

**ECON742: Questionnaire 4**  
**"The Economic Costs of Conflict: a Case-Control Study for the Basque Country"**

The questions are based on Abadie, A. and J. Gardeazabal (2003), "The Economic Costs of Conflict: a Case-Control Study for the Basque Country" *American Economic Review* 93 (1): 113-132.

1. From a theoretical perspective, describe the specific mechanisms that would link terrorist activity to GDP per capita in the Basque province. Are these specific mechanisms directly tested in the data? If not, why? Do you have ideas on how this could be done?
2. Referring to Figures 1 and 4, explain precisely how the synthetic comparison groups are constructed. Why don't the authors compare directly the GDP in the Basque region to the one of other regions in the country less affected by the terrorist activities of ETA? How and why the initial characteristics of the Basque region described in Table 3 could affect future performance? What assumptions must be done to isolate the effect of terrorism in the real Basque region compared to the synthetic Basque region? Do you find these assumptions plausible assumptions, and how would you improve the identification strategy?
3. Referring to tables A2 and 5, explain how the authors proceed to identify Basque stocks, and non-Basque stocks. Does this classification make sense? Referring specifically to equation (1), explain how the long-term risk factors to return on stocks are controlled for. Referring now to Table 6 and Figure 6, explain how the abnormal returns are calculated. Do you find it credible to attribute the abnormal returns on Basque stocks to the timing of negotiations between ETA and the government? How does the use of the variables good and bad news help to solve this problem?
4. Referring to table 7, explain how the use of alternative models of stock returns affects the results of Table 6. To what extent could these models be considered improvements of the Fama-French model? Do the results of table 7 make you more confident in the ability of authors to isolate the effects of ETA-government negotiations? What other factors could cause these results?
5. How is it possible to reconcile the two halves of the paper? Do the results on the performance of stocks reassure you about the results on GDP comparisons? What are the channels through which the performance of the stock market could influence the economic performance?
6. According to you, what are the policy implications that you can draw the paper? Can this paper inform us about the potential economic impacts of terrorism in the U.S. or Canada? Are the pathways through which the terrorist activity in the Basque region affects economic activity the same as those in the U.S. or Canada today?