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Partisan Conflict, Policy Uncertainty and Aggregate Corporate Cash Holdings*

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Abstract

This paper distinguishes political uncertainty from policy uncertainty shocks and uncovers new empirical facts about how each impacts the aggregate cash holdings of US firms. Our baseline structural vector autoregression model shows that an exogenous one standard deviation shock to political and economic policy uncertainty is followed by a 1 and 1.8 percent increase in aggregate corporate cash-to-total assets after five and eight quarters, respectively. The baseline result also shows that policy uncertainty shocks tend to raise financial market volatility while political uncertainty shocks tend to lower financial market volatility. Moreover, we find evidence that political uncertainty exerts asymmetric effects on aggregate corporate cash holdings, with a shock tending to raise cash holdings under normal financial conditions and lower cash holdings under tight financial conditions. Our main results are robust against a wide range of shock identification schemes as well as against parametric and non-parametric model estimations.

Keywords: Partisan Conflict, cash holdings, Economic Policy Uncertainty, VAR, sign restrictions, local projections

JEL Classification: G30, G32, E32.

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