Political Conflict and Corporate Policies: Evidence from the Basque Country

François Derrien[†] Stavriana Hadjigavriel[‡] Jose M. Martin-Flores[§]

Arthur Romec[¶]

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Abstract

This paper examines how political conflict affects corporate policies focusing on the Spanish Basque Country. We exploit the announcement by the Basque nationalist terrorist group ETA of the definitive cessation of its armed and extortion activities as an exogenous shock to the exposure of firms in the Basque Country and Navarre to extortion risk. We find that, following the announcement, firms in these regions significantly increase their cash holdings and exhibit higher cash flow sensitivity of cash. They also reduce investment in fixed assets and rely less on short-term debt, consistent with a shift away from strategic liquidity minimization under extortion risk. Finally, firm performance improves. Overall, the results suggest that political conflict distorts cash management, financing choices, and investment decisions.

Keywords: Cash holdings, Political conflict, Revolutionary tax, Basque Country

JEL Classification: G12, G30,

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[†]HEC Paris - *derrien@hec.fr*

[‡]CUNEF Universidad - *stavriana.hadjigavriel@cunef.edu*

[§]CUNEF Universidad - *josemaria.martin@cunef.edu*

[¶]Toulouse Business School - *arthur.romec@gmail.com*

1 Introduction

Political conflicts create frictions that distort local economic activity. While their macroeconomic effects are well documented (e.g., Abadie and Gardeazabal 2003, 2008; Blomberg, Hess, and Orphanides 2004; Bandyopadhyay, Sandler, and Younas 2014), evidence at the firm level remains scarce. How do companies respond to the frictions generated by local political conflicts? And what are the consequences for their investment and financing policies, and ultimately for their performance? Addressing these questions is challenging because political conflicts typically affect local economies indirectly through multiple channels simultaneously, such as disruptions in labor markets and institutional instability.

In this paper, we focus on the politically motivated extortion activities of ETA, the Basque separatist organization active in the Basque Country and Navarre, and we examine their impact on the financial and investment policies of local firms. Studying this specific conflict offers two advantages. First, ETA's impact on local firms is relatively well identified and geographically confined. The group financed its violent actions, primarily directed against the central Spanish government, by collecting a "revolutionary tax" from local businesses, exposing them to significant extortion risk.[1] Over 10,000 business owners were targeted (Gastaminza 2018), with tax levels largely determined by each company's ability to pay. Anecdotal evidence and testimonies from targeted executives suggest that, from the mid-90s onward, ETA amplified and broadened its extortion activities by exploiting financial statements filed by Basque firms in local commercial courts (Gastaminza 2018). ETA also gathered information from a network of sympathetic "informers".[2] The extortion letters (see

1. We use the terms "political conflict," and "extortion risk" interchangeably throughout the paper. Although analytically distinct, these concepts are closely related in the context of ETA as political conflict describes the broader dispute, and extortion risk the specific form of violence within it which involved coercive financial demands.

2. Such "informers" reportedly included company employees and personnel at local bank branches (with

examples in the Internet Appendix) resembled official documents and even included reference numbers, reflecting the high level of sophistication in ETA's extortion activities. Companies refusing to pay the revolutionary tax were threatened with boycott, robberies, kidnappings, and assassination. Thus, from the perspective of Basque and Navarre firms, ETA was de facto a stakeholder that effectively imposed an actual or potential tax on local firms. Second, the announcement of ETA's cessation of activities in 2011 was largely unanticipated. This allows us to compare firm behavior before and after the end of ETA's activities, providing a clean setting to infer the causal effects of ETA's extortion and armed activities on corporate decisions.

To examine the effect of ETA's extortion activities on corporate policies, we use accounting data from a large sample of private firms located in the Basque country and Navarre (12,213 firms). We explore their changes in policies around the unanticipated announcement of ETA's cessation of its activities in 2011. As for counterfactual firms, we use another large sample of private firms (19,950 firms) in neighboring Spanish autonomous communities, which were not targeted by ETA's extortion activities.

In line with the corporate cash holdings literature, we posit that firms choose their cash levels by trading off the costs and benefits of liquidity. In this context, greater cash holdings signal a firm's ability to pay the revolutionary tax, making it a more attractive target to ETA. Therefore, ETA's revolutionary tax introduced an additional cost to holding cash, reducing optimal cash balances. The data support this hypothesis: After ETA's cessation, firms in the Basque Country and Navarre increased their cash holdings by approximately 1% of total assets relative to comparable firms in neighboring regions. This effect is both economically meaningful and empirically robust to alternative specifications, control samples

direct access to accounts), both being a source of privileged information on the financial situation of ETA's potential and actual targets.

and definitions of our main variables of interest.

The key identifying assumption for causal interpretation in such a difference-in-differences exercise is that treated and control firms share parallel trends before the treatment. This identification relies on the assumption that the outcome variable (i.e., cash holdings) would have behaved in a similar way across treated and control groups absent treatment (i.e., the announcement of the end of ETA's activities). In our sample, Basque and Navarre firms exhibited pre-2011 cash-holding dynamics similar to those of the control group, and the divergence occurs only after ETA announced the end of its armed and extortion activities.

Consistent with the idea that extortion by ETA altered the trade-offs inherent in cash-holding decisions, we find stronger effects in areas with greater local support for ETA proxied by the voting support for Batasuna (a Basque nationalist party considered the political arm of ETA). These findings are consistent with the idea that greater local support for ETA facilitated extortion through information sharing from sympathetic "informers", thereby reinforcing local firms' incentives to reduce cash holdings. Conversely, the effects are weaker among financially constrained firms or firms that are closer to bankruptcy, for which the precautionary value of cash is particularly high.

We next explore the real consequences of the cash holding decisions of Basque and Navarre firms. Their lower cash levels imply that they consume liquidity more rapidly than similar but unconstrained firms, leading to lower contemporaneous cash levels and a lower cashflow sensitivity of cash. Indeed, we find that the cashflow sensitivity of cash of Basque and Navarre firms increases relative to comparable firms after ETA ceases its operations.

A natural follow-up question is how these firms used their cash during the period of extortion by ETA. One possibility is that they invested in real, less liquid assets that were harder to expropriate. Consistent with this hypothesis, we find that Basque and Navarre

firms reduced both the investment and the level of fixed assets after 2011. This pattern is consistent with our hypothesis and contradicts two alternative explanations: (i) that post-2011 cash increases merely reflect the end of direct extortion, and (ii) that the end of ETA's activities coincided with, or even caused, an improvement of economic conditions in the Basque country and Navarre, leading to a relative improvement in the cash situation of local firms and of their investment opportunities. Both alternatives would predict higher, not lower, investment in fixed assets when ETA ceases its extortion activities.

Maintaining low cash holdings implies that Basque and Navarre firms had to rely on alternative sources of funding to meet their liquidity needs, notably short-term debt financing. The end of ETA's extortion activities should reduce the need for these alternative sources of liquidity. Consistent with this prediction, Basque and Navarre firms experience a decrease in short-term debt financing following ETA's announcement in 2011.

Finally, the end of ETA's extortion activities lifted a significant friction constraining the financial and investment decisions of firms in the Basque Country and Navarre. We therefore expect these firms to experience improvements in their operating performance following the end of ETA's activities. Consistent with this prediction, we find that firms in the Basque Country and Navarre experience an increase in asset turnover (i.e., the ratio of sales to total assets), operating margins, and return on assets (ROA) in the years following the end of ETA's extortion activities.

The main contribution of this paper is to provide firm-level empirical evidence that political conflicts affect corporate policies. It shows that, when facing extortion risk, even small and medium-size firms change their investment and financing policies, with consequences on their performance. Prior literature mainly focuses on the macro-economic effects of political conflicts and the evidence on the impact of political conflicts on firms is comparatively

scarce. Two notable and recent exceptions include Jola-Sanchez and Serpa (2021) and Custodio, Mendes, and Mendes (2022). Both studies examine corporate decisions in the context of armed conflicts in Colombia and Mozambique, respectively. They find that armed conflicts have significant effects on purchase decisions as well as inventory-management decisions. The conflict between ETA and the Spanish government, which affects companies essentially through its revolutionary tax, has different but broad consequences on firms' financing and investment decisions. Our conclusions are generalizable to other firms exposed to comparable forms of extortion risk. Revolutionary taxes have been imposed on firms in various contexts, such as by the Irish Provisional IRA in Ireland, the Corsican National Liberation Front in France, the Movimiento Nacionalista Tacuara (targeting Jewish businesses) in Buenos Aires, Argentina, and local guerilla movements in Colombia and Nepal. Other instances of corporate extortion include payments demanded by drug cartels or gangs in Latin America (e.g., Brown et al. 2025; Dammert 2021; Magaloni et al. 2020) or by political parties in India and Pakistan (e.g., Siddiqui, Stommes, and Waseem 2024).

A related body of research focuses on the impact of terrorist attacks on corporate outcomes like acquisitions (Nguyen, Petmezas, and Karampatsas 2023), CEO compensation (Dai et al. 2020), disclosure and innovation (Chen, Wu, and Zhang 2021), and risk-taking (Antoniou, Kumar, and Maligkris 2017). These studies exploit terrorist attacks in the U.S. essentially as exogenous shocks to managerial sentiment or uncertainty. Our paper differs from them in several ways. First, terrorist attacks are significant isolated events with broad but relatively short-lived effects. Second, Basque and Navarre firms are directly affected by ETA's extortion activities. Therefore, although risk aversion or uncertainty may have played a role in our context, they do not seem to be the main drivers of the effects we document.

Another related body of research explores the role of criminal organizations and their

impact on the economy. More specifically, Bianchi et al. (2022) and Slutzky and Zeume (2024) analyze the effect of anti-mafia regulations and law enforcement in Italy on local companies. An important difference between organized crime like the Italian mafia and our setting is that organized crime plays an active role in local economies, interacting with many economic actors in various ways depending on the involvement of these actors in the organization. On the contrary, ETA's actions were very limited in scope, essentially to extortion. As a consequence, their effect on local firms is more direct and relatively easy to identify.

This paper also contributes to the literature on corporate cash holdings and its determinants (e.g., Opler et al. 1999; Almeida, Campello, and Weisbach 2004; Faulkender and Wang 2006), and more specifically, to the literature showing that firms act strategically, through their capital structure or cash holdings, to improve their bargaining power with stakeholders like labor unions (e.g., DeAngelo and DeAngelo 1991; Bronars and Deere 1993; Klasa, Maxwell, and Ortiz-Molina 2009; Matsa 2010; Bova 2013; Chung et al. 2016; Myers and Saretto 2016; Di Giuli, Matta, and Romec 2023). Our findings expand this literature in two ways. First, prior studies usually focus on large publicly listed companies. To the best of our knowledge, our study is the first to document strategic actions taken by small and medium companies facing extortion risk. Second, our paper focuses on a different stakeholder. Despite the illegal nature of its claim on corporate cash-flows, ETA arguably represents a powerful stakeholder as it can impose significant threats and costs on companies.

Finally, our paper is related to the literature on the interplay between politics and corporate cash holdings. Prior evidence shows that firms decrease cash holdings when the threat of extraction from politicians increases (Caprio, Faccio, and McConnell 2013; Smith 2016), but increase them when the opportunities of bribing officials are higher (Aggarwal and Litov

2025).

2 Background

In this section, we provide an overview of the revolutionary tax and the extortion activities of ETA against Basque and Navarre companies. We then discuss ETA's announcement of the definitive cessation of its armed and extortion activities in 2011. A more general description of the history of the Basque political conflict can be found in Abadie and Gardeazabal (2003).

2.1 Revolutionary tax

To finance its activities, ETA engaged in extensive extortion activities targeting entrepreneurs, business owners, chief executives, small businesses, and liberal professionals (i.e., mainly doctors and lawyers). The extortion process began with sending letters to business owners who were typically given instructions on how to make payments anonymously, often through covert channels. These demands were denominated revolutionary tax because the terrorist group claimed that they had a legitimate claim on Basque businesses' money because true Basque people should be in favor of their cause: to free Basque country from the oppression exercised by the Spanish state. These letters were not only an intended source of financial income for ETA but also a tool to instill fear and assert their presence in the regions of Basque Country and Navarre.

While specific criteria to select letter recipients remain unknown, studies based on police records, interviews with members of the terrorist groups and victims of ETA's extortion indicate that ETA carefully selected targeted businesses (e.g., Reinares 2011; Buesa 2011; Sáez de la Fuente Aldama 2017; Gastaminza 2018)). ETA intended to collect money from

well-functioning businesses and avoided making requests to very small businesses owned by working-class people or firms that were going through difficult times. This behavior aimed to avoid putting employment at risk, in line with ETA's far-left ideology. Moreover, ETA was seeking to have legitimacy within the Basque working-class people. In the early years, ETA relied on a network of "informers" (i.e., people sympathizing with ETA's cause) to obtain financial information on businesses and select the targets of its revolutionary tax. However, as from the mid-90s ETA's extortion activities became more sophisticated (Buesa 2011). Specifically, evidence found in police investigations points to ETA making use of firms' annual financial statements from the corporate registry as well as financial information provided by "informers" (Sáez de la Fuente Aldama 2017). These "informers", including bank employees with direct access to accounts, board members and even business partners, supplied privileged information on the economic situation of Basque firms (Gastaminza 2018, p.397).

