

is difficult to come by. However, several influential recent studies suggest that information problems are empirically relevant.

Portes and Rey (2005) find that information costs play a significant role in inhibiting international trade in financial assets. Previous work had documented a significant home bias in asset holdings, and several authors had suggested that "informational distance" between countries may be part of the explanation. Portes and Rey use a gravity model, where the volume of asset trade between countries depends on their incomes and on trading costs. They first confirm that the physical distance between countries reduces asset trade flows. Since financial assets are essentially weightless, they argue that transport costs cannot be the explanation, and they investigate whether distance may be a proxy for information costs. They use measures of information flows between countries, such as the number of telephone calls between countries and the number of branches in country j of banks with headquarters in country i (to explain trade between i and j). The hypothesis is that large values of either of these variables indicate better information flows and therefore should be associated with a larger volume of asset trade. Their results confirm this—both variables are statistically significant, and both tend to increase asset trade flows. Moreover, the sign on the distance coefficient gets smaller once these variables are included, suggesting that distance is indeed proxying for information.

Portes and Rey (2005) also use the same approach to investigate the effects of information flows on trade in manufactured goods. As with asset trade, better information flows (as captured by their telephone and banking variables) are associated with increased goods trade. And as with asset trade, the coefficient on distance falls once the information variables are included: the elasticity of trade flows with respect to physical distance falls from -0.55 to -0.28 . The distance variable is often thought to be capturing transportation costs when explaining goods trade; this suggests that it is also capturing the effects of information flows.

Nicita and Olarreaga (1999) test for two different effects of information. First, if there are fixed costs of entering and devel-