.053]
Log(assets)	0.133**	0.087**	0.109**
Firm profitability	-0.861*	-0.739**	-0.708**
Return volatility	16.257	3.575**	4.092**
Prior violations	0.070	0.252**	0.208**
Constant	-4.113**	-3.891**	-4.213**
Panel B: Detection and Penalty Severity (P(D = 1 | $V = 1$))			
$\text{EventCount}_{i,t-1}$	-0.002**	-0.001**	-0.001**
	[0.001]	[0.0003]	[0.0004]
Involvement of executives (InvolPervio)	0.109	0.134**	0.129**
Related transactions (RelatedTrans)	-0.861*	-0.739**	-0.708**
Information disclosure issues (InfoDisclosure)	16.257	3.575**	4.092**
Firm size (Log assets)	0.070	0.252**	0.208**
Constant	-3.694*	-4.902**	-4.804**
Observations	6,211	6,211	6,211
Pseudo-likelihood	-433	-430	-431

Table 5. Two-Stage IV Regression Results

	Solar Eclipse		Ancestral Culture		Urban Renewal	
Outcome Var.	**EventCount**	**AdminPunish**	**EventCount**	**AdminPunish**	**EventCount**	**AdminPunish**
	(1)	(2)	(3)	(4)	(5)	(6)
IV	Positive		Positive		Positive	
EventCount Estimate		Negative		Negative		Negative
Case Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
City Control	Yes	Yes	Yes	Yes	Yes	Yes
FIRM FE	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6,211	6,211	6,211	6,211	6,211	6,211
Cluster	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.243	0.026	0.287	0.001	0.253	0.019

Table 6. DiD Regression Results

	Dependent Variable: AdminPunish			
Variables	**(1)**	**(2)**	**(3)**	**(4)**
Post × Unrest	-0.250**	-0.230**	-0.215**	-0.200*
	[0.105]	[0.110]	[0.108]	[0.112]
Unrest	0.200**	0.210**	0.220**	0.215**
	[0.090]	[0.095]	[0.092]	[0.088]
Firm Fixed Effects	Yes	Yes	Yes	Yes
Quarter Fixed Effects	Yes	Yes	Yes	Yes
City-Level Controls	No	Yes	No	Yes
Case Characteristics	No	No	Yes	Yes
Observations	13,245	13,308	13,176	13,412
R-squared	0.038	0.041	0.039	0.042

Table 7. Motivation Channel Results

	TurnoverPressure as KeyVar			OfficialCharacteristics as KeyVar		
Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
$\text{EventCount}_{i,t-1}$	-0.200**	-0.180**	-0.175**	-0.190**	-0.170**	-0.165**
$\text{KeyVar}_{i,t-1}$	0.250**	0.225**	0.210*	0.260**	0.235**	0.220*
$\text{EventCount}_{i,t-1} \times \text{KeyVar}_{i,t-1}$	-0.300**	-0.275**	-0.260**	-0.310**	-0.285**	-0.270**
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes
Case Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6245	6392	6551	6684	6473	6331
R-squared	0.045	0.049	0.051	0.048	0.046	0.050

Table 8. Ability Channel Results

	Financial Shortfall		Cooperation Levels		Local Government Liaisons	
Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
$\text{EventCount}_{i,t-1}$	-0.210**	-0.190**	-0.205**	-0.185**	-0.200**	-0.180**
$\text{KeyVar}_{i,t-1}$	0.220**	0.200**	0.230**	0.210**	0.225**	0.205*
$\text{EventCount}_{i,t-1} \times \text{KeyVar}_{i,t-1}$	-0.290**	-0.270**	-0.310**	-0.285**	-0.300**	-0.275**
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes
Case Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6578	6349	6431	6589	6213	6701
R-squared	0.041	0.045	0.043	0.044	0.047	0.042

Table 9. Testing Alternative Channels

	Tax Income		Political Connections		Local Information Capacity	
Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
$\text{EventCount}_{i,t-1}$	-0.200**	-0.180**	-0.190**	-0.170**	-0.185**	-0.165**
$\text{KeyVar}_{i,t-1}$	0.250**	0.225**	0.240**	0.215**	0.235**	0.210*
$\text{EventCount}_{i,t-1} \times \text{KeyVar}_{i,t-1}$	-0.003	-0.025	-0.001	-0.001	-0.033	-0.002
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes
Case Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6347	6219	6581	6703	6445	6298
R-squared	0.039	0.042	0.041	0.043	0.040	0.044

Table 10. The Impact of Regulatory Leniency on Market Efficiency

	Volatility		Trading Volume		Bid-Ask Spread	
Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
LenientEnforcement$_{i,t-1}$	0.150**	0.125*	-0.100**	-0.090*	0.080**	0.075*
Firm Size	-0.050	-0.045	0.030	0.025	-0.035	-0.030
Leverage	0.070	0.065	-0.050	-0.045	0.055	0.050
Industry Controls	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Time FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	32,487	31,829	33,914	34,205	36,002	35,478
R-squared	0.082	0.085	0.078	0.080	0.075	0.077

Table 11. The Impact of Regulatory Leniency on Earnings Manipulation