On-line Appendix to A Dissection of Trading Capital: Trade in the Aftermath of the Fall of the Iron Curtain

Matthias Beestermöller and Ferdinand Rauch

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1 Appendix A: Data

The main source we rely on to obtain bilateral trade flows is the standard United Nations Commodity Trade Statistics Database (COMTRADE). While a cleaned version of these data are available (Feenstra et al. 2005) we use the raw data as it gives us more years after 2000, up to 2011. We undertake some data cleaning ourselves, as described below. We verify that our main results are robust to using the Feenstra data up to 2000. We download aggregate trade data.[1] Our original sample of annual aggregate trade flow contains 32,386 observations reported as imports from 47 European economies over the period 1990 to 2011. The year 1990 marks the fall of the Iron Curtain and 2011 is the most recent year for which a full set of reported trade statistics are available. We use the 4-digit Standard International Trade Classification, revision 2, commodity code (SITC2) as it is the most detailed product classification for which the COMTRADE database offers data spanning back to 1989, and it is the same as used by Feenstra et al. (2005). Individual observations are identified by origin-destination-year dimensions. Table 1 lists all countries in the dataset.

The first problem we encounter is that of missing reported trade values. These are especially common in early years after a break-up or creation of an economy in the aftermath of the fall of the Iron Curtain. For example, Slovakia only starts reporting its trade flows in 1994, one year after the break-up of Czechoslovakia. Following the approach taken by Feenstra et al. (2005) we prefer importer reported statistics, assuming these are more accurate than those trade values reported as exports. Wherever possible we use exporter reported trade flows if the import reported trade flows is missing for a country-pair. By this method we replace 2,293 missing observations in the total trade dataset - about ten per cent of observations.

Within Comtrade, import reported data is valuated CIF (cost, insurance and freight) and export reported data is valuated FOB (free on board). FOB-type values include the transaction value of the goods and the value of services performed to deliver goods to the border of the exporting country. CIF in addition includes the value of the services performed to deliver the goods from the border of the exporting country to the border of the importing country. Following the methodology of HMR we correct this discrepancy by discounting CIF values by 10 per cent. We compare the import and exported reported trade statistics whenever both reports are available. If we ignore all exporter and importer reported values that differ by a factor of greater than two either way, we find that reports valued as CIF exceed FOB reported values by a factor 1.12 on average, which confirms the HMR methodology.

For the product level regressions we rely on the BACI dataset from CEPII (see Gauillaume and Zignago 2010). BACI provides bilateral values and quantities of exports at the HS 6-digit product disaggregation, for more than 200 countries. BACI data are available from 1995 only, we are greatful for CEPII to provide us with data from 1992. We cannot include 1990 and 1991 in our product level analysis. Services are not included in this dataset, and thus services is the HS 2-digit category that we do not include in the analysis. It is the only omitted category. The control variables from CEPII are measured as follows: *Distance between both countries:* Measured as great circle distance using the coordinates of both capital cities. *Common officially joint language:* Indicator created from the CIA World Factbook database of official languages,

[1] COMTRADE data are revised over time. The data described here were accessed on June 23, 2013 via the website http://comtrade.un.org.

up to three per country. *Common spoken language:* Indicator informative if at least nine percent of the population in both countries speak that language. Computed so that it can vary over time, in practise it hardly does for the period and countries we study. *Common legal institutions:* As by the definition of the "Correlates of War Project" based at the Paris School of Economics. *Common currency:* Varying over time, information on Euro accession dates from Eurostat. *Regional trade agreements:* As defined by the WTO. *EU membership* Dates of membership taken from Eurostat.

We use UN definitions (2013) to determine which countries to include as Europe. We start with all European countries, but undertake some aggregations to balance the data. Some of the nation break-ups following the fall of the Iron Curtain occur within key economies of the former Habsburg Empire. We prefer to work with a panel of stable country boundaries so that compositional differences do not drive our results. Fortunately these border changes consisted of splits in such a way that they can easily be mapped into larger units that remain stable over time. We aggregate trade flows to the smallest possible country which we can observe continually over the sample period. Table 1 lists all country groups and years that merge/split and that we aggregate. After aggregating we drop within country trade (i.e. trade flows that were formerly reported as Czech Republic to Slovakia). Note that we only observe trade statistics from the Former Yugoslav Republic of Macedonia starting in 1993. Usually COMTRADE country borders changes only occur at the beginning of a calendar year. There is one notable exception to this: Both Serbia and Serbia-Montenegro report trade data in 2005. We keep and aggregate these observations within the same year as it might be due to Serbia-Montenegro breaking up at some point during the year, such that Serbia starts reporting its imports from some month when Serbia-Montenegro ceases to do so. Consequently, our measure of Yugoslavia contains reports from former Yugoslavia in 1990-1991, reports from four countries in 1992, five countries from 1992 to 2004, six countries in 2005 where both Serbia and Serbia-Montenegro report data, and six countries from 2006 and thereafter as Montenegro replaces Serbia-Montenegro. We drop a number of countries that belong to the former Soviet Union from the dataset (Belarus, Ukraine, Latvia, Lithuania and Estonia as well as the Russian Federation). With the dissolution of the Soviet Union these countries and the political turmoil these economies only appear in the trade statistics two years after the beginning of the sample period (in 1992). We decide that the cost of introducing noise by including them is greater than the benefit of gaining some more observations, especially as these countries are not directly relevant for the question we study. We omit tiny countries such as the Vatican and the Faroe Islands, but include them as partner countries. Given these changes, the resulting panel of countries we work with is balanced throughout all the years we study.

We drop reported destinations that are designated "bunkers" (UN code 837), "free zones" (838), "special categories" (839) and "areas not elsewhere specified (nes)" (899). Moreover, we drop the highly incomplete observations reporting trade with San Marino, the Vatican, Andorra, Faroer Islands and Gibraltar. Table 2 reports the elements by year for the countries that involve aggregation for our dataset.

