Referee report on

"Islands in trade: disentangling distance from border effects"

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The paper deals with a novel and interesting research question, whether there is evidence of a difference in the border effect for territories being an island. In particular, the main hypothesis is that the maritime border implies high fixed costs, which makes the interregional trade flows, thus, on medium distances unprofitable. To empirically analyse this question, the authors choose the Spanish case, where two out of 17 regions are island regions. In their econometric investigation, they proceed in two steps. First, they estimate an augmented gravity model accounting for multilateral resistance terms. Second, based on the estimation results, they apply the Blinder-Oaxaca decomposition technique to precisely account for the "border-type discrimination" against the islands. The results support the main hypothesis.

Although the paper potentially delivers a valuable contribution to the existing literature, there are still points which need to be clarified/improved.

Main comments:

1. There is a substantial need to explain the exact nature of the fixed costs connected with the sea border. In the introduction (first paragraph) it is stated that "in the case of the sea border that fixed cost is due to the use of two modes of transport (road and see typically)". First, it is still difficult to understand where such fixed costs come from? Once the necessary (road and sea) infrastructure is established, do the fixed costs still exist? If, where do they come from? Second, why air transportation is not mentioned here? Third, considering that the mainland uses the road (and air) transport as well, shouldn't this imply the existence of the fixed cost in this case too? In this regard, the authors state (page 3, last to the least sentence) that "the fixed cost of trade between the Balearic Islands and Barcelona due to the sea border does not exist between Barcelona and Vigo, because the latter are both located in the Iberian Peninsula", but it is not explained why the fixed costs in the former case exist, whereas in the latter case do not.

1. In considering the two island regions, and in confronting them with the mainland regions, no particular attention is dedicated to more concrete economic characteristics, for instance and most importantly, related to their respective industrial structures. More precisely, the fact that the Spanish islands trade less with the mainland Spain could be related to their industrial specialization patterns, which could be less economically relevant for the mainland as compared to other non-Spanish territories. Think about the tourism sector that is one of the main exported economic activities by

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the Spanish island: a relatively higher share of these exports is supplied through international trade relations than to the mainland Spain. The only way to control for these peculiarities is through the fixed effects, which might be very imprecise or even unable (if the industrial stricter is weakly time-varying) in accounting for such differences. Consequently, there would be space for improvements of the gravity specification equation, by singling out some factors that in principle are observable.

2. There is still not much told about the further going implications of the results. I am conscious about the difficulty to provide any valid policy implication for Spain. Indeed, provided that the results are true, there is not much to be done about the fact of having a particular kind of geographic border. Still, the authors themselves recognize (p. 10) that "the issue assumes greater political economy relevance for these regions, because the small economic size of island regions elevates their trade deficit up to 27.3% of their GDP, whilst they account for only 2.3% and 4.5% of Spain's export and import flows, respectively." In my opinion, it should be the case to comment (at least) on this in the conclusions. Additionally, it would be interesting to have an opinion on the extendibility of the results to territories outside Spain. In particular, could we expect that the maritime border effect is a disadvantage in trade for countries being islands? Could there be a U-shape relationship between the distance effect and trade for such sovereign islands? This would be an important counterfactual investigation, also permitting to negate the hypothesis raised in the previous point. Clearly, if it is the industrial specialization (which I suppose to be much more intensive in island regions within a country than in sovereign islands) that drives the direction of trade, there could be not much left to be explained by the discrimination against the maritime border.

Minor comments:

1. The discussion introducing the gravity approach, and particularly regarding the multilateral resistance terms should be more organized. What is still missing is the clear conceptual explanation of the logic of multilateral resistance. This is important in my opinion, given that the journal is directed to a broader economic audience and not only trade experts. Related to this, the last two sentences of the first paragraph on page 3 should be elaborated. In particular, it is difficult to understand the meaning of "the model specified with economic variables" as opposed to the fixed effects model. Moreover, this part of the paragraph is quite disconnected from its previous part.

2. The introductory sentences in Section 2 could be excluded, as much of the information provided there has been already given in the introduction.

3. It is still not very clear to me, how the passage from eq. 6 to eq. 7 was made. By substituting Y_{St} in place of $\Sigma_{it}Y_{it}$, and subsequently substituting S_{it} for the ratio Y_{it}/Y_{St}, one should end with $M_{ijt}=Y_{jt}S_{it}*$(bilateral costs expression).

4. I have doubts about the rightness of the numbers provided for the shares of interregional trade over international trade for the island and mainland regions (p. 10, third sentence of the first full paragraph). From my calculations, the opposite is true, i.e. the shares of the international trade over the interregional trade are 71% and 63%, respectively.

5. Please check the spelling in the x axis in Figure 2, as there is "Min" instead of "Main".

6. I cannot fully agree with the interpretation of the adjacency result (p. 12 in the last paragraph). The authors state that the large positive effect suggests that the contiguous regions trade more "not because they are closer, but because the transport connectivity between them is higher and because they face lower information costs in their bilateral trade due to the existence of business and personal contacts leading to better knowledge of the consumers and producers, as well as of market opportunities". In my opinion the short distance goes very much hand in hand with the fact of meeting mentioned economic opportunities. Thus, it is very much distance that is captured here. At least, this is what the new economic geography teaches us. This brings me to raise another issue regarding the specification: given that adjacency is captured by the short distance, do the results hold by excluding adjacency variable?

7. The results reported in column 4 in Table 4 are divergent from the results obtained with the other three methods (in the same table). The reason for this is not sufficiently discussed.

7. The last sentence on page 12 is not very elegant; I suggest rewriting it.

8. Some editing work is still needed: some commas are missing, whereas some others are superfluous; some expressions are unusual (for instance, "on Table").