

The Death of the Distance Puzzle

Topic: Global Value Chain Analysis

Author: Bart Los

Co-Authors: Pieter IJtsma

The longstanding "distance puzzle" in international trade relates to the finding that the trade-hampering effects of distance as found in a gravity equation framework do not decrease over time, despite the widespread notion that international trade has become more attractive due to improvements in ICT, reduced transportation costs and lowered trade barriers. This study shows that the distance puzzle vanishes as soon as not only international trade flows but also domestic trade flows are considered. Such an analysis is suggested by the focus on the extensive trade margin ("Why does a firm sell abroad or not?") in the micro-economic trade literature (Melitz, 2003; Chaney, 2008). Until recently, the required data were not available, but the recently constructed World Input-Output Database (WIOD) allows for inclusion of domestic trade flows in an analysis covering the pre-crisis period 1995-2008. The global input-output tables in WIOD also allow for an improved specification of the mass variables in product-specific gravity equations. We find that the elasticity of trade to distance has significantly decreased over 1995-2008, which implies the death of the distance puzzle.