We add a number of standard control variables, relying on standard sources. We obtain data on aggregate GDP and populations from the World Banks World Development Indicators (2013). We compute GDP per capita as GDP divided by population, both as reported by the UN. Following our methodology of aggregating trade flows, we derive GDP and population measures for Yugoslavia and Czechoslovakia as the sum of GDP and populations of the underlying countries.

Table 1
List of European Economies and our aggregation method

Albania	Fmr Yugoslavia	Poland
Andorra*	France	Portugal
Austria	Germany	Rep. of Moldova**
Belarus**	Gibraltar*	Romania
Belgium***	Greece	Russian Federation**
Belgium-Luxembourg	Vatican City State*	San Marino*
Bosnia Herzegovina***	Hungary	Serbia***
Bulgaria	Iceland	Serbia and Montenegro***
Croatia	Ireland	Slovakia***
Czech Rep.***	Italy	Slovenia***
Czechoslovakia	Latvia**	Spain
Denmark	Lithuania**	Sweden
Estonia**	Luxembourg***	Switzerland
Faeroe Isds*	Malta	TFYR of Macedonia***
Finland	Montenegro**	Ukraine**
Fmr Dem. Rep. of Germany***	Netherlands	United Kingdom
Fmr Fed. Rep. of Germany***	Norway	

Notes: Trade values estimated following the methodology of Feenstra et al. (2005). * Only appear as partner, not included as reporter country as trade and production data unreliable. Do not report trade statistics themselves. ** Former Soviet Union with changing borders. *** Aggregated with another country to balance the sample.

For example, Czechoslovakia's population is calculated as the sum of the Czech Republic's and Slovakian populations. GDP is measured in current US dollar (millions) and, in accordance to trade flows, not deflated. We obtain a number of gravity variables from the CEPII distance database used in Mayer and Zignago (2005).[2] These include the country-specific variable landlocked as well as dyadic variables common border, common (official) language, shared language spoken by at least 9 per cent of the population, and distance. As measure of distance we use distance between capitals as it is a consistent measure we can apply to the aggregated economies. For example, we use Prague as the capital of Czechoslovakia throughout the sample period. The variables time difference, shared legal history, area and shared religion are from the gravity data set provided by HMR.[3] We also use this source to add time varying variables GATT/WTO membership, membership of RTAs (Regional Trade Agreements) and a common currency indicator. Since the HMR dataset only spans the years up to 2006, we update the time varying variables using data from the WTO.[4] Finally, we construct dummy variables for EU and Eurozone membership.[5] This latest source also allows us to generate a variable that indicates membership in the common currency.

[2]These data are vailable at http://www.cepii.fr/anglaisgraph/bdd/distances.htm (accessed June 19, 2013).
[3]These data are available at http://strategy.sauder.ubc.ca/head/sup (accessed June 19, 2013).
[4]Here we rely on two sources, http://www.wto.org/english/thewto_e for GATT/WTO membership and http://rtais.wto.org/UI/PublicPreDefRepByEIF.aspx for RTAs (both sites accessed June 19, 2013).
[5]We use the EU web site http://europa.eu/about-eu/countries/index_en.htm (accessed July 10, 2013)

Table 2
Aggregated Economies

Country	Years observed
Germany	
Germany	1991 - 2012
Fmr Dem. Rep. of Germany	1989 - 1990
Fmr Fed. Rep. of Germany	1989 - 1990
Czechoslovakia	
Czechoslovakia	1989 - 1992
Czech Rep.	1993 - 2012
Slovakia	1993 - 2012
Yugoslavia	
Fmr Yugoslavia	1989 - 1991
Slovenia	1992 - 2012
Bosnia Herzegovina	1992 - 2012
Croatia	1992 - 2012
TFYR Macedonia	1993 - 2012
Serbia and Montenegro	1992 - 2005
Serbia	2005 - 2012
Montenegro	2006 - 2012
Belgium-Luxembourg	
Belgium-Luxembourg	1989 - 1998
Belgium	1999 - 2012
Luxembourg	1999 - 2012

2 Appendix B: Robustness and additional results

We verify that our results are robust to a number of alternative specifications and estimation methods. We omit the detailed numbers and figures for some of these robustness tests for reasons of space. Details on all robustness checks not displayed here are available upon request.