To monitor its extortion targets, ETA put in place a system of internal procedures and used a sophisticated computerized accounting system (Gastaminza 2018). To enforce its extortion requests, ETA exercised violence against individuals or businesses that ignored or defied the payment demands.[3] ETA kept close watch on non-payers, resorting to harassment, physical attacks on business facilities, and even launching boycott campaigns.[4] Many studies conclude that ETA had a high level of organization in tracking payment requests and using various threat mechanisms (e.g., Buesa 2011; Buesa and Baumert 2013).

3. The last person assassinated by ETA for refusing to pay the revolutionary tax was Ignacio Uría, the owner of a construction company involved in infrastructure projects. This assassination occurred in December 2008 (Europa Press, January 21st, 2009: https://www.europapress.es/nacional/noticia-eta-dice-asesino-uria-implicacion-tav-negarse-pagar-impuesto-revolucionario-20090121011310.html).

4. In 2005, ETA published a list of companies that were targeted but refused to pay. As a consequence, the terrorist group launched a boycott campaign against their products (El Mundo, December 20th, 2005: https://www.elmundo.es/elmundo/2005/12/20/espana/1135046595.html)

While there is considerable uncertainty about the exact amounts demanded by ETA as part of its revolutionary tax, some sources report that the average amount requested was around €172,000 per company, ranging from €3,000 to over €700,000 (Gastaminza 2018). Other sources suggest that it ranged between €35,000 and €400,000 per company.[5] These relatively wide ranges reflect the breadth of ETA's extortion activities, which targeted both large famous companies (e.g., BBVA, Seguros Bilbao, Conservas Isabel) and small businesses (e.g., Estación de Servicios de Puntxas). For four companies for which we were able to obtain extortion letters, we find that the amounts demanded ranged from €6,000 to €144,000, representing between 1.5% and 6.5% of their cash balances.[6]

2.2 Definitive cessation of ETA's activity

In 2011, ETA announced that it would cease all activities. In April of that year, the organization declared an end to its long-standing practice of extortion through letters demanding payment of the so-called revolutionary tax. This decision was communicated to CONFEBASK and CEN, the business associations representing firms in the Basque Country and Navarre. According to these organizations, as well as several political groups, the announcement constituted a credible signal that ETA was abandoning its financial demands, unlike previous ceasefires such as the one in 2006, during which ETA continued to issue extortion letters.[7] Finally, in October 2011, ETA declared a definitive ceasefire, formally committing to end

5. Source: NATO reports: https://www.nato.int/docu/speech/2002/s020222i.htm

6. Figure IA.1 presents an example of an extortion letter received by a Basque company. For confidentiality reasons, the names of the company and the letter's recipient have been removed. Strikingly, the letter appears highly professional, resembling an official document and even including a reference number. This reflects the high degree of sophistication in ETA's extortion activities. The letter specifies the amount of the revolutionary tax requested, outlines the payment instructions, and warns that refusal to pay would expose the recipients and their property to potential consequences.

7. Spanish newspapers documented that some extortion letters were sent during the ceasefire (El Mundo, April 15th, 2006: https://www.elmundo.es/papel/2006/04/14/espana/)

both armed actions and extortion.

The cessation of ETA's activities was the result of two main factors. First, in the 2000s the struggle between ETA and security forces began to tilt in favor of the latter. A coordinated Spanish–French police offensive led to the arrest of several ETA leaders and substantially weakened the organization's operational capacity. Second, support for Basque independence in general, and for ETA's cause in particular, declined from the early 2000s onward, as shown in Figure 1), as perceptions of repression by the central state had diminished considerably after more than thirty years of democracy in Spain.

These elements could raise concerns for identification if ETA was already too weak to make credible threats when it announced the end of its activities. In such a scenario, ETA's 2011 announcement, even if unexpected, may have had little impact. However, ETA had been weakened by police crackdowns in the past and had subsequently managed to regain strength and maintain its extortion and terrorist activities. Results from opinion polls reported in Figure 2 show that a large share of Basque citizens still feared participating in politics in the years prior to 2011. This percentage fell abruptly, by roughly 40%, after the 2011 announcement and after rising between 2007 and 2010 following the failure of the 2006 ceasefire. ETA also continued to carry out attacks in the years just before halting its activities: According to the Global Terrorism Database,[8] the organization perpetrated 30 terrorist attacks in the Basque Country and Navarre between 2008 and 2010. Furthermore, on January 21, 2009, ETA claimed responsibility for the assassination of Ignacio Uría, the last business owner it killed, explicitly citing his refusal to pay the revolutionary tax and warning that similar actions could follow.

Taken together, this evidence suggests that, although weakened, ETA's extortion threats

8. Available at https://www.start.umd.edu/data-tools/GTD

and the broader climate of fear they generated were still salient prior to 2011. These threats effectively disappeared only after the definitive ceasefire later that year.

3 Empirical predictions

ETA and its revolutionary tax represent a significant source of extortion risk for firms in the Basque country and Navarre. Once targeted, firms can pay the revolutionary tax or face threats, including boycotts, attacks on their facilities, kidnappings, or even assassination. As discussed above, although the tax level set by ETA cannot be precisely estimated, it is determined by firms' ability to pay, making it effectively similar to a tax on cash holdings. Therefore, our hypothesis is that higher cash holdings increase both the probability of being targeted by ETA and the amount requested, and as a consequence, the expected revolutionary tax.

To examine the effect of this tax on cash, we assume, as does most of the literature (e.g., Opler et al. 1999), that a firm's cash level results from a trade off between the benefits and costs of holding cash. On the positive side, cash offers a precautionary buffer, particularly for firms that are financially constrained. On the negative side, cash offers low returns. ETA's tax on cash makes cash holdings more costly. Therefore, firms should hold less cash than their first-best level under ETA. Our central prediction is therefore that firms in the Basque Country and Navarre maintain low cash holdings to reduce the risk and expected cost of extortion by ETA. With the cessation of ETA's extortion activities, they no longer need to maintain low cash holdings. This leads to our first empirical prediction:

Prediction 1: Basque and Navarre firms increase their cash holdings following the end of ETA's extortion activities

A related prediction concerns the cash flow sensitivity of cash. As discussed in Almeida, Campello, and Weisbach (2004), a firm's cash flows and its cash holdings should be related, particularly so if the firm is financially constrained. Given that firms in our sample are typically small and do not have access to capital markets to finance their activities, this relationship should be particularly pronounced for them. However, compared to similar firms not facing ETA's extortion threat, Basque and Navarre firms under ETA should consume the cash they generate so as to maintain low levels of cash. This should weaken the relation between cash flows and cash holdings. Following the cessation of ETA's extortion practices, we expect the cash retention behavior of Basque and Navarre firms to normalize. That is, their cash holdings should become more responsive to cash flows, as the strategic need to avoid liquidity accumulation diminishes. This leads to our second empirical prediction:

Prediction 2: The cashflow sensitivity of cash increases for Basque and Navarre firms following the end of ETA's extortion activities

Our third prediction concerns the allocation of cash in the presence of extortion risk. One possible way for firms in the Basque Country and Navarre to maintain low levels of cash is to invest in fixed assets, which are less liquid than cash and therefore more difficult to extract. Consistent with this argument, Caprio, Faccio, and McConnell (2013) find that firms increase their investment in fixed assets when the threat of extraction by politicians is high.[9] Following the cessation of ETA's activities, firms in the Basque Country and Navarre no longer need to invest in fixed assets to limit extortion risk.

Prediction 3: Basque and Navarre firms reduce their investment in fixed assets following the end of ETA's extortion activities

9. An alternative strategy is to increase payout. However, this mechanism is unlikely to be relevant in our setting because the vast majority of firms in our sample are small and medium-sized private firms that do not pay dividends (only 2.5% of our sample firms pay dividends). Consequently, payout is not a viable channel for sheltering cash from extortion in our context.

One consequence of maintaining low cash holdings is that firms in the Basque Country and Navarre may have had to rely more heavily on alternative sources of liquidity, notably short-term debt financing. From this perspective, the cessation of ETA's extortion activities should lead to increased cash balances and reduced need for alternative sources of liquidity, implying a decline in short-term debt financing.

Prediction 4: The end of ETA's extortion activities decreases (short-term) debt financing for firms in the Basque Country and Navarre

Our last prediction concerns the impact of ETA's announcement on firm performance. ETA's extortion activities pushed Basque and Navarre firms to operate at a suboptimally low level of cash holdings, investing their cash in projects that they might have rejected in the absence of extortion threats. The removal of this extortion-related threat eliminates a friction constraining the financial and investment decisions of these firms. As a result, we expect the performance of firms in the Basque country and Navarre to improve when ETA stops its extortion activities.

Prediction 5: The financial performance of Basque and Navarre firms improves following the end of ETA's extortion activities

4 Sample Selection and Research Design

4.1 Data Sources and Sample Construction

We use a combination of different data sources in our empirical analysis. First, accounting and financial data are from the SABI database of Bureau Van Dijk, which provides detailed accounting information for Spanish companies filing annual financial statements at local

commercial courts. From SABI, we also obtain data on the location of firms' headquarters.[10] Second, we obtain province-level macroeconomic data from the Spanish National Institute of Statistics, data on the stock of lending granted to individuals or private entities in the province from the Spanish Banking Association (AEB), and data on the results of political elections from the Spanish Ministry of the Interior. Finally, we obtain data on ETA's attacks from the Global Terrorism database.

In our baseline analysis, we estimate changes in cash holdings at the firm-year level over a two-sided 3-years window around ETA's announcement of the definitive cessation of its armed activity.[11] The construction of our main sample therefore starts with all Spanish companies in the SABI database over the period 2008-2014. Our treatment firms are all the firms located in the two autonomous communities in which ETA was active and operating, namely, the Basque Country and Navarre, while we use firms located in neighboring autonomous communities (i.e., Aragon, Cantabria, Castile and Leon, and La Rioja) as controls. Figure IA.2 displays the location of the Basque Country and Navarre (in blue) and neighboring autonomous communities (in grey) on a map of Spain. We further drop firms with missing data on cash holdings or on our other main control variables. These data filters provide us with an unbalanced sample of 303,354 firm-year observations. Finally, to ensure that our results are not driven by spurious changes in cash due to firms entering or exiting the sample, we restrict the sample to firms that are continuously present over the sample period. This approach follows standard practice in the literature, where such dynamics may pose an identification threat (e.g., Matray 2021). This restriction results in a final balanced sample of 192,978 firm-year observations, with 12,213 unique firms in the treatment group, i.e., in

10. SABI reports each firm's location as of the time of data extraction. Since the data was extracted in 2024, the firm locations used in our analysis correspond to those recorded that year.

11. In robustness tests, we consider alternative windows from 2-years to 5-years around ETA's announcement.

the Basque country or Navarre, and 19,950 in the control group, i.e., located in neighboring areas.[12]

4.2 Descriptive Statistics

Table 1, Panel A reports summary statistics of the main variables used throughout the empirical analysis for the balanced sample of firm-year observations. Appendix A provides information on the definitions and construction of all the variables. Continuous variables are winsorized at the 1st and 99th percentiles. The average firm in our sample has a mean (median) ratio of cash to total assets of 14.4% (8%). The median firm in our sample is small, with an average value of total assets of €650k $(= 1{,}000 \times \exp(6.476))$. In fact, thanks to the broad coverage of the SABI dataset, our sample firms are representative of firms in the Basque and Navarre economies and of the potential targets of ETA's extortion activities.

Panel B of Table 1 reports the mean differences in our main variables between treated and control firms during the pre-period (i.e., the three years preceding the end of ETA's activity in 2011). In the overall sample, treated firms, i.e., firms from the Basque country and Navarre, tend to be larger, to hold more cash and to have less tangible assets and less long-term debt. To account for time-invariant differences between the two groups of firms, we include firm fixed effects in subsequent tests. To ensure that our results are not driven by some time-varying differences across firms in different regions, we also construct a matched set of treated and control firms prior to the shock, using a propensity score matching (PSM) algorithm.[13] Panel C reports the mean differences in our main variables between treated and control firms during the pre-period for the matched sample. After matching, treated

12. In the Internet Appendix, we show that our results hold if we use the PSM matched sample.

13. We match each treated firm to a control firm operating within the same NAICS-2 industry classification. Matching is based on the following covariates measured in 2010, the last year before ETA's announcement: cash growth, profitability, size, fixed assets, sales/assets and working capital.

and control firms do not differ significantly across most characteristics.

5 Empirical Analysis

5.1 Empirical Design

In our empirical analysis, we exploit ETA's announcement of a definitive cessation of its armed and extortion activities in 2011 as a source of exogenous variation in the revolutionary tax and associated threats against firms located in the Basque and Navarre regions. To test our prediction, we use a difference-in-differences analysis and compare changes in cash holdings before and after ETA's announcement between Basque and Navarre firms and a set of control firms located in the neighbouring provinces. Specifically, we estimate the following regression at the firm-year level, over a window of three years before (2008-2010) to three years after (2012-2014) ETA's announcement:[14]

$$\text{Cash Holdings}_{i,t} = \beta_0 + \beta_1 \text{Treated}_i \times \text{Post}_t + \beta_2 \mathbf{X}_{i,t} + \gamma_i + \delta_{j,t} + \epsilon_{i,t}, \tag{1}$$

where Cash Holdings$_{i,t}$ is the ratio of cash and equivalents to total assets. *Treated*$_i$ is a dummy variable that is equal to one if the firm is headquartered in the Basque Country or in Navarre, and *Post*$_t$ is a dummy variable that is equal to one after ETA's announcement (i.e., the period 2012-2014) and zero before the announcement (i.e., the period 2008-2010). In our baseline tests, we use all firms in the treated and control regions. The vector $\mathbf{X}_{i,t}$ contains various firm and province-level characteristics including size, profitability, credit distribution,

14. As discussed in section 2, ETA announced the definitive cessation of its activities in October 2011. Since the announcement was made toward the end of 2011, we exclude the year 2011 from the empirical analysis.

inflation and gross domestic product. We control for firm (γ_i) and industry-year ($\delta_{j,t}$) fixed effects. The standalone variables $Treated_i$ and $Post_t$ are absorbed by firm and time fixed effects, respectively. Standard errors are clustered at the municipality level. The coefficient of interest, β_1, captures the difference in cash holdings for Basque and Navarre firms relative to other firms, following the announcement of the end of ETA's armed and extortion activities.

