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# The Distance Effect in Banking and Trade

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## Abstract

The empirical gravity literature finds geographical distance to be a large and growing obstacle to trade, contradicting the popular notion that globalization heralds “the end of geography”. This distance puzzle disappears, however, when measuring the effect of cross-border distance relative to that of domestic distance (Yotov, 2012). We uncover the same result for banking when comparing cross-border positions with domestic credit, using the most extensive dataset on global bank linkages between countries. The role of distance remains substantial for trade as well as for banking where transport cost is immaterial – pointing to the role of information frictions as a common driver. A second contribution is to show that the forces of globalization are also evident in other, less prominent, parts of the gravity framework.

JEL: F14, F34, F65, G21.

Keywords: Globalization, gravity framework, distance, international trade, international banking.

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