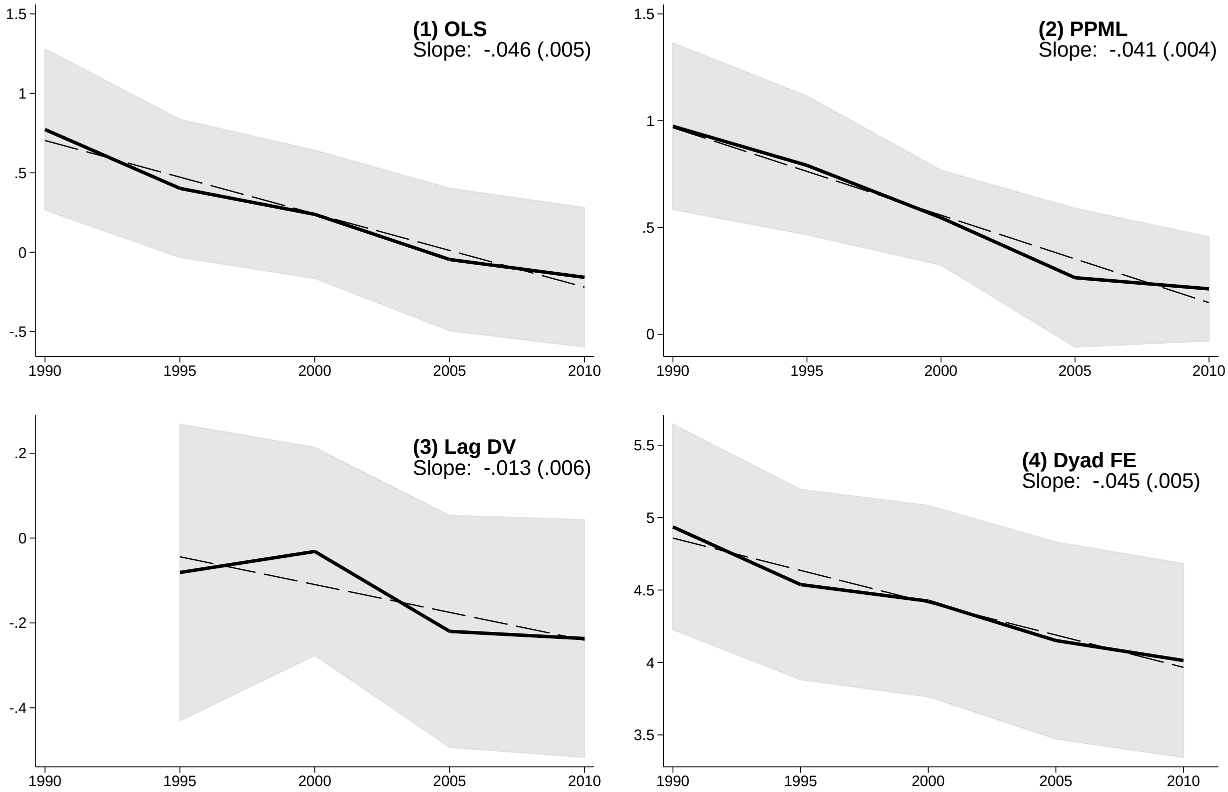
2.1 Habsburg definition

We define the Habsburg measure in different ways. We include all countries that are at least partly former Habsburg members, thus adding Italy, Poland, Romania, Serbia and Ukraine to the countries covered by the Habsburg fixed effects. The Habsburg coefficients remain fairly similar, yet become somewhat statistically weaker. This is as expected, given that this measure includes areas that were outside of the monarchy and thus should add more noise than signal. We run a separate regression including only Yugoslavia as an additional Habsburg member, and one in which we code Yugoslavia as being west of the Curtain. Yugoslavia is an ambiguous case given its unique history during the 20^{th} century. The monotonic downward slope is strongly robust to these specifications and variations thereof.

2.2 Panel estimation

We address the concerns brought forward by Anderson and Yotov (2012), that a disadvantage of pooling gravity data over consecutive years is that dependent and independent variables cannot fully adjust in a single year's time. We address this concern using the suggested methodology of keeping only intervals of 3 or 5 years. The downward slope in Panel (1) in Figure 3 of the paper becomes -.038 (.004) when keeping only every third year from 1990, and -.034 (.002) when keeping only every fifth year. Our findings seem not to be much changed by this adjustment. See also Figure 1.

Figure 1
Anderson-Yotov 5 year intervals



2.3 Additional control variables

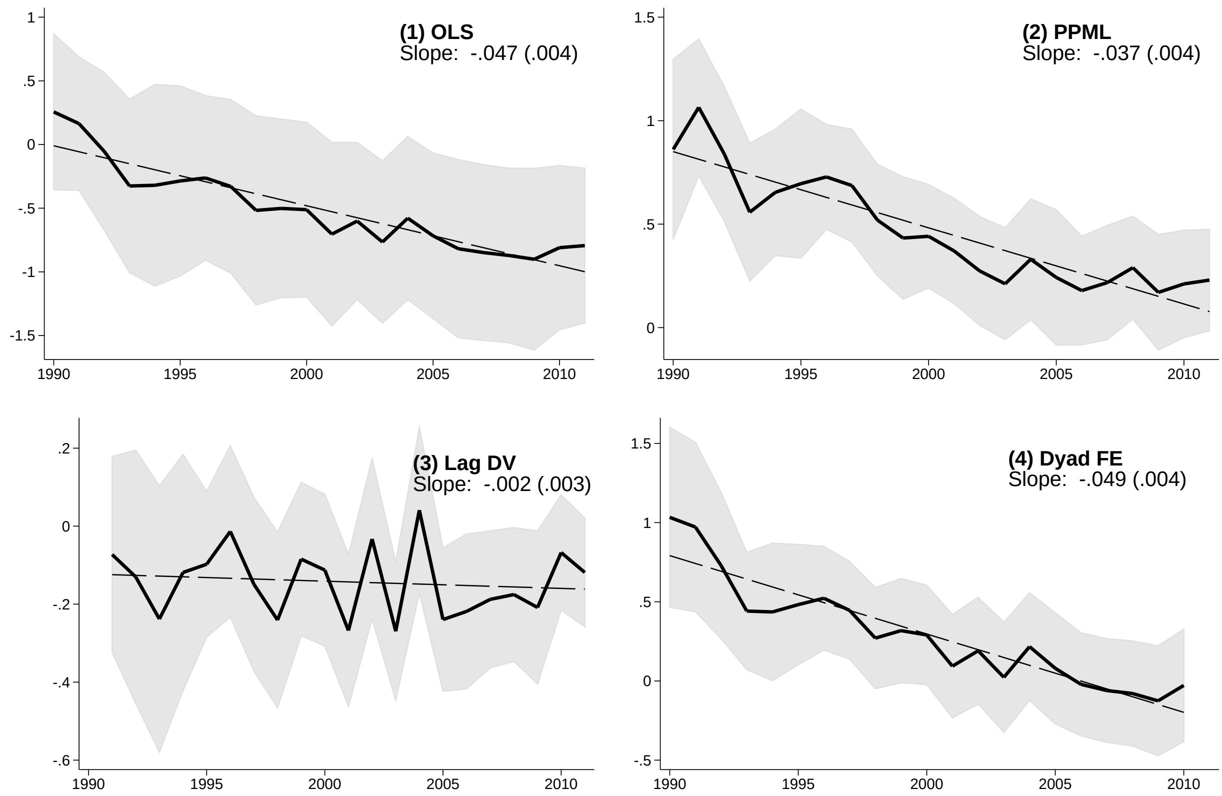
Country pairs that are most affected by the fall of the Iron Curtain are those country pairs that shared an East-West border along the Iron Curtain, such as Austria-Czekoslovakia, Italy-Slovenia, Greece-Albania. To avoid a potential omitted variable biase we include time varying control variables for these country pairs. We continue to observe the downward sloping Habsburg coefficient with a fairly similar magnitude. We also include a dummy variable indicating that both countries are west of the Iron Curtain. The slope in our preferred estimation remains numerically at -0.044, and is not statistically significant from any of our estimated slopes at the 1 percent level of statistical significance. We also add measures of cultural proximity. These are variables indicating Eurovision voting preference (data from Felbermayr and Toubal 2010), genetic distance (data from Spolaore and Wacziarg 2009) and cultural and religious similarity (data from Spolaore and Wacziarg 2015). Roughly speaking, the definition of genetic distance in that database is an approximate measure of the probability that two people from different countries share a gene. Similarly, the measure of linguistic similarity is built using tools from lexicostatistics. It measures the probability that two countries, even of different language, share a similar word for the same thing. this approach would recognise the similarity between 'tavola' in Italian and 'table' in English. The measure of cultural distance uses the World Values Survey for a similar exercise. Finally, the religious measures compute the probability that two people share the same religion, where religion is subdivided into for example different varieties of Christianity or Islam. In total, this approach distinguishes around 50 religions. This measure takes into account similarity of religions. The inclusion of these additional control variables does not change the slope in our main estimation, which remains at -0.047, close to the estimate in our main specification. These and other time invariant bilateral variables we may have omitted are covered by our specification that includes bilateral fixed effects. These results are also reported in Figure 2.