5.2 Baseline results

Table 2 reports the results of estimating Equation (1). Column 1 shows that the coefficient on Treated × Post is positive and statistically significant at the 1% level, indicating that firms in the Basque Country and Navarre increased their cash holdings in the years following the announcement of the end of ETA's armed and extortion activities, relative to other firms. Specifically, firms in these regions increase their cash holdings by 1.1 percentage points relative to the control firms, representing approximately 6.5% of the standard deviation of this variable. In Column 2, we replace year fixed effects with industry-year fixed effects to account for industry specific shocks or any other time-varying factors at the industry level that may affect cash holdings. In Column 3, we include firm- and province-level characteristics. The coefficient on Treated × Post is positive and statistically significant at the 1% level across both specifications and remains similar in magnitude. Overall, the results from Table 2 are consistent with our prediction that firms in the Basque Country and Navarre strategically manage their cash holdings to mitigate extortion risk.

We corroborate our finding that firms in the Basque Country and Navarre increase their cash holdings following ETA's announcement in a series of robustness tests. First, in Table IA.1, we reestimate Equation (1) considering alternative time windows around ETA's announcement, using 2, 4 and 5 years before and after the announcement. In all columns, the

coefficient on Treated × Post is positive and statistically significant at the 1% level and the magnitude of the coefficient is similar across specifications. Our findings are therefore not sensitive to the choice of the time window around ETA's announcement.

Second, in Table IA.2, we confirm our baseline finding using alternative definitions of cash holdings. Specifically, we consider the natural logarithm of cash and equivalents divided by total assets (Column 1), the natural logarithm of the amount of cash and equivalents (Column 2), the ratio of cash and equivalents to total assets minus cash and equivalents (Column 3), the ratio of cash and equivalents to total assets measured as of 2008 (Column 4), as well as the natural logarithms of these two variables (Columns 5 and 6). In all columns, the coefficient on Treated × Post is positive and statistically significant at the 1% level, confirming our baseline finding.

Third, an alternative explanation for our baseline results is that Basque and Navarre firms were keeping money on separate accounts outside the firm to be able to pay the revolutionary tax in a discrete way. This alternative explanation predicts that the effect documented earlier should be less pronounced for audited firms. Indeed, audited firms are less likely to be able to keep money out on separate accounts to make payments to ETA. In Table IA.3, Panel A, we report tests showing that the treatment effect is not statistically different for audited firms. Furthermore, firms with revenues exceeding €7 million were inspected by both the Basque and Spanish State fiscal authorities. On the contrary, for smaller Basque firms, the Basque provincial Treasuries are the only tax authorities responsible for collecting and levying the corporate income tax. To the extent that State fiscal authorities are less lenient than regional ones, it should be more difficult for larger firms to keep money on separate accounts. In Panel B, we show that our main results hold both for firms above and below €7 million in revenues (based on 2010 values).

Fourth, in Table IA.4, we probe the robustness of our findings to alternative definitions of treated and control firms. In Column 1, we only include Basque firms in the treated group (and we drop Navarre firms from the sample). This robustness test is motivated by anecdotal evidence that ETA's extortion activities were less intense and successful in Navarre.[15] Likewise, we check that the results are robust if we exclude firms in the different neighboring autonomous communities from the control group. None of the control autonomous communities seem to be driving the main results. Finally, in our baseline setting, control firms consist of firms located in neighboring autonomous communities. To further mitigate the concern that our results could be driven by local economic shocks, we impose that the distance between control firms and the Basque Country should be lower than 100 kilometers. Our results are robust if we impose this restriction.

Finally, we check that our main results hold if we rely on the PSM matched sample (Table IA.5) or if we consider alternative clusterings of standard errors (Table IA.6).

5.3 Parallel Trends

The validity of difference-in-differences tests depends on the parallel trends assumption: In the absence of treatment (in our case, the end of ETA's armed activities), the cash holdings of treated firms (i.e., firms headquartered in the Basque Country and Navarre) would have evolved in a similar way as those of control firms. To compare the pre-treatment trends of treated and control firms and assess the dynamics of the treatment, we re-estimate Equation (1) replacing the Post variable with dummies capturing the individual years surrounding ETA's announcement. In this dynamic specification, we estimate effects relative to the year

15. For example, according to the data gathered in Marrodán (2014), only 5% of firm owners who received the extortion letters in Navarre paid the revolutionary tax. Moreover, Navarre also had an administrative system more favorable for targeted firms' owners to report cases of extortion to the authorities (Gastaminza 2018).

2010 (i.e., the last year before the treatment).

Figure 3 reports the results of the dynamic specification. Specifically, it plots the coefficient estimates on the interaction terms between Treated and dummy variables for the different years around ETA's announcement as well as the 95% confidence intervals. To better capture possible pre-trends and reversals, we expand the time window to 5 years before and after the announcement.[16] Figures IA.3 and IA.4 report the results using respectively the balanced and matched samples.

Three main findings emerge from Figure 3. First, prior ETA's announcement, treated and control firms behave similarly and we observe no significant differences in their cash holdings. One notable exception is for the year 2008 where the coefficient is significantly negative, indicating that Basque and Navarre firms had significantly lower cash holdings in 2008. However, in Figure IA.4, the coefficient for the year 2008 is no longer significant when we use the matched sample. Overall, the results confirm that there is no violation in the parallel trends assumption. Second, treated firms react immediately to ETA's announcement by increasing their cash holdings in the year following the announcement. Third, treated firms operate with significantly higher cash holdings throughout the post period and we do not observe any reversal in the years following ETA's announcement.

5.4 Cross-sectional heterogeneity

5.4.1 Local support for Batasuna

If the increase in cash holdings observed for Basque and Navarre firms after ETA ceased its activities reflects a trade off between the costs and benefits of holding cash, it should be

16. In unreported tests, we find similar results if we consider a time windows of 3 years before and after the announcement.

more pronounced in firms for which the expected cost of extortion is higher. To test this prediction, we rely on voting support for Batasuna, a Basque nationalist party viewed as the political arm of ETA, in the city where the firm is located.[17] ETA is likely to be more powerful in areas where voting support for Batasuna is high, which increases extortion risk in these areas. Moreover, as discussed in Section 2.1, ETA relied on a network of "informers" to obtain financial information and select its targets. Greater voting support for Batasuna may indicate that a larger part of the local population sympathizes with ETA, which could facilitate the selection and monitoring of target firms and increase expected extortion costs for local firms.

Since voting support for Batasuna is only available for Basque and Navarre firms, we use this variable to capture differences in intensity of the treatment among treated firms. In Table 3, we re-estimate Equation (1) considering different definitions of treated firms based on the voting support for Batasuna in the area of firms' headquarters. Specifically, we create two dummy variables, Treated_High and Treated_Low, equal to one if firms are respectively located in areas where voting support for Batasuna falls in the top quartile and below the top quartile of the distribution. We measure the local voting support for Batasuna based on the results of the 1999 municipal elections, the last election in which Batasuna was allowed to run before being banned.

In Column 1 of Table 3, we restrict the sample to treated firms. The results show that the coefficient on the interaction between Treated_High and Post is positive and significant at the 10% level, indicating that Basque and Navarre firms located in areas with high support for Batasuna increase their cash holdings more than other treated firms following ETA's

17. Batasuna had strong links with ETA and ended up being included in the European Union list of terrorist organizations as a component of ETA. Before being banned for its links with ETA, Batasuna was able to run for different elections and obtained representatives in the European Parliament as well as in the Navarre and Basque parliaments.

announcement. In Column 2, we include all sample firms and compare how Basque and Navarre firms located in areas with high and low support change their cash holdings compared to control firms. We find that the coefficients on the two interaction terms Treated_High ×Post and Treated_Low×Post are both statistically significant at the 1% level. However, the magnitude of the coefficient is higher for firms in areas with high support for Batasuna. A Wald-test confirms that the coefficients are statistically different. In Table IA.7, Panel A, we show that the results hold if we consider the matched sample.

The results from Table 3 are consistent with the idea that the expected cost of extortion was higher in areas with strong local support for Batasuna, because ETA was more powerful in these regions or because local complicity facilitated target selection. A non-mutually exclusive explanation is that firms in such areas were more sympathetic to ETA's cause and thus more willing to pay the revolutionary tax. A natural consequence of ETA's announcement is that these firms stopped paying the revolutionary tax and increased their cash holdings as a consequence. To disentangle these explanations, we examine whether ETA perpetrated more attacks, particularly against businesses and private property, in areas with stronger support for Batasuna. If firms in these areas were willingly paying the revolutionary tax, we should observe fewer attacks against businesses. By contrast, if ETA was more powerful in these areas, we would expect to see more attacks.

At the municipality level, we compute the number of attacks perpetrated by ETA during the period preceding the 2011 announcement using data from Global Terrorism database. Table IA.8 reports regressions of either the number or the likelihood of ETA attacks in a given municipality on the Treated_High dummy (indicating strong support for Batasuna) and the natural logarithm of the number of inhabitants. The results from Column 1 show that municipalities with strong support for Batasuna experience a higher number of ETA

attacks. In Column 2, in which the dependent variable is the likelihood of having at least one attack, the coefficient is positive but not statistically significant. In Columns 3 and 4, we find similar results if we restrict the analysis to ETA attacks against businesses and private properties. Overall, the results from Table IA.8 indicate that ETA perpetrated more attacks in areas with stronger local support for Batasuna. This suggests that, in these areas, the expected cost of extortion was higher.

5.4.2 The role of financial constraints and bankruptcy risk

In this section, we explore cross-sectional heterogeneity based on financial constraints or bankruptcy risk. There are two non-mutually exclusive reasons why the effect of ETA's 2011 announcement might be less pronounced for more fragile firms. First, for these firms, reducing cash holdings could further increase financial fragility. Despite the need to mitigate extortion risk, they might be therefore reluctant to significantly reduce their cash holdings. Second, as discussed in Section 2, ETA was concerned about not putting employment at risk when soliciting the payment of the revolutionary tax. As a result, it might avoid targeting firms with greater bankruptcy risk, which reduces their need to reduce their cash holdings. Both arguments predict that firms with greater financial constraints or bankruptcy risk should be less likely to change their cash holdings following ETA's announcement.

To test this prediction, we consider three proxies for financial constraints or bankruptcy risk; i) a loss-making dummy, ii) high leverage, and iii) low Altman Z-score. Specifically, we

estimate an augmented version of Equation (1):

$$\text{Cash Holdings}_{i,t} = \beta_0 + \beta_1(\text{Treated}_i \times \text{Post}_t) + \beta_2(\text{Treated}_i \times \text{Post}_t \times \text{Financial constraints}_i) + \beta_3 \mathbf{X}_{i,t} + \gamma_i + \delta_{j,t} + \epsilon_{i,t}, \tag{2}$$

where *Financial constraints*$_i$ is a generic dummy variable that identifies different subsets of firms with greater financial constraints or bankruptcy risk. We include the same control variables and fixed effects as in Equation (1).

Table 4 reports the estimations of Equation (2). The proxy for financial constraints or bankruptcy risk used in the regression is indicated at the top of each column. Across all specifications, the coefficient on the triple interaction term is negative (though not statistically significant in Column 1), indicating that the treatment effect is weaker for firms with greater financial constraints or bankruptcy risk. The results from Table 4 are consistent with the prediction that firms with greater financial constraints or bankruptcy risk have lower incentives to strategically manage their cash holdings and are therefore less likely to adjust their cash holdings following ETA's announcement.[18]

5.5 The cash flow sensitivity of cash

So far, the results are consistent with our main prediction that the cessation of ETA's extortion activities should lead to an increase in cash holdings for firms in the Basque Country and Navarre. Our second prediction concerns the cashflow sensitivity of cash. Specifically, due to extortion risk, Basque and Navarre firms have an incentive to avoid retaining cash, making their cash holdings less responsive to cash flows compared to control firms. Following

18. In Table IA.7, Panel B, we show that the results hold if we consider the matched sample.

the cessation of ETA's activities, however, the cash retention behavior of Basque and Navarre firms should normalize and cash flows are more likely to be retained than in the pre-period. Therefore, we expect the cash flow sensitivity of cash of Basque and Navarre firms to increase after ETA's announcement.

