

Referee report on
“Islands in trade: disentangling distance from border effects”
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The paper studies the effect of sea border on trade between regions in Spain.

In order to do that the authors estimate a trade equation for Spanish regions including two island regions and apply a Blinder-Oaxaca decomposition to disentangle the distance and the border effect.

The paper answers an interesting question what is the impact of a sea border on inter-regional trade. In general the idea is interesting. There are however several issues that I would like the authors to address.

1. My first set of remarks is very general. The two island regions are tourism economies. It has several implications for the paper. First of all, their main focus are tourism activities and therefore they do not produce many export products. As a consequence, they highly rely on imports of consumer goods from Spain for the tourism sector. Second, if tourists are included the population of these regions is much larger (for example according to <http://www.spanish-fiestas.com/> more than 4 mln people visited Balearic islands in 2013). It explains the high trade deficits of this regions. It also may be a possible explanation for the insignificant distance effect for island's region exports. I would guess that a lot of ships may leave islands regions with less products than they brought there. Hence, the authors should try to control for tourism sector for example by taking into account the number of tourists or their spending in the regression analysis.
2. My second set of remarks concerns the descriptive statistics section. I find this part very interesting; however there are several issues that are worth to be explained.
 - Table 1 is really difficult to read and therefore I am not sure what the authors mean when saying for example that island regions sell more domestically (within the region or within Spain?). I also did not quite understand the following sentence: “they sell relatively more internationally than to other Spanish regions (the interregional trade of island regions is 71% of their international trade, against 63% for mainland regions)”, as the second part of it does not really prove the first part.
 - There is an important issue that we can read from Figure 2. Island international imports and exports rely mostly on road transport while their interregional counterparts on sea transport. This indicates that there might be a problem with the data. Islands international trade should solely rely on sea transport. However, I can imagine that most of trade flows operate via mainland regions and then they shipped to island regions (and recorded as being transported using roads). In this case the interregional and international statistics are

recorded differently and they should not be directly compared. I would like the authors to elaborate more on that issue.

- In addition, the authors say that island regions have a disadvantage in interregional trade since they have to use both road and sea transport. This is not necessarily true since sea transport is found to be much cheaper than land transport. For example Limao & Venables (2001) find that an extra 1000km distance raises costs by seven times more if the distance is overland than if it is maritime.¹

3. My third set of remarks concerns the regression analysis.

- Including the quadratic distance effect creates the following issues. First of all, using logarithms controls already for non-linearity of the distance. Second the authors do not necessarily prove that distance matters the most at intermediate distances. For the island regions they find that distance is not significant (see my first set of remarks for a possible explanation) for exports, and the coefficients point to an U-shaped curve for imports. However, the size of the coefficients indicates a minimum at about 900 km. This distance in case of the islands regions (especially Canary Islands) is not an intermediate distance. Second as far as mainland regions are concerned, the inverse U-shaped curve reaches the maximum at respectively at 30 km for exports and 50 km for imports. Since there are not such short distances between regions it does not show the non-linearity. Hence, using traditional log of distance seems to be more appropriate.

4. Minor comments

- Empirical strategy part is too long (especially the part on the gravity equation) and would be more logical if it was placed just before the empirical results part.
- Abbreviations in Table 1 are not clear.
- If the data for the regions of Ceuta and Melilla is available, why not including them in the estimations (especially given the fact that they have a sea border with other Spanish regions)?
- Typos in the x axis of the Figure 2.
- It would be more logical to change the order of columns in table B1 since the authors refer to the first two ones as group B and to the last two ones as group A.
- Table 5 is in the middle of the conclusion.

¹ See more references on the transportation costs in the references. The authors should include more references from this literature.

References:

Abe, K & J Wilson (2009), 'Weathering the Storm: Investing in Port Infrastructure to Lower Trade Costs in East Asia', World Bank Policy Research Working Paper 4911.

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Hummels, D (2007), 'Transportation Costs and International Trade in the second era of Globalization', Journal of Economic Perspectives 21 (3), 131–154.

Limão, N & A Venables (2001), 'Infrastructure, Geographical Disadvantage, Transport Costs and Trade', World Bank Economic Review, 15 (3), 451-479.