2.4 Placebo

We run a couple of placebo exercises where we replace Austria by other Western European countries. These address the possibility that the opening of trade relations between East and West might be dynamic, increasing or decreasing, in the first years after the opening of the Iron Curtain because of various reasons other than the decline of historic and cultural ties. For example, the installation or reuse of transport infrastructure might suggest a dynamic trade relationship between an eastern and a western country, or the slow establishment of personal exchange and interaction. In both these examples we would expect an increasing relationship, but there may be others. To mitigate concerns that such effects drive our results we run a placebo exercise in which we estimate "Habsburg" effects on a relationship other than Habsburg, for which we do not expect the same decay of cultural ties. We chose Germany as our preferred placebo country. It shares the language with Austria, and also a direct border with many eastern countries. When we estimate the trading relationship with Germany instead of Austria being the "Habsburg" country west of the curtain, we do not find significant relationships. These results are reported in Table 3, and in this table we use the same specification as applied in Tables 2 and 3 of the paper. The PPML estimates display an increase of the effect for intermediate years, which may point to some form of catch up in the interim years. This effect however shows no monotonic trend in t and is not robust to the other specifications displayed. Most of the coefficients in Table 3, including in the PPML specification are not statistically significant. We interpret this finding to cast doubt on the relevance of other dynamic effects shaping initial trade relationships. We also show further robustness tests using Switzerland, the Netherlands, Belgium-Luxembourg and Italy as placebo countries. Switzerland is similar to Austria in some cultural aspects and geographically close, yet does not share the Habsburg history. It also does not have a history of division and unification like Germany. The Netherlands and Belgium-Luxembourg are other countries similar in size and wealth to Austria. Italy is geographically

Figure 2

Additional control variables: countries that share an east-west border (time varying), genetic distance, Eurovision voting, cultural and religious similarity.



close to both Austria and the Iron Curtain. As in the estimation with the German placebo, these estimations are exactly like our main estimation for Habsburg countries with the exception of replacing Austria by each of the placebo countries in turn. We display the main OLS estimation for these four countries in Figure 3. The magnitudes of the slopes in all these four cases are much lower than for the main Habsburg specification. Switzerland and the Netherlands show a slightly positive trend with small magnitudes. Only Italy shows a negative slope, moderately significant and also small in magnitude. Italy is the only country of the four that partly had a Habsburg history herself, so the one placebo country where we might have expected a small negative slope.