To test this prediction, we rely on the cash retention model from Almeida, Campello, and Weisbach (2004). In their model, the cash flow sensitivity of cash is estimated from a specification in which the change in a firm's cash holdings is regressed on the firm's cash flows and control variables. The coefficient on cash flows is an estimate of the cash flow sensitivity of cash. Following the same approach, we examine whether the cessation of ETA's extortion activities has an impact on the cash flow sensitivity of cash by estimating the following regression at the firm-year level:

$$\begin{aligned}\Delta\text{Cash Holdings}_{i,t} &= \beta_0 + \beta_1\text{CFO}_t + \beta_2\text{Post}_i \times \text{CFO}_t + \beta_3\text{Treated}_i \times \text{Post}_t \\ &+\beta_4\text{Treated}_i \times \text{CFO}_i + \beta_5\text{Treated}_i \times \text{Post}_t \times \text{CFO}_i + \beta_6\mathbf{X}_{i,t} + \gamma_i + \delta_{j,t} + \epsilon_{i,t},\end{aligned} \tag{3}$$

where ΔCash Holdings$_{i,t}$ is the change in cash holdings from year t-1 to year t. *Treated*$_i$, and *Post*$_t$ are defined as above. CFO$_t$ equals EBITDA$_t$ - ΔAccounts receivables$_t$ + ΔAccounts payables$_t$ - Corporate taxes$_{t-1}$, scaled by total assets. The coefficient β_1 measures the cash flow sensitivity of cash for the full sample. The main coefficient of interest is β_5 which captures the change in the cash flow sensitivity of cash for Basque and Navarre firms after the cessation of ETA's extortion activities.

Table 5 reports the results of estimating Equation (3). Columns 1 and 2 include an interaction term between CFO and Post and report the results separately for treated firms and control firms. In Column 1, the coefficient on Post $\times$ CFO is positive and statistically significant at the 1% level, indicating that the cash flow sensitivity of cash increases for

Basque and Navarre firms after the cessation of ETA's extortion activities. This result cannot be explained by a general increase in the cash flow sensitivity of cash in the post period, as the coefficient on Post × CFO in Column 2 is negative and not statistically significant. In Column 3, we pool treated and control firms and estimate the full version of Equation (3). In this regression, the main variable of interest is the triple interaction Treated × Post × CFO, which captures the change in the cash flow sensitivity of cash for Basque and Navarre firms after the cessation of ETA's extortion activities. The coefficient on the triple interaction term is positive and statistically significant, confirming that the cash flow sensitivity of cash increases for Basque and Navarre firms after the cessation of ETA's extortion activities.

Overall, the results from Table 5 are consistent with the prediction that Basque and Navarre firms avoided retaining cash to mitigate extortion risk under ETA. The cessation of ETA's extortion activities leads to an increase in their cash flow sensitivity of cash.

5.6 Investment in fixed assets and other corporate outcomes

5.6.1 Investment in fixed assets

The findings from the previous sections raise the question of how Basque and Navarre firms used their cash under ETA. To mitigate extortion risk, firms may choose to make investments in fixed assets that are harder to extract due to their illiquid nature. If the mechanism for sheltering cash from ETA is to invest in fixed assets, we expect Basque and Navarre firms to decrease investments in fixed assets following ETA's announcement of the cessation of its armed and extortion activities.

To test this prediction, in Table 6, we report estimations of Equation (1) using the ratio

of property, plant, and equipment to total assets as the dependent variable.[19] The results show that the coefficient on Treated × Post is negative and statistically significant at the 5% level in the most demanding specification of Column 3, indicating that firms in the Basque Country and Navarre decreased their investments in fixed assets in the years following ETA's announcement relative to control companies. We find similar results if we use the matched sample (Table IA.7, Panel C). Figure 4 reports the results of the dynamic specification using the ratio of property, plant, and equipment to total assets as the dependent variable. PPE levels are not statistically different between treatment and control firms before 2011. Post-2011, on the contrary, treated firms operate with significantly lower fixed assets. The difference between treated and control firms increases throughout the post period, in line with the view that Basque and Navarre firms reduce their investment post-2011. Figures IA.3 and IA.4 show that the findings are similar if we consider the balanced and matched samples. In Table IA.9, we repeat the analysis and find similar results when using alternative dependent variables including the natural logarithm of PPE or the ratio of PPE scaled by total assets as measured in 2008. In Table IA.10, we find that our results hold if we use the change in PPE from year t-1 to year t scaled by total assets as an approximation for the firm's capital expenditures.[20]

The results from this section suggest that the cash was used to make investments in fixed assets for which extortion risk is lower. Another way to reduce a firm's cash holdings to

19. Ideally, investment in fixed assets comes from the cash flow statements of firms. However, since the SABI database reports only total cash flows from investment activities and contains many missing observations, we use variations in PPE to proxy for investment in fixed assets. We do not include depreciation in our estimates because it is not available for small firms that report under the simplified Spanish model.

20. In Table IA.11, we examine whether ETA's 2011 announcement affected firms' inventories and accounts receivable. We find no evidence of such an effect. This is consistent with the notion that inventories and account receivables are relatively liquid assets that can be easily converted into cash and therefore do not provide the same protection against extortion risk as fixed assets.

reduce extortion risk is to pay dividends.[21] However, because many of the firms targeted by ETA are small and medium unlisted companies, only a small fraction of our sample firms (2.5%) pay dividends. Paying out cash to shareholders is therefore unlikely to be a relevant channel through which Basque and Navarre firms could shelter cash from ETA. Moreover, it is less clear that paying higher dividends would allow sheltering cash from ETA. Indeed, the cash would simply be transferred from the company to the business owners who can be personally targeted by ETA.

5.6.2 Debt financing

In this section, we examine whether the cessation of ETA's extortion activities affects debt financing. One consequence of maintaining low cash holdings to mitigate extortion risk is that Basque and Navarre firms may have had to find alternative ways to meet their liquidity needs. One natural solution is to rely more heavily on bank debt, in particular short-term debt financing. The ETA announcement should decrease the need for this reliance, leading to a decrease in bank debt, particularly short-term debt.

Table 7 presents the results of estimating Equation (1) using various debt measures as dependent variables (Table IA.7, Panel C reports the same regressions for the matched sample). In Columns 1 and 2, we consider long-term debt and bank debt, respectively. In both cases, the coefficient on Treated $\times$ Post is close to zero and not statistically significant, indicating that firms in the Basque Country and Navarre did not experience a significant increase in debt financing following ETA's announcement. These findings help alleviate the concern that the observed rise in cash holdings merely reflects improved access to external financing, rather than a strategic response to extortion risk. We also examine whether firms

21. Consistent with this argument, Hossain, Hossain, and Kryzanowski (2021) find that US firms headquartered in states with greater levels of corruption have higher payout ratios.

in the Basque Country and Navarre became less risky after the cessation of ETA's activities. Using the standard deviation of ROA and the Altman Z-score as proxies for firm risk, we find no evidence of a significant change in risk (see Table IA.12). In Column 3, we consider the ratio of short-term debt to total assets. The coefficient on Treated × Post is negative and statistically significant at the 5% level, suggesting a reduction in short-term debt among Basque and Navarre firms post-2011.[22] This result is consistent with the idea that, as a consequence of having low cash balances to curb extortion risk, firms in the Basque Country and Navarre were relying on short-term financing to meet their liquidity needs.

5.6.3 Performance

The results from the previous sections indicate that firms in the Basque Country and Navarre maintain low cash holdings and invest in fixed assets to limit extortion risk arising from ETA's revolutionary tax. A related prediction is that the operational performance of these firms should improve after the ETA's announcement, when firms move closer to their first-best cash and investment levels. The end of ETA's extortion activities eliminates a key friction that was weighing negatively on firms in the Basque Country and Navarre, leading to an improvement in operating and financial performance.

To test this prediction, in Table 8, we report estimations of Equation (1) using different proxies for operational performance as the dependent variables. In Column 1, we consider asset turnover (i.e., the ratio of sales over total assets). The coefficient on Treated × Post is positive and statistically significant at the 1% level, indicating that firms in the Basque Country and Navarre experienced an increase in asset turnover in the years following the cessation of ETA's extortion activities. This result can be partially explained by the fact

22. The number of observations shrinks in Column 3 because data on short-term debt are missing for many observations.

that Basque and Navarre have decreased their investment in fixed assets. The results from Column 2 indicate that these firms also experience an increase in operating expenses scaled by total assets, which is plausible given higher asset turnover. Finally, the results from Columns 3 and 4 indicate that firms in the Basque Country and Navarre improved their operating margin and ROA after the cessation of ETA's extortion activities. In Table IA.7, Panel C, we find similar results if we use the matched sample.

Overall, the results from Table 8 are consistent with our prediction that the end of ETA's extortion activities led to improvements in the operating and financial performance of firms in the Basque country and Navarre. However, other factors may have contributed to the observed performance gains. For instance, ETA's announcement may have positively influenced public sentiment in the Basque Country and Navarre, potentially stimulating local consumption and boosting sales for firms in these autonomous communities. Prior studies exploit terrorist attacks in the US as exogenous shocks to negative managerial sentiment. In particular, Antoniou, Kumar, and Maligkris (2017) show that corporate managers located near major terrorist attacks experience negative emotions, which induces them to adopt more conservative corporate policies. In our context, given that the end of ETA's extortion constitutes a positive shock of managerial sentiment, an emotion-related explanation would predict a decrease in cash holdings for firms in the Basque Country and Navarre. Another possible interpretation of these results is that improved ROA stems from the fact that firms in the Basque Country and Navarre no longer spend on protection and security services (e.g., bodyguards, night watchmen) or for some firms, the fact that they no longer pay the revolutionary tax to ETA. While this could plausibly enhance profitability, it is unlikely to explain the observed improvements in sales and operating margins, as well as the decrease in fixed assets documented in previous sections.

6 Conclusion

Many regions of the world are affected by violent political conflicts. While prior studies document that political conflicts can disrupt economic activity and harm economic growth, micro-level evidence on the impact of political conflicts on firms is scarce. Focusing on the Basque political conflict and exploiting ETA's announcement of a definitive cessation of its armed and extortion activities as an exogenous shock in the exposure of Basque firms to extortion risk, we provide evidence that political conflicts affect corporate cash holdings.

Our results suggest that Basque firms strategically reduce their cash holdings to mitigate extortion risk and shield themselves from ETA's extortion activities and revolutionary tax. This effect is more pronounced for firms located in areas where political support for ETA is higher. We also find that the cashflow sensitivity of cash of Basque and Navarre firms increases, indicating a shift in cash retention behavior. They also reduce their investment in property, plant, and equipment, consistent with the notion that they previously used fixed assets as a way to shelter cash from ETA. Finally, firms in the Basque Country and Navarre experience a significant increase in financial performance (measured by asset turnover, operating margins, and ROA), consistent with the end of ETA's extortion activities removing a significant friction constraining firms' financial and investment decisions.

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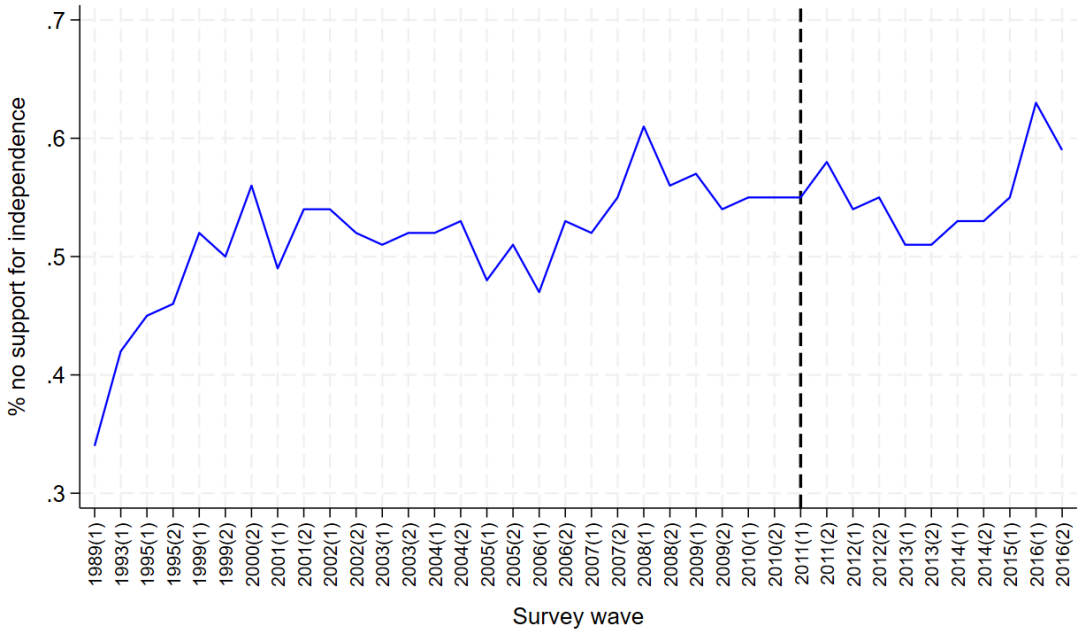

Figure 1: Evolution of the percentage of people who declare no support for the independence of Basque Country. This figure plots the percentage of people that declares no or very little support for Basque independence. The source of the data is the Euskobarometro, a survey run twice a year by the University of the Basque Country based on a sample of citizens of the region. They do the survey twice a year (typically May (labeled by (1)) and November (labeled by (2)). The vertical dashed line indicates the last survey before the cessation of ETA's activities.