2.5 Aggregation

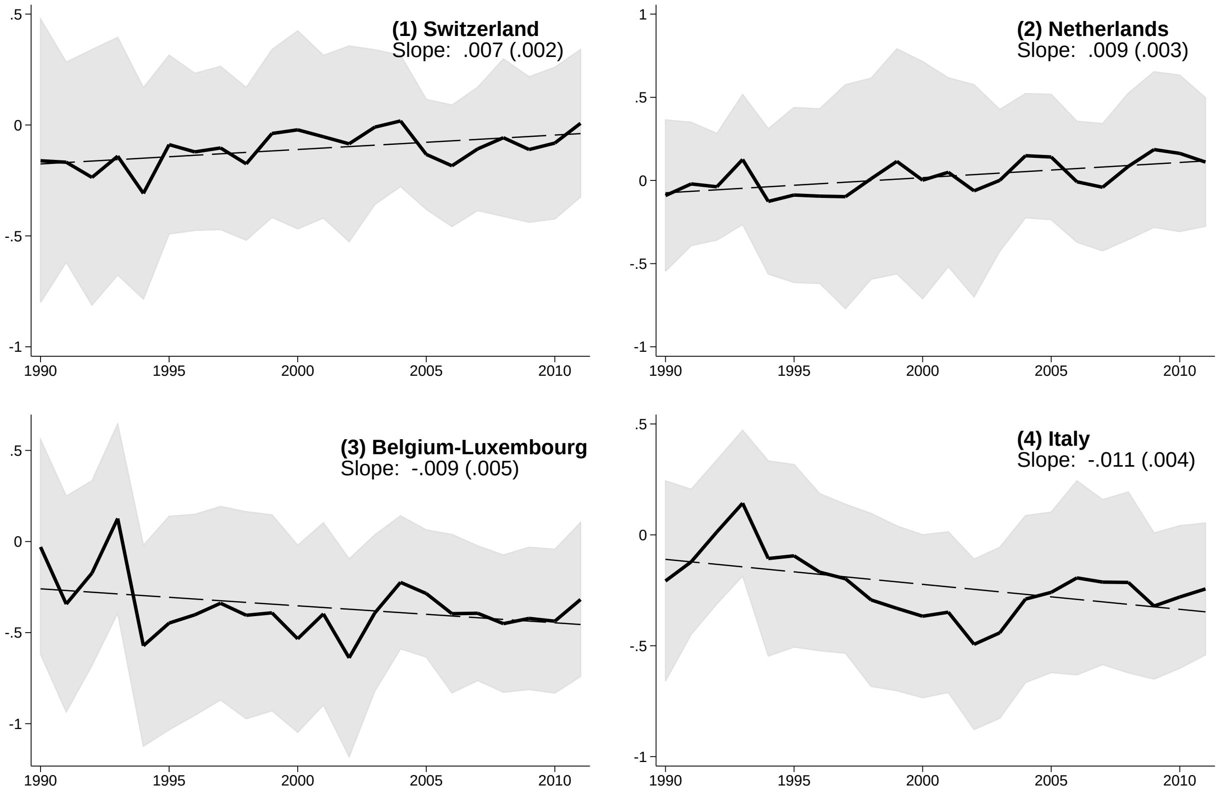
We test the sensitivity of our results to the choices of aggregating countries we make. We go to both extremes, by creating the most disaggregated and the most aggregated unit we can. In the most aggregated version we add all countries east of the Iron Curtain that were part of Habsburg into one observation, such that the dummy of interest becomes the bilateral flow

Table 3
Germany Placebo Coefficients

	(1) OLS	(2) PPML	(3) Lag DV	(4) Dyad FE
Dependent variable:	$\ln(x_{int})$	x_{int}	$\ln(x_{int})$	$\ln(x_{int})$
1990	-0.230	0.342		-0.130
	(0.375)	(0.225)		(0.238)
1991	-0.287	0.113	-0.213**	-0.278
	(0.285)	(0.213)	(0.0981)	(0.181)
1992	-0.140	0.196	0.0853	-0.0514
	(0.294)	(0.171)	(0.0944)	(0.175)
1993	0.106	0.431***	0.228***	0.186
	(0.286)	(0.167)	(0.0809)	(0.162)
1994	-0.158	0.358**	-0.227	-0.110
	(0.318)	(0.142)	(0.196)	(0.155)
1995	-0.0570	0.317*	0.108	-0.0191
	(0.346)	(0.180)	(0.0817)	(0.150)
1996	-0.0678	0.304*	-0.0319	-0.0151
	(0.307)	(0.184)	(0.0632)	(0.138)
1997	-0.00333	0.395**	-0.000351	0.0679
	(0.296)	(0.183)	(0.0804)	(0.132)
1998	-0.0299	0.490***	-0.0406	0.0433
	(0.291)	(0.177)	(0.0752)	(0.141)
1999	-0.00454	0.506***	0.0522	0.104
	(0.313)	(0.177)	(0.0796)	(0.137)
2000	-0.0777	0.416**	-0.0934	0.0192
	(0.330)	(0.178)	(0.0848)	(0.143)
2001	-0.0327	0.460***	0.0385	0.0688
	(0.305)	(0.170)	(0.0572)	(0.134)
2002	-0.0519	0.530***	-0.0353	0.0493
	(0.329)	(0.158)	(0.118)	(0.169)
2003	0.0254	0.544***	0.0483	0.133
	(0.274)	(0.144)	(0.0480)	(0.138)
2004	0.0509	0.462***	0.0112	0.160
	(0.263)	(0.159)	(0.0753)	(0.133)
2005	-0.0569	0.316*	-0.106	0.0521
	(0.281)	(0.189)	(0.0753)	(0.136)
2006	-0.115	0.268	-0.0585	-0.00521
	(0.310)	(0.184)	(0.0903)	(0.139)
2007	-0.145	0.214	-0.0530	-0.0417
	(0.287)	(0.175)	(0.0634)	(0.134)
2008	-0.183	0.154	-0.0743	-0.0802
	(0.288)	(0.172)	(0.0656)	(0.136)
2009	-0.156	0.0905	-0.00779	-0.0530
	(0.291)	(0.166)	(0.0813)	(0.143)
2010	-0.147	0.0673	-0.0296	-0.0469
	(0.291)	(0.166)	(0.0813)	(0.143)
2011	-0.102	0.102	0.0114	
	(0.323)	(0.170)	(0.103)	

Notes: Placebo exercise: Habsburg coefficients with Germany instead of Austria. Stars denote statistical significance on the level of one (***), five (**) and ten (*) per cent. Robust standard errors used.