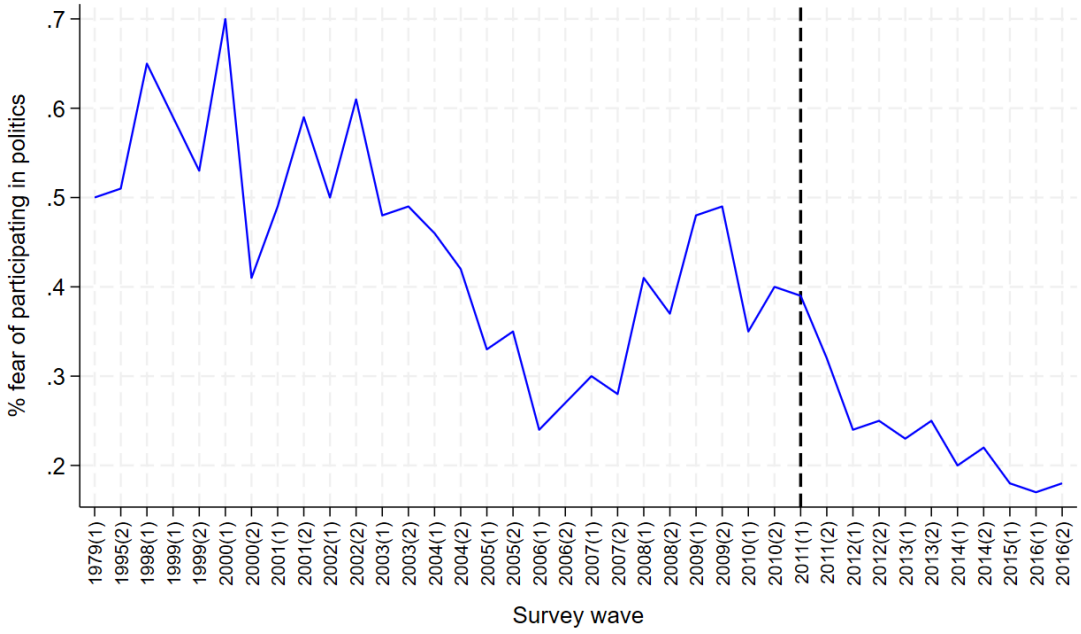

Figure 2: Evolution of the percentage of people who declare they fear to engage in politics or political associations. This figure plots the percentage of people that declares feeling fear to engaging in politics or political associations. The source of the data is the Euskobarometro, a survey run twice a year by the University of the Basque Country based on a sample of citizens of the region. They do the survey twice a year (typically May (labeled by (1)) and November (labeled by (2)). The vertical dashed line indicates the last survey before the cessation of ETA's activities.

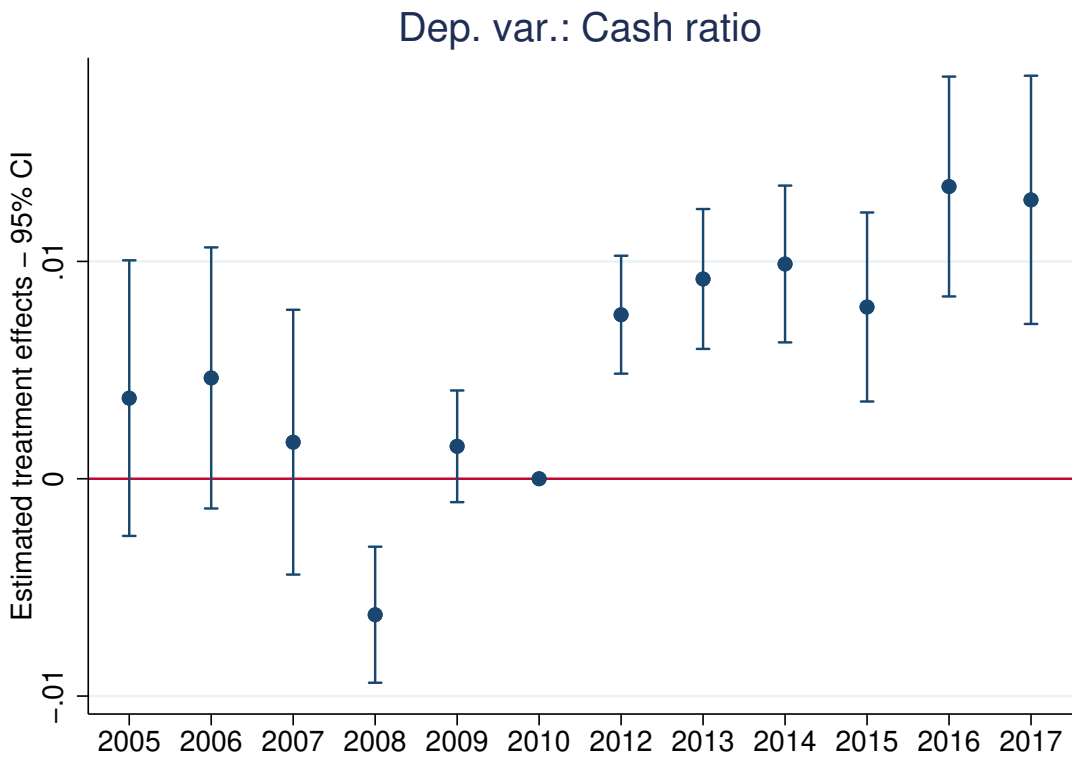

Figure 3: Effect of ETA's announcement on cash holdings (balanced sample). This figure plots the coefficient estimates on the interaction terms between Treated (a dummy variable equal to one for firms located in the Basque Country and Navarre) and dummy variables coding for the different years around ETA's announcement as well as the 95% confidence intervals. The regressions are based on the balanced sample and include the control variables from Table 2 as well as firm and industry-by-year fixed effects. The dependent variable is cash holdings scaled by total assets.

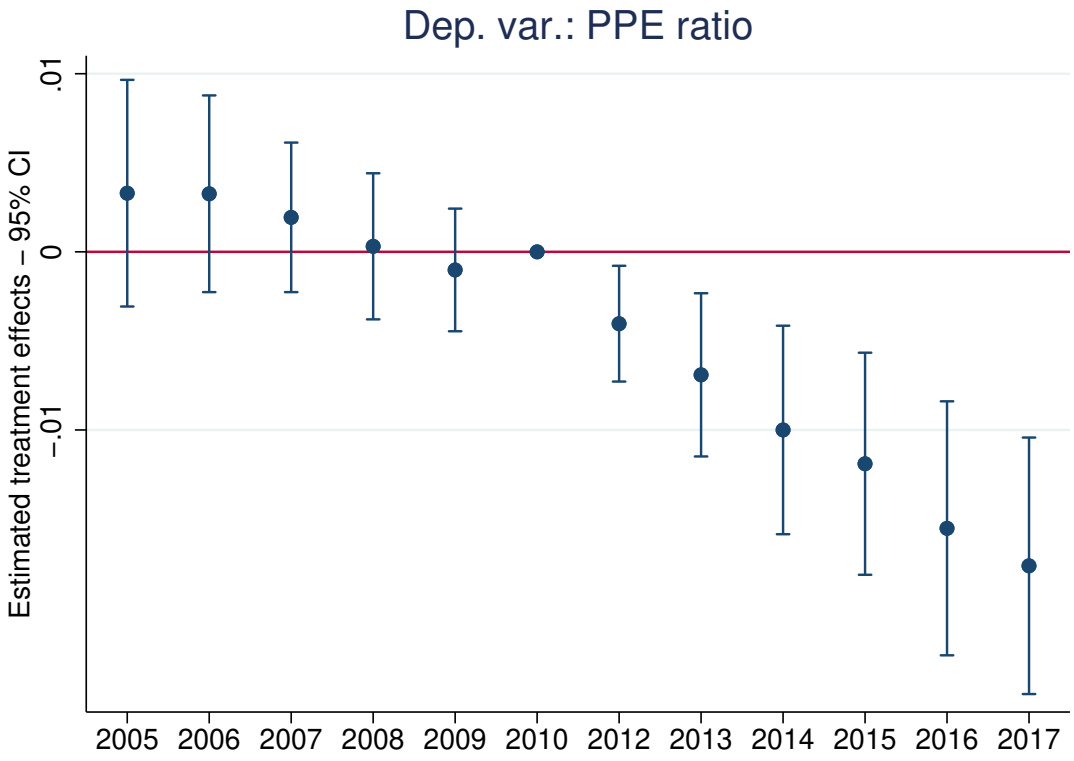

Figure 4: Effect of ETA's announcement on PPE (balanced sample). This figure plots the coefficient estimates on the interaction terms between Treated (a dummy variable equal to one for firms located in the Basque Country and Navarre) and dummy variables coding for the different years around ETA's announcement as well as the 95% confidence intervals. The regressions are based on the balanced sample and include the control variables from Table 6 as well as firm and industry-by-year fixed effects. The dependent variable is PPE scaled by total assets.

Table 1: Summary statistics. This table reports the summary statistics for the variables we use throughout the paper. Panel A reports the summary statistics for the main sample. Panel B reports the mean differences (control minus treated) of the firm-level variables calculated over the three pre-treatment years and Panel C reports the mean differences (control minus treated) of the firm variables after applying propensity score matching (PSM) based on same industry, lagged and current growth of Cash, Cash ratio, Size, Profitability, PPE ratio, Sales/Assets and working capital ratio in a regression using 2010 observations. A caliper of 0.01 is applied. In Panels B and C, the columns "N Control" and "N treated" report the number of firms in the control and treatment groups, respectively.

Panel A: All sample summary statistics

Variables	Observations	Mean	SD	P25	Median	P75
Firm-level						
Cash/Assets	192978	0.144	0.169	0.023	0.080	0.203
Size	192978	6.586	1.588	5.476	6.476	7.590
Profitability	192978	0.003	0.111	-0.020	0.010	0.046
PPE/Assets	189364	0.370	0.273	0.132	0.321	0.575
Working capital/Assets	192388	0.079	0.369	-0.090	0.095	0.303
LT Debt/Assets	192978	0.138	0.202	0.000	0.034	0.210
Bank Debt/Assets	192978	0.095	0.160	0.000	0.000	0.130
ST Debt/Assets	91738	0.147	0.176	0.027	0.084	0.202
Sales/Assets	186645	1.401	1.184	0.606	1.119	1.831
Operating margin	186641	-0.011	0.285	-0.019	0.020	0.064
ROA	192763	0.054	0.131	0.005	0.053	0.111
Cash Flow (CFO)	106789	0.056	0.222	-0.017	0.052	0.133
Altman Z score	116285	15.263	46.100	2.096	3.888	7.562
Inventory/Assets	149132	0.231	0.230	0.050	0.154	0.342
Receivables/Assets	188368	0.242	0.208	0.066	0.194	0.367
Province-level						
Ln(Loans per capita)	192978	10.347	0.229	10.203	10.408	10.544
Ln(GDP per capita)	192978	10.134	0.154	10.071	10.151	10.237
Inflation	192978	2.056	1.370	0.700	2.200	2.800
Ln(Population)	192978	6.265	0.633	5.845	6.381	6.877

Panel B: Pre-treatment differences in levels (control minus treated)

Variables	Mean diff.	p-value	N Control	Mean control	N Treated	Mean Treated
Cash/Assets	- 0.005	0.003	19950	0.146	12213	0.151
Size	- 0.281	0.000	19950	6.519	12213	6.800
Profitability	- 0.000	0.671	19950	0.016	12213	0.016
PPE/Assets	0.023	0.000	19602	0.376	11788	0.353
LT Debt/Assets	0.010	0.000	19950	0.150	12213	0.139
Bank Debt/Assets	0.012	0.000	19950	0.108	12213	0.096
ST Debt/Assets	0.017	0.000	8576	0.165	4810	0.148
Sales/Assets	- 0.080	0.000	19170	1.470	11742	1.550
Operating margin	0.005	0.013	19169	0.021	11742	0.016
ROA	0.003	0.025	19923	0.076	12199	0.073

Continued on next page

Table 1 — *continued from previous page*

Panel C: Pre-treatment differences in levels after PSM matching (control minus treated)						
Variables	Mean diff	p-value	N Control	Mean Control	N Treated	Mean Treated
Cash/Assets	0.001	0.707	11503	0.151	11503	0.150
Size	0.021	0.326	11503	6.836	11503	6.815
Profitability	0.002	0.265	11503	0.008	11503	0.006
PPE/Assets	0.001	0.698	11503	0.347	11503	0.345
LT Debt/Assets	-0.008	0.004	11503	0.133	11503	0.141
LT Bank Debt/Assets	-0.001	0.716	11503	0.097	11503	0.098
ST Debt/Assets	0.009	0.009	5851	0.145	5402	0.136
Sales/Assets	-0.022	0.162	11503	1.427	11503	1.449
Operating margin	0.011	0.019	11503	0.000	11503	-0.011
ROA	0.000	0.955	11485	0.060	11493	0.060

Table 2: Effect of ETA's announcement on cash holdings. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings. The dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Cash/Assets	(2) Cash/Assets	(3) Cash/Assets
Treated × Post	0.011***	0.011***	0.010***
	(7.624)	(8.387)	(7.067)
Size			-0.020***
			(-9.224)
Profitability			0.140***
			(28.524)
Ln(Loans per capita)			-0.009
			(-1.045)
Ln(GDP per capita)			0.025
			(1.034)
Inflation			0.001*
			(1.692)
Ln(Population)			0.029
			(0.518)
Firm FE	Yes	Yes	Yes
Year FE	Yes	No	No
Year-Industry FE	No	Yes	Yes
N	192978	192978	192978
Within R^2	0.00	0.00	0.02
Cluster S.E.	City	City	City