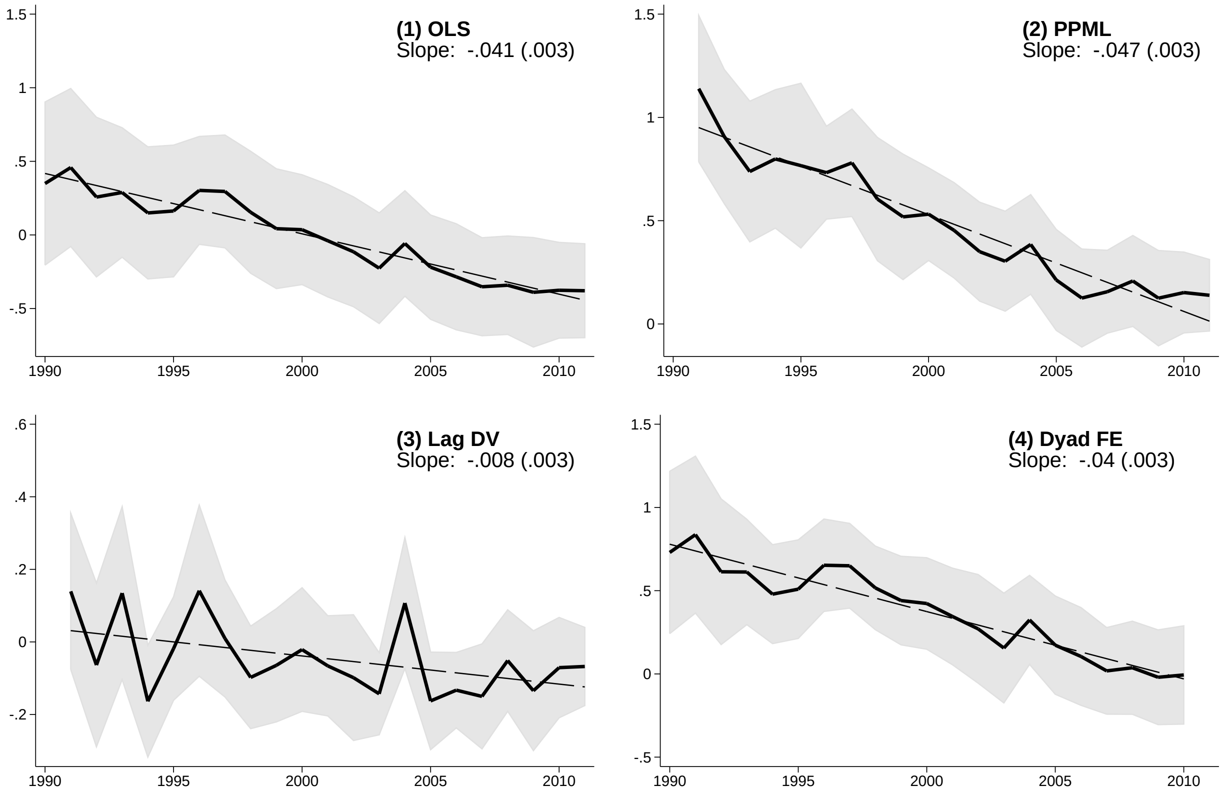
Figure 3
Further Placebo regressions.



between one Eastern and one Western aggregate. Despite the small sample of treatment in this robustness, which is just one bilateral trade flow between Austrian and the Eastern Aggregate, a strong, significant downward slope remains, although somewhat smaller in absolute magnitude than in the main specification (see Figure 4). In this Figure we do not include Yugoslavia. When we do include Yugoslavia in the eastern aggregate we find a very similar picture, with a strong, significant downward slope of -0.033 (0.003) in our main specification.

In Figure 5 we repeat the main table for the most disaggregated version of countries, which splits Yugoslavia and Czechoslovakia into its components today from the moment of separation. This exercise is only possible for the years from 1993 onwards, when countries were separated. The downward slope remains strong and negative in all four specifications. The turbulent history of the countries of former Yugoslavia and the corresponding big shocks to their trade relationships are likely to contribute to the increased noise apparent in this graph compared to our main specification.

Figure 4
Aggregate Eastern countries.



2.6 Missing data

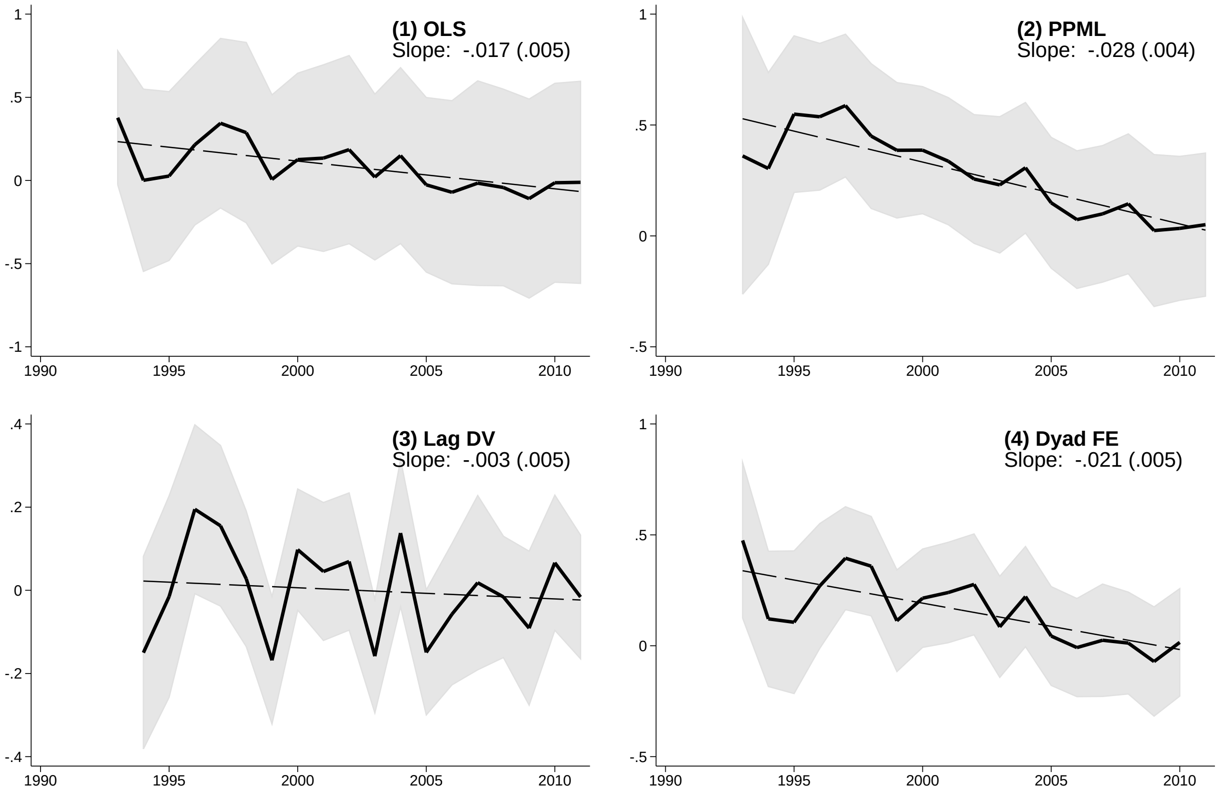
In the main parts of this paper we treat missing trade flows in the CEPII or comtrade data as a zero trade flow and include such observations in the analysis. We test the robustness of our results to treating zeros in different ways. First, omit zeros from the sample or second we replace zeros by 1. Again, our main conclusions in the main results table does not seem to be altered by these specifications. These results are available for our main tables by request.

2.7 Internal trade

Yotov (2012) argues that gravity models should not just focus on international flows but explicitly take into account national integration, internal distance and internal trade costs. We follow the gravity literature on how to construct internal trade flows. We construct internal trade flows as the difference between GDP from the World Bank (World Development Indicators) and total exports from our COMTRADE dataset. Related recent contributions (for example Heid et al. 2015) use production data from the UN's Industrial statistics database on the industry level. This measure, however, suffers from significant missing observations in the

Figure 5

Disaggregate Eastern countries.

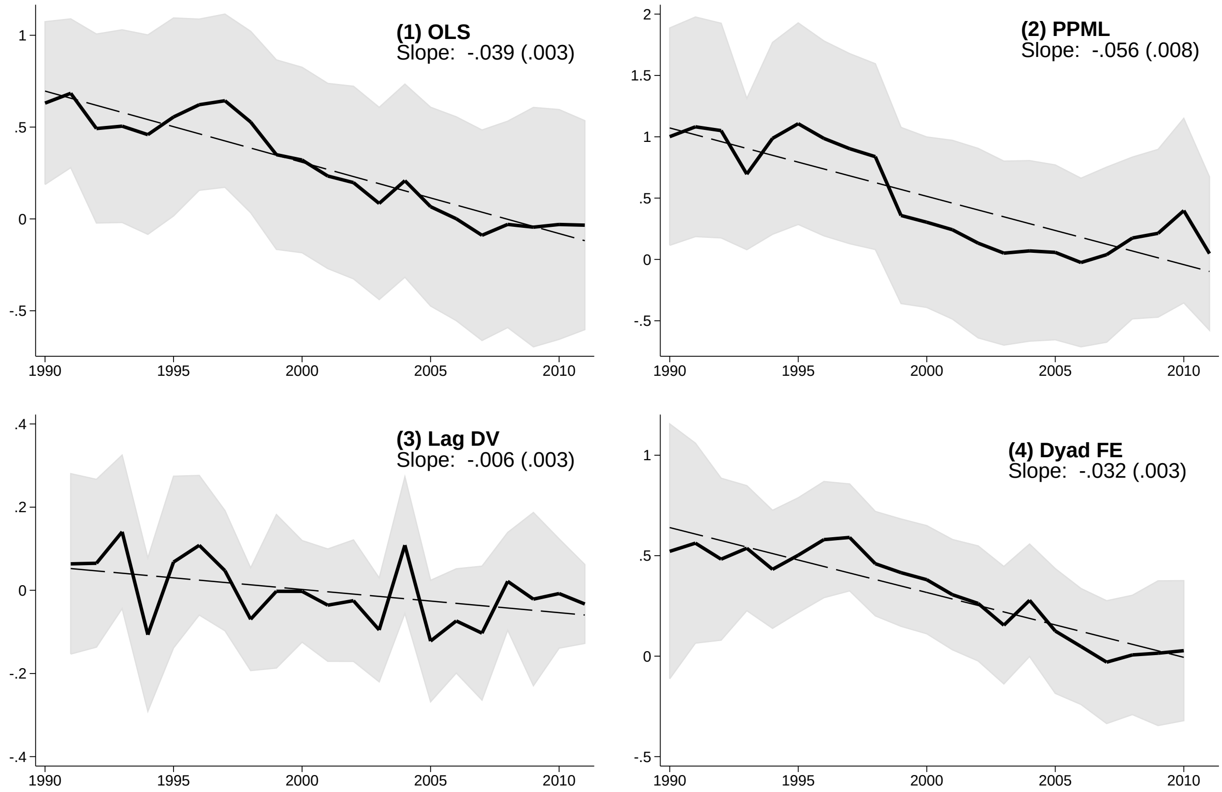


early 1990s. Thus and because our specification focuses on aggregate trade flows, we prefer using GDP data. Regarding the coding of covariates for internal flows, we adopt the measures suggested by the CEPII. These standard definitions also include suggested controls for internal trade flows. These are then consistent with our previous controls. For example, the population-weighted distance allows a consistent use of internal and international distances. See Figure 6 for the results of this exercise. As shown in Figure 6 the internal trade specification does not change the slopes or picture much comparred with the main estimate. We would have expected results to be weaker, as we count the internal trade flow of Habsburg countries as part of the treatment effect, but don't expect that part of trade to be important. In other words, we add noise to the treatment. And indeed the OLS slope is slightly weaker than in the main results specification. This decrease is neither very pronounced nor robust across all specifications.