Table 3: Effect of ETA's announcement on cash holdings in ETA-supportive regions. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings for firms located in areas with high versus low support for Batasuna. The dependent variable is the ratio of cash holdings to total assets. Controls are the same as in Table 2. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Cash/Assets	(2) Cash/Assets
Sample	Treated firms	All firms
Treated_High × Post	0.005*	0.014***
	(1.929)	(5.702)
Treated_Low × Post		0.010***
		(6.441)
Controls	Yes	Yes
Firm FE	Yes	Yes
Year-Industry FE	Yes	Yes
N	73212	192972
Within R^2	0.02	0.02
Cluster S.E.	City	City
F-test: Treated_High × Post − Treated_Low × Post		0.005*

Table 4: Effect of ETA's announcement on cash holdings: cross-sectional heterogeneity. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings for firms with high versus low financial constraints. The dependent variable is the ratio of cash holdings to total assets. Financial constraints is a generic dummy variable that identifies subsets of firms with greater financial constraints or bankruptcy risk. The proxy for financial constraints used in the regression is indicated at the top of each column. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)
	Cash/Assets	Cash/Assets	Cash/Assets
Financial Constraints is defined as:	Loss-making	High leverage	Low Altman Z score
Treated × Post	0.012***	0.013***	0.012***
	(6.089)	(5.810)	(5.058)
Post × Financial Constraints	-0.011***	0.007***	0.004***
	(-6.198)	(4.766)	(2.781)
Treated × Post × Financial Constraints	-0.002	-0.006**	-0.007***
	(-0.708)	(-2.087)	(-2.677)
Controls	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes
N	192978	192978	106302
Within R^2	0.02	0.02	0.02
Cluster S.E.	City	City	City
F-test: Treated × Post + Treated × Post × Financial Constraints	0.010***	0.007***	0.005**

Table 5: Effect of ETA's announcement on cash flow sensitivity of cash. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on the cash flow sensitivity of cash. The dependent variable is the change in the ratio of cash holdings to total assets. The main dependent variables of interest are the interaction term between Post and Cash Flow and the triple interaction term between Treated, Post, and Cashflow. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)
	Chg. Cash/assets	Chg. Cash/assets	Chg. Cash/assets
Sample	Treated	Control	All firms
Cash Flow (CFO)	0.062**	0.113***	0.112***
	(2.377)	(8.475)	(8.214)
Post × Cash Flow (CFO)	0.077**	-0.026	-0.026
	(2.082)	(-0.906)	(-0.887)
Treated × Post			1.784***
			(3.411)
Treated × Cash Flow (CFO)			-0.050*
			(-1.690)
Treated × Post × Cash Flow (CFO)			0.103**
			(2.189)
Size	-0.002	0.001	0.001
	(-0.536)	(0.551)	(0.558)
Chg. PPE/Assets	-0.480***	-0.487***	-0.486***
	(-23.946)	(-57.361)	(-57.097)
Chg. Working Capital/Assets	-0.384***	-0.387***	-0.387***
	(-29.020)	(-21.806)	(-21.797)
Chg. ST Debt/Assets	-0.245***	-0.235***	-0.234***
	(-14.914)	(-17.467)	(-17.399)
Ln(Loans per capita)	0.026	0.003	0.004
	(0.724)	(0.466)	(0.610)
Ln(GDP per capita)	0.061	0.008	-0.002
	(0.721)	(0.329)	(-0.099)
Inflation	0.002	0.001	0.001
	(0.358)	(0.510)	(0.985)
Ln(Population)	-0.239	-0.023	-0.037
	(-1.428)	(-0.289)	(-0.459)
Post × Control	Yes	Yes	No
Treated × Post × Control	No	No	Yes
Year-Industry FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
N	40879	65910	106789
Within R^2	0.42	0.43	0.42
Cluster S.E.	City	City	City

Table 6: Effect of ETA's announcement on PPE. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on PPE. The dependent variable is the ratio of PPE to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) PPE/Assets	(2) PPE/Assets	(3) PPE/Assets
Treated × Post	-0.006*	-0.006**	-0.007**
	(-1.933)	(-2.184)	(-2.327)
Size			-0.027***
			(-9.593)
Profitability			-0.163***
			(-26.913)
Ln(Loans per capita)			0.007
			(0.755)
Ln(GDP per capita)			0.003
			(0.092)
Inflation			-0.001
			(-1.527)
Ln(Population)			0.068
			(0.849)
Firm FE	Yes	Yes	Yes
Year FE	Yes	No	No
Year-Industry FE	No	Yes	Yes
N	189364	189364	189364
Within R^2	0.00	0.00	0.03
Cluster S.E.	City	City	City

Table 7: Effect of ETA's announcement on Debt. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on debt. The dependent variable is the ratio of long-term debt total assets in Column 1, the ratio of bank debt to total assets in Column 2, and the ratio of short-term debt to total assets in Column 3. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)
	LT Debt/Assets	Bank Debt/Assets	ST Debt/Assets
Treated × Post	0.004	0.002	-0.006**
	(1.465)	(0.964)	(-2.345)
Size	0.040***	0.034***	-0.019***
	(16.192)	(19.110)	(-5.150)
Profitability	-0.111***	-0.079***	-0.168***
	(-20.509)	(-21.029)	(-16.962)
Ln(Loans per capita)	0.011	0.016*	0.011
	(1.096)	(1.699)	(0.803)
Ln(GDP per capita)	-0.042	-0.017	0.031
	(-1.516)	(-0.625)	(0.845)
Inflation	0.003***	0.003***	-0.004***
	(2.870)	(2.945)	(-3.203)
Ln(Population)	-0.122*	-0.073	0.109
	(-1.687)	(-1.032)	(1.411)
Firm FE	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes
N	192978	192978	91738
Within R^2	0.02	0.02	0.02
Cluster S.E.	City	City	City

Table 8: Effect of ETA's announcement on performance. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on performance. The dependent variables are the asset turnover (i.e., the ratio of sales to assets) in Column 1, operating profit scaled by sales in Column 2, and ROA in Column 3. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)
	Sales/Assets	Operating margin	ROA
Treated × Post	0.057***	0.018***	0.008***
	(5.958)	(6.204)	(4.214)
Size	-0.618***	0.046***	0.056***
	(-36.139)	(12.520)	(25.004)
Profitability	0.747***	1.177***	
	(18.744)	(51.991)	
Ln(Loans per capita)	0.001	0.004	-0.002
	(0.017)	(0.223)	(-0.183)
Ln(GDP per capita)	0.157	0.038	-0.053**
	(1.049)	(0.909)	(-2.226)
Inflation	-0.008	-0.002	-0.006***
	(-1.392)	(-1.092)	(-4.525)
Ln(Population)	0.351	0.009	0.055
	(1.023)	(0.098)	(1.034)
Firm FE	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes
N	186645	186641	192763
Within R^2	0.12	0.24	0.02
Cluster S.E.	City	City	City

Appendix A. Variable definitions

Variable	Definition	Data Source
Altman Z score	0.717*(current assets current liabilities)/total assets) + 0.847*(sales/total assets) + 3.107*(operating profit/total assets) + 0.42*(Retained Earnings/non-current liabilities) + 0.998*(sales/total assets)	SABI
Assets	Total assets (in thousands)	SABI
Bank Debt/Assets	Long term debt with credit units over total assets	SABI
Cash/Assets	Cash over total assets	SABI
Cash Flow (CFO)	EBITDA minus change in account receivables plus change in account payables, then all divided by lagged total assets	SABI
Inflation	Annual inflation rate at the province level	INE
Ln (GDP per capita)	Natural logarithm of the gross domestic product per capita at the province level	INE
Ln(Loans per capita)	Natural logarithm of the stock of lending per capita at the province level. It includes loans granted to individuals and private entities.	AEB and INE
Ln (Population)	Natural logarithm of the population at the province level	INE
LT Debt/assets	Long-term debt divided by total assets	SABI
Operating margin	Operating profit divided by sales	SABI

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Variable	**Definition**	**Data Source**
Ln(SD-Profitability)	Natural logarithm of the standard deviation of ROA	SABI
Post	Dummy variable equal to one for the years after ETA's announcement, and zero otherwise	SABI
PPE	Property, Plant and Equipment	SABI
Profitability	Net profit divided by total assets	SABI
Receivables/Assets	Account receivables divided by total assets	SABI
ROA	EBITDA divided by lagged total assets	SABI
Sales/Assets	Sales divided by total assets	SABI
Size	Natural logarithm of assets (in thousands)	SABI
ST Debt/Assets	Short-term debt divided by total assets	SABI
Inventory/Assets	Inventory divided by total assets	SABI
N. Attack	Number of attacks in the municipality perpetrated by ETA, Basque Separatists or Jarrai from 1970 to 2010.	Global terrorism database
N. Attack Business-Prop	Number of attacks in the municipality against businesses or private property perpetrated by ETA, Basque Separatists or Jarrai from 1970 to 2010.	Global terrorism database
Treated	Dummy variable equal to one for firms located in Basque Country or Navarre, and zero otherwise	SABI

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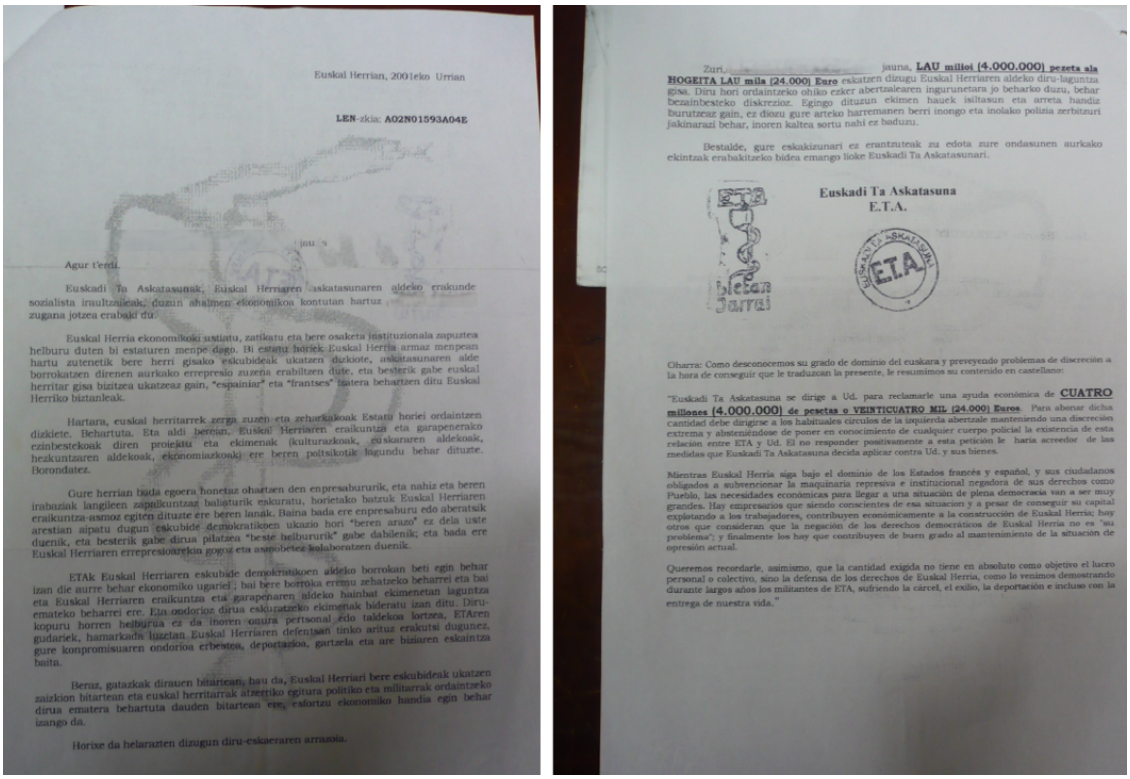
Variable	Definition	Data Source
Treated_High	Dummy variable equal to one if a firm is headquartered in a municipality where voting support for Batasuna is in the top quartile, and zero otherwise. We use voting data at the municipality level in the Basque Country and Navarre for the 1999 elections, the last elections in which Batasuna and related parties participated before being banned.	Spanish Ministry of the Interior
Treated_Low	Dummy equal to one if a firm is headquartered in a municipality where voting support for Batasuna is below the top quartile, and zero otherwise. We use voting data at the municipality level in the Basque Country and Navarre for the 1999 elections, the last elections to which Batasuna and related parties participated before being banned.	Spanish Ministry of the Interior
Working Capital/Assets	Current assets minus cash minus current liabilities, divided by total assets	SABI

Internet Appendix

for

"Political Conflict and Corporate Policies: Evidence from the Basque Country"



Euskal Herrian, 2001eko Urrian

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jau

Agur t'erdi.

Euskadi Ta Askatasunak, Euskal Herriaren askatasunaren aldeko erakunde sozialista iraultzaileak, duzun ahalmen ekonomikoa kontutan hartuz zugana jotzea erabaki du.

Euskal Herria ekonomikoki ustiatu, zatikatu eta bere osaketa instituzionala zapuztea helburu duten bi estaturen menpe dago. Bi estatu horiek Euskal Herria armaz menpean hartu zutenetik bere herri gisako eskubideak ukatzen dizkiote, askatasunaren alde borrokatzen direnen aurkako errepresio zuzena erabiltzen dute, eta besterik gabe euskal herritar gisa bizitzea ukatzeaz gain, "espainiar" eta "frantses" izatera behartzen ditu Euskal Herriko biztanleak.

Hartara, euskal herritarrek zerga zuzen eta zeharkakoak Estatu horiei ordaintzen dizkiete. Behartuta. Eta aldi berean, Euskal Herriaren eraikuntza eta garapenerako ezinbestekoak diren proiektu eta ekimenak (kulturazkoak, euskararen aldekoak, hezkuntzaren aldekoak, ekonomiazkoak) ere beren poltsikotik ligundu behar dituzte. Borondatez.

Gure herrian bada egoera honetaz ohartzen den enpresabururik, eta nahiz eta beren irabaziak langileen zapalkuntzaz baliaturik eskuratu, horietako batzuk Euskal Herriaren eraikuntza-asmoz egiten dituzte ere beren lanak. Baina bada ere enpresaburu edo aberatsik arestian aipatu dugun eskubide demokratikoen ukazio hori "beren arazo" ez dela uste duenik, eta besterik gabe dirua pilatzea "beste helbururik" gabe dabilenik; eta bada ere Euskal Herriaren errepresioarekin gogoz eta asmoberez kolaboratzen duenik.

ETAk Euskal Herriaren eskubide demokratikoen aldeko borrokan beti egin behar izan die aurre behar ekonomiko ugariei; bai bere borroka eremu zehatzeko beharrei eta bai eta Euskal Herriaren eraikuntza eta garapenaren aldeko hainbat ekimenetan laguntza ematerako beharrei ere. Eta ondorioz dirua eskuratzeko ekimenak bideratu izan ditu. Diru-kopuru horren helburua ez da inoren ontura pertsonal edo taldekoa lortzea, ETAren gudariek, hamarkada luzetan Euskal Herriaren defentsan tinko aritur erakutsi dugunez, gure konpromisuaren ondorioa erbestea, deportazioa, gartzela eta are bizitzaren eskaintza baita.

Beraz, gatazkak dirauen bitartean, hau da, Euskal Herriari bere eskubideak ukatzen zaizkion bitartean eta euskal herritarrak aberriko egitura politiko eta militarrak ordaintzeko dirua ematera behartuta dauden bitartean ere, esfortzu ekonomiko handia egin behar izango da.

Horixe da helarazten dizugun diru-eskaeraren arrazoia.

Zuri, jauna, **LAU milioi (4.000.000) pezeta ala HOGEITA LAU mila (24.000) Euro** eskatzen dizugu Euskal Herriaren aldeko diru-laguntza gisa. Diru hori ordaintzeko ohiko ezker abertzalearen ingurunetara jo beharko duzu, behar bezainbesteko diskrezioz. Egingo dituzun ekimen hauek isilbasun eta arreta handiz burutzeaz gain, ez diozu gure arteko harremanen berri inongo eta inolako polizia zerbitzuri jakinarazi behar, inoren kaltea sortu nahi ez baduzu.

Bestalde, gure eskakizunari ez erantzuteak zu edota zure ondasunen aurkako ekintzak erabakitzeko bidea emango lioke Euskadi Ta Askatasunari.

Euskadi Ta Askatasuna
E.T.A.

Oharra: Como desconocemos su grado de dominio del euskara y previyendo problemas de discreción a la hora de conseguir que le traduzcan la presente, le resumimos su contenido en castellano:

"Euskadi Ta Askatasuna se dirige a Ud. para reclamarle una ayuda económica de **CUATRO millones (4.000.000) de pesetas o VEINTICUATRO MIL (24.000) Euros**. Para abonar dicha cantidad debe dirigirse a los habituales círculos de la izquierda abertzale manteniendo una discreción extrema y absteniéndose de poner en conocimiento de cualquier cuerpo policial la existencia de esta relación entre ETA y Ud. El no responder positivamente a esta petición le haría acreedor de las medidas que Euskadi Ta Askatasuna decida aplicar contra Ud. y sus bienes.

Mientras Euskal Herria siga bajo el dominio de los Estados francés y español, y sus ciudadanos obligados a subvencionar la maquinaria represiva e institucional negadora de sus derechos como Pueblo, las necesidades económicas para llegar a una situación de plena democracias van a ser muy grandes. Hay empresarios que siendo conscientes de esa situacion y a pesar de conseguir su capital explotando a los trabajadores, contribuyen económicamente a la construcción de Euskal Herria; hay otros que consideran que la negación de los derechos democráticos de Euskal Herria no es "su problema"; y finalmente los hay que contribuyen de buen grado al mantenimiento de la situación de opresión actual.

Queremos recordarle, asimismo, que la cantidad exigida no tiene en absoluto como objetivo el lucro personal o colectivo, sino la defensa de los derechos de Euskal Herria, como lo venimos demostrando durante largos años los militantes de ETA, sufriendo la carcel, el exilio, la deportación e incluso con la entrega de nuestra vida."

Figure IA.1: Extortion letter. This figure displays an example of extortion letters sent by ETA. The number on top right-hand side reflects the code attributed to the letter recipient in ETA books. For confidentiality reasons, we remove the company and person's name of the letter recipient. The letter is in *Euskera* and Spanish languages. A translation of the text in Spanish is provided: *"Note: Since we do not know your degree of command of Euskera language and, foreseeing problems of discretion when it comes to getting this translated for you, we summarize its content in Spanish: "Euskadi Ta Askatasuna addresses you to demand from you an economic aid of FOUR million (4,000,000) pesetas or TWENTY-FOUR THOUSAND (24,000) euros. To pay said amount you must go to the habitual circles of the abertzale left, maintaining extreme discretion and refraining from making known to any police force the existence of this relation between ETA and you. Not responding positively to this request would make you liable to the measures that Euskadi Ta Askatasuna decides to apply against you and your property. While the Basque Country remains under the rule of the French and Spanish states, and its citizens are obliged to subsidize the repressive and institutional machinery that denies their rights as a People, the economic needs to reach a situation of full democracy are going to be very great. There are business people who, being aware of this situation and despite obtaining their capital by exploiting the workers, contribute economically to the construction of the Basque Country; there are others who consider that the denial of the democratic rights of the Basque Country is not "their problem"; and finally there are those who contribute willingly to the maintenance of the current situation of oppression. We also wish to remind you that the amount demanded does not in any way have as its objective personal or collective profit, but rather the defense of the rights of the Basque Country, as we have been demonstrating for many years we militants of ETA, suffering prison, exile, deportation and even with the giving of our life."*

Figure IA.2: Map of Spanish regions. This figure displays the location of the Basque Country and Navarre (in blue) and neighboring Autonomous Communities (in grey).

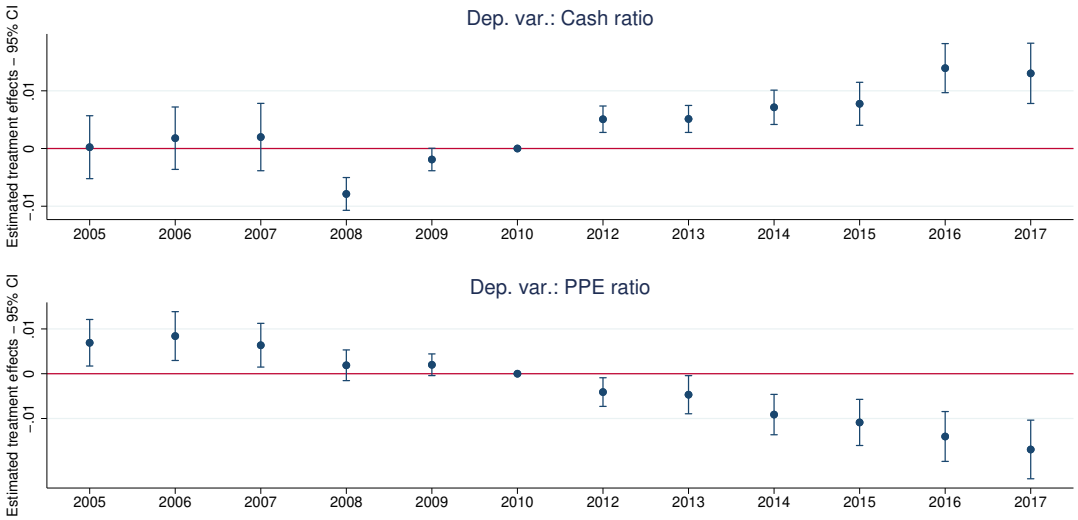

Figure IA.3: Effect of ETA's announcement on cash and PPE (unbalanced sample). This figure plots the coefficient estimates on the interaction terms between Treated (a dummy variable equal to one for firms located in the Basque Country and Navarre) and dummy variables coding for the different years around ETA's announcement as well as the 95% confidence intervals. The regressions are based on the unbalanced sample and include the control variables from Table 2 as well as firm and industry-by-year fixed effects. The dependent variable is cash holdings scaled by total assets in the first graph and PPE scaled by total assets in the second graph.

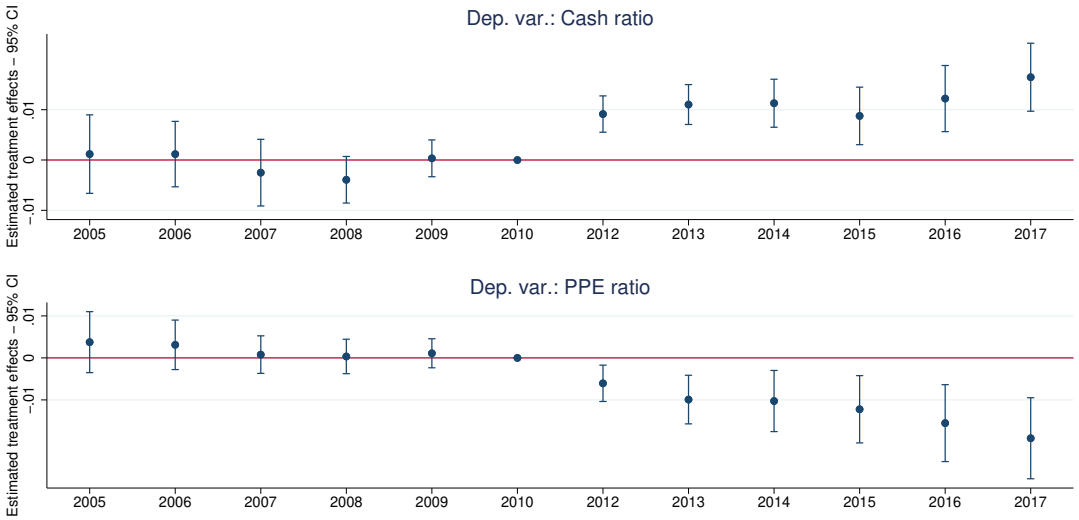

Figure IA.4: Effect of ETA's announcement on cash and PPE (PSM matched sample). This figure plots the coefficient estimates on the interaction terms between Treated (a dummy variable equal to one for firms located in the Basque Country and Navarre) and dummy variables coding for the different years around ETA's announcement as well as the 95% confidence intervals. The regressions are based on the matched sample and include the control variables from Table 2 as well as firm and industry-by-year fixed effects. The dependent variable is cash holdings scaled by total assets in the first graph and PPE scaled by total assets in the second graph.

Table IA.1: Effect of ETA's announcement on cash holdings: Alternative time windows. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings for alternative time windows. We consider windows to 2 years, 4 years, 5 years before and after ETA's announcement. The dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)
	2-years	4-years	5-years
Treated × Post	0.007***	0.010***	0.009***
	(4.219)	(4.103)	(3.218)
Size	-0.017***	-0.025***	-0.026***
	(-4.948)	(-11.816)	(-14.589)
Profitability	0.124***	0.147***	0.160***
	(19.243)	(23.585)	(27.052)
Ln(Loans per capita)	-0.004	-0.009	-0.001
	(-0.397)	(-0.743)	(-0.064)
Ln(GDP per capita)	0.003	0.003	0.008
	(0.105)	(0.111)	(0.311)
Inflation	-0.001	0.002*	0.002*
	(-0.725)	(1.768)	(1.848)
Ln(Population)	0.018	-0.039	-0.013
	(0.258)	(-0.544)	(-0.204)
Year-Industry FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
N	117804	235608	292745
Within R^2	0.02	0.02	0.03
Cluster S.E.	City	City	City

Table IA.2: Effect of ETA's announcement on cash holdings: Alternative measures of cash. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on different measures of cash holdings. The measure of cash holdings used as the dependent variable is indicated a the top of each column. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)	(4)	(5)	(6)
	Ln(Cash ratio baseline)	Ln(Cash in th. €)	Cash/(Assets-Cash)	Cash/2008 Assets	Ln(Cash/(Assets-Cash))	Ln(Cash/2008 Assets)
Treated × Post	0.070***	0.069***	0.028***	0.009***	0.086***	0.071***
	(4.178)	(4.232)	(5.436)	(5.226)	(4.696)	(4.126)
Size	-0.196***	0.811***	-0.060***	0.121***	-0.220***	0.793***
	(-11.050)	(48.092)	(-6.643)	(37.385)	(-10.520)	(47.655)
Profitability	1.065***	1.085***	0.363***	0.158***	1.277***	1.087***
	(34.251)	(36.779)	(16.385)	(28.074)	(37.510)	(34.484)
Ln(Loans per capita)	-0.034	-0.013	-0.034	-0.012	-0.051	-0.033
	(-0.320)	(-0.123)	(-1.310)	(-1.133)	(-0.448)	(-0.302)
Ln(GDP per capita)	0.023	0.047	0.091	0.003	0.063	0.018
	(0.093)	(0.187)	(1.082)	(0.112)	(0.225)	(0.070)
Inflation	0.005	0.006	0.003	0.001	0.007	0.005
	(0.609)	(0.695)	(1.113)	(1.048)	(0.831)	(0.654)
Ln(Population)	0.149	0.155	-0.071	0.075	0.156	0.142
	(0.243)	(0.255)	(-0.389)	(1.194)	(0.229)	(0.228)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	192978	192978	192898	192978	192897	192978
Within R^2	0.01	0.08	0.01	0.12	0.01	0.07
Cluster S.E.	City	City	City	City	City	City