2.8 Standard errors

As an alternative treatment of standard errors, we conduct a robustness test in which we cluster standard errors by bilateral country pairs. Coefficients remain identical, we verify that this does

Figure 6
Include internal trade.



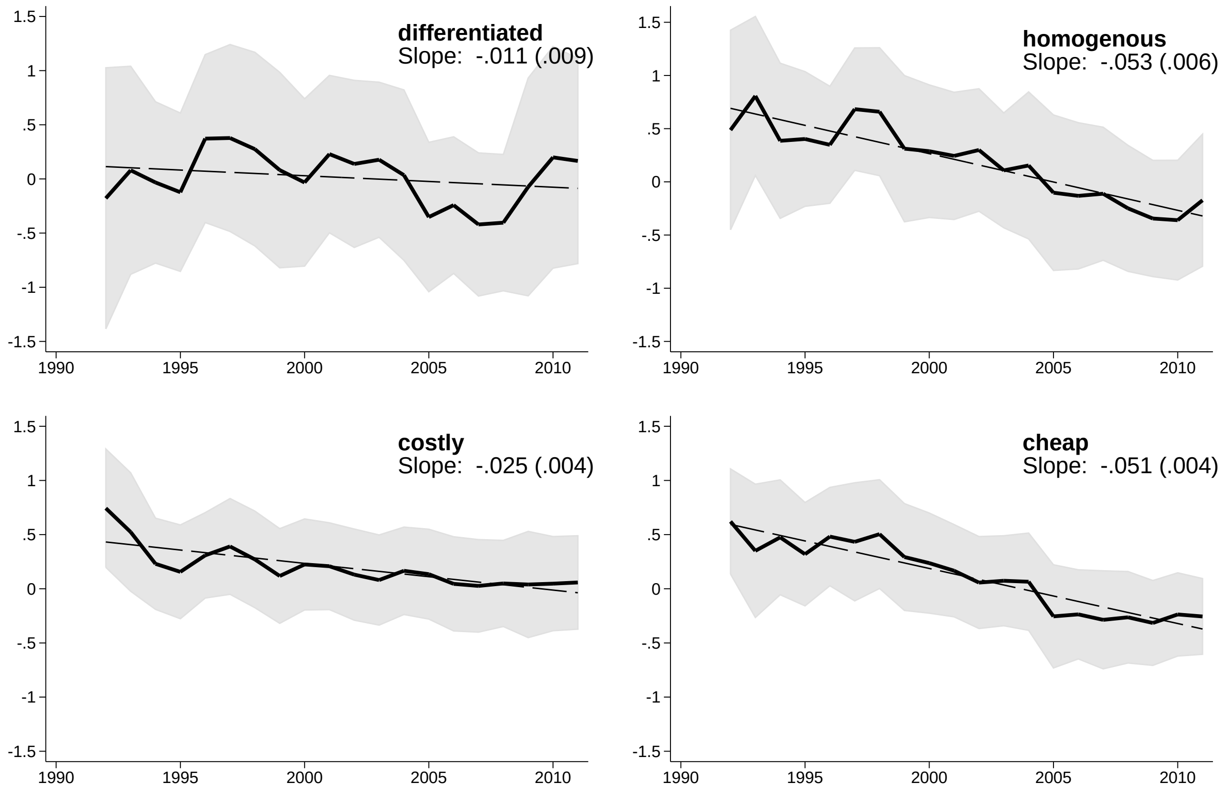
not change the significance of coefficients reported in Figure 3 in a meaningful way. Results indeed remain strongly significant. It should be quite apparent from the monotonic downward slope visible in that figure that the significance of this downward slope is strongly robust to other or even more demanding specifications.

2.9 Product heterogeneity

We next study the effect by heterogeneous and homogeneous products, following the standard classification by Rauch (1999). We merge the classification at the level of HS4, keeping only matched trade flows. These are fifteen per cent of total trade flows. We think that the Habsburg bonus disappears over time as Europe adjusts to the new trading environment, and converges to the new optimum. This suggests that initial deviations from the optimum, which here happen to coincide with the gravity framework, were not the first best choice. We would expect to find that the Habsburg bonuses are thus stronger for homogeneous goods, for which search costs and the costs of not using the optimum product are smaller, and thus the temptation to follow an intuitive heuristic when buying greater. As can be seen in the top panels of Figure 7, indeed we find the bonus is stronger initially, and falls more rapidly for the homogeneous goods, while there is not such a clear pattern for the differentiated products.

Figure 7

By degree of heterogeneity and transport costs.



Notes: Coefficients of the Habsburg by year interaction term with 95 per cent confidence intervals. The top two panels compare trade of differentiated and homogeneous goods. The bottom two panels consider the different transport costs.

If transport infrastructure surviving from the Empire was an important driver of our findings, we should expect to see a stronger effect for goods easier to transport. To measure this effect we obtain data on unit values from the CEPII TUV dataset.[6] This dataset gives Free on Board (FoB) unit values per ton for each HS6 product. If, in line with some literature, we assume that the costs to ship a ton of any good are fairly similar, then inverse unit value data can serve as a proxy for transport costs, as the ratio of transport costs per value transported would be smaller. Using this proxy we compare above and below median goods separately, in the bottom two panels of Figure 7. The panel of 'costly' goods refers to above median transport cost goods, while 'cheap' refers to below median ones. The standard pattern emerges, and the initial surplus trade is similar in both specifications. If there was a difference, it would be that the goods that are harder to transport adjust earlier. An explanation for this earlier drop

[6]Downloaded from www.cepii.fr/CEPII/en in September 2014.

may be that for these goods the costs of a suboptimal country to import from are higher, so adjustment may be quicker. In any case, this difference is not very strong, and coefficients rest firmly within the confidence intervals of the other graph in both cases.

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