Table IA.3: Effect of ETA's announcement on cash holdings: Auditing status and 7 million threshold. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings differentiating between audited and non-audited firms (Panel A) and between firms with revenues above and below €7million (Panel B). In Panel A, the test in column 1 includes the full sample of firms and in column 2 only audited firms. Auditing status and revenue threshold are determined in 2010. In both panels, the dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Panel A: Auditing status		
	(1)	(2)
	Cash/Assets	Cash/Assets
Sample	All firms	Audited firms
Treated × Post	0.010***	0.007**
	(6.762)	(2.296)
Post× Audited	0.008***	
	(4.014)	
Treated × Post × Audited	-0.004	
	(-1.416)	
Controls	Yes	Yes
Year-Industry FE	Yes	Yes
Firm FE	Yes	Yes
N	192978	13086
Within R^2	0.02	0.01
Cluster S.E.	City	City
F-test: Treated × Post + Treated × Post × Audited	0.006**	-

Panel B: Firms above and below €7 million in revenue		
	(1)	(2)
	Cash/Assets	Cash/Assets
Sample	>€7 mill.	≤€7 mill.
Treated × Post	0.008***	0.010***
	(2.644)	(6.663)
Controls	Yes	Yes
Year-Industry FE	Yes	Yes
Firm FE	Yes	Yes
N	15744	177234
Within R^2	0.01	0.02
Cluster S.E.	City	City

Table IA.4: Effect of ETA's announcement on cash holdings: Alternative treated and control groups. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings based on alternative definitions of treated and control groups. In Column 1, we exclude Navarre firms from the treatment group. In Columns 2 to 5, we successively exclude firms located in each of the different neighboring autonomous communities. In Column 6, we restrict the control group to firms that are less than 100km away from the Basque Country. In all columns, the dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Ex. Navarre	(2) Ex. Aragon	(3) Ex. Cantabria	(4) Ex. Castille and Leon	(5) Ex. La Rioja	(6) Firms less 100km away in control
Treated × Post	0.011***	0.010***	0.010***	0.011***	0.010***	0.010***
	(7.299)	(5.933)	(6.790)	(6.630)	(7.153)	(3.282)
Size	-0.021***	-0.020***	-0.020***	-0.019***	-0.020***	-0.020***
	(-9.429)	(-8.601)	(-9.004)	(-6.975)	(-8.982)	(-5.600)
Profitability	0.144***	0.134***	0.140***	0.137***	0.139***	0.125***
	(28.531)	(33.127)	(27.785)	(21.224)	(27.215)	(25.128)
Ln(Loans per capita)	-0.011	-0.008	-0.008	-0.025*	-0.008	-0.016
	(-1.248)	(-0.912)	(-1.002)	(-1.849)	(-0.923)	(-1.351)
Ln(GDP per capita)	0.023	0.026	0.024	-0.009	0.025	-0.055
	(0.933)	(0.974)	(0.942)	(-0.242)	(1.007)	(-1.296)
Inflation	0.002**	0.002*	0.001	0.002	0.002*	0.001
	(2.408)	(1.960)	(1.638)	(1.520)	(1.913)	(0.522)
Ln(Population)	0.038	0.062	0.025	-0.070	0.029	-0.069
	(0.552)	(1.070)	(0.427)	(-0.987)	(0.518)	(-0.786)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	176010	148644	184548	135372	183648	84942
Within R^2	0.02	0.02	0.02	0.02	0.02	0.02
Cluster S.E.	City	City	City	City	City	City

Table IA.5: Effect of ETA's announcement on cash holdings: Matched sample. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings for the matched sample. The propensity score matching is based on same industry, lagged and current growth of Cash, Cash ratio, Size, Profitability, PPE ratio, Sales/Assets and working capital ratio in a regression using 2010 observations. A caliper of 0.01 is applied. The dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Cash/Assets	(2) Cash/Assets	(3) Cash/Assets
Treated × Post	0.012***	0.012***	0.012***
	(6.468)	(6.764)	(6.009)
Controls	No	No	Yes
Firm FE	Yes	Yes	Yes
Year FE	Yes	No	No
Year-Industry FE	No	Yes	Yes
N	138036	138036	138036
Within R^2	0.00	0.00	0.02
Cluster S.E.	City	City	City

Table IA.6: Effect of ETA's announcement on cash holdings: Alternative clustering of standard errors. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on cash holdings for alternative clusterings of standard errors. In Column 1, we cluster standard errors at the industry level and in Column 2, at the firm level. The dependent variable is the ratio of cash holdings to total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the industry or firm level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Cash/Assets	(2) Cash/Assets
Treated × Post	0.011***	0.011***
	(5.480)	(6.817)
Size	-0.020***	-0.020***
	(-6.876)	(-8.608)
Profitability	0.131***	0.131***
	(23.082)	(29.326)
Ln(Loans per capita)	-0.007	-0.007
	(-0.876)	(-0.831)
Ln(GDP per capita)	0.024	0.024
	(1.032)	(1.113)
Inflation	0.001	0.001
	(0.956)	(0.979)
Ln(Population)	0.022	0.022
	(0.348)	(0.457)
Firm FE	Yes	Yes
Year-Industry FE	Yes	Yes
N	176706	176706
Within R^2	0.02	0.02
Cluster S.E.	NAICS 2	Firm

Table IA.7: Results based on the matched sample. This table reports the main regressions based on the matched sample. Panel A reports the regressions from Table 3 based on the matched sample. Panel B reports the regressions from Table 4 based on the matched sample. Panel C reports the main regressions from Tables 6, 7, and 8 based on the matched sample. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Panel A: Batasuna supportive regions

Dependent variable:	(1) Cash/Assets	(2) Cash/Assets
Sample	Treated firms	All firms
Treated_High × Post	0.005*	0.016***
	(1.930)	(5.453)
Treated_Low × Post		0.012***
		(5.503)
Controls	Yes	Yes
Firm FE	Yes	Yes
Year–Industry FE	Yes	Yes
N	59070	128088
Within R^2	0.01	0.02
Cluster S.E.	City	City
F-test: Treated_High × Post > Treated_Low × Post		0.004**

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Table IA.7 — *continued from previous page*

Panel B: Financial constraints

Dependent variable:	(1) Cash/Assets	(2) Cash/Assets	(3) Cash/Assets
Financial Constraints is defined as:	Loss-making	High leverage	Low Altman Z score
Treated × Post	0.013***	0.016***	0.013***
	(5.042)	(5.337)	(4.346)
Post × Financial Constraints	-0.011***	0.007**	0.006**
	(-3.029)	(2.573)	(2.113)
Treated × Post × Financial Constraints	0.000	-0.007**	-0.007**
	(0.060)	(-1.973)	(-2.033)
Controls	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Year–Industry FE	Yes	Yes	Yes
N	138036	138036	78900
Within R^2	0.02	0.01	0.01
Cluster S.E.	City	City	City
F-test: Treated × Post + Treated × Post × Financial Constraints	0.013***	0.009***	0.006***

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Table IA.7 — *continued from previous page*

Panel C: PPE, Debt, and Performance

Dependent variable:	(1) PPE/Assets	(2) LT Debt/Assets	(3) Bank Debt/Assets	(4) ST Debt/Assets	(5) Sales/Assets	(6) Operating margin	(7) ROA
Treated × Post	-0.009**	-0.000	-0.001	-0.001	0.080***	0.015**	0.007***
	(-2.537)	(-0.072)	(-0.757)	(-0.355)	(7.673)	(2.391)	(2.829)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year–Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	137208	138036	138036	67485	136481	136472	137863
Within R^2	0.03	0.02	0.02	0.03	0.12	0.13	0.03
Cluster S.E.	City	City	City	City	City	City	City

Table IA.8: ETA attacks per municipality. This table reports shows a cross-sectional regression at the municipality level (475 municipalities). The dependent variable is either the number of attacks, or the number of attacks against businesses or private properties perpetrated by ETA. Both variables are determined during the period ETA is operating (1970-2010). Only municipalities in the Basque Country or Navarre are included. The regression method is Poisson. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) N. Attack	(2) N. Attack Business-Prop
Treated_High	0.693***	0.628***
	(3.841)	(2.604)
Ln(Population)	1.233***	1.286***
	(23.662)	(20.359)
N	475	475

Table IA.9: Effect of ETA's announcement on PPE: Alternative measures. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on different measures of PPE. The measure of PPE used as the dependent variable is indicated a the top of each column. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)	(4)
	Ln(PPE ratio baseline)	Ln(PPE in th. €)	Ln(PPE/(Assets-PPE))	Ln(PPE/2008 Assets)
Treated × Post	-0.037**	-0.039**	-0.053**	-0.036**
	(-2.189)	(-2.378)	(-2.484)	(-2.139)
Size	-0.159***	0.844***	-0.210***	0.821***
	(-13.092)	(68.180)	(-11.670)	(69.810)
Profitability	-0.731***	-0.710***	-1.071***	-0.703***
	(-25.923)	(-26.388)	(-29.768)	(-25.096)
Ln(Loans per capita)	0.033	0.020	0.048	0.027
	(0.705)	(0.440)	(0.797)	(0.576)
Ln(GDP per capita)	-0.229*	-0.226*	-0.237	-0.240*
	(-1.751)	(-1.723)	(-1.259)	(-1.820)
Inflation	-0.005	-0.004	-0.008	-0.004
	(-0.725)	(-0.656)	(-1.160)	(-0.640)
Ln(Population)	0.063	0.142	0.211	0.031
	(0.149)	(0.343)	(0.377)	(0.073)
Firm FE	Yes	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes	Yes
N	189364	189284	189364	189364
Within R^2	0.02	0.14	0.03	0.13
Cluster S.E.	City	City	City	City

Table IA.10: Effect of ETA's announcement on investment. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on different measures of investment. The dependent variable is the change in PPE between year t and t-1 scaled by total assets. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)
Variable	(Chg. PPE)/Assets
Treated × Post	-0.002*
	(-1.776)
Size	0.032***
	(39.383)
Profitability	-0.032***
	(-4.996)
Ln(Loans per capita)	-0.003
	(-0.737)
Ln(GDP per capita)	-0.005
	(-0.385)
Inflation	-0.000
	(-0.585)
Ln(Population)	-0.003
	(-0.106)
Firm FE	Yes
Year-Industry FE	Yes
N	188036
Within R^2	0.02
Cluster S.E.	City

Table IA.11: Effect of ETA's announcement on inventory and account receivables. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on inventories (Column 1) and account receivables (Column 2). Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1) Inventory/Assets	(2) Receivables/Assets
Treated × Post	-0.002	-0.001
	(-0.827)	(-0.253)
Size	-0.009***	0.014***
	(-3.071)	(5.749)
Profitability	-0.097***	0.079***
	(-20.067)	(12.966)
Ln(Loans per capita)	0.003	0.011
	(0.250)	(1.121)
Ln(GDP per capita)	0.000	-0.054**
	(0.017)	(-2.197)
Inflation	0.000	-0.001
	(0.115)	(-1.607)
Ln(Population)	-0.227***	-0.015
	(-3.194)	(-0.267)
Firm FE	Yes	Yes
Year-Industry FE	Yes	Yes
N	149132	188368
Within R^2	0.01	0.01
Cluster S.E.	City	City

Table IA.12: Effect of ETA's announcement on risk. This table reports the effect of the ETA's announcement of the definitive end of its extortion activities on different measures of risk. The measure of cash holdings used as the dependent variable is indicated a the top of each column. Variable definitions are provided in the Appendix. T-stats are based on standard errors clustered at the municipality level and shown in parentheses. The significance levels are represented as follows: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

	(1)	(2)	(3)	(4)
	Ln(SD-Profitability)	Altman Z score	F.Altman Z score	F2.Altman Z score
Treated × Post	0.057*	-0.212	0.406	0.504
	(1.946)	(-0.287)	(0.570)	(0.764)
Size	-0.562***	-3.122***	-0.894	0.295
	(-21.226)	(-4.909)	(-1.391)	(0.512)
Profitability	-1.425***	10.828***	7.935***	5.399***
	(-24.294)	(8.573)	(4.556)	(4.084)
Ln(Loans per capita)	-0.061	0.003	-1.354	4.190
	(-0.184)	(0.001)	(-0.385)	(1.124)
Ln(GDP per capita)	0.520	5.748	-1.880	6.981
	(0.994)	(0.709)	(-0.201)	(0.718)
Inflation	0.016	-0.530	0.011	-0.612
	(0.700)	(-1.564)	(0.035)	(-1.162)
Ln(Population)	-5.026***	25.221	45.138**	59.751***
	(-2.747)	(1.211)	(2.327)	(3.216)
Firm FE	Yes	Yes	Yes	Yes
Year-Industry FE	Yes	Yes	Yes	Yes
N	64311	116285	94309	90909
Within R^2	0.05	0.00	0.00	0.00
Cluster S.E.	City	City	City	City