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## Ethical distance and difference in bilateral trade

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**Asia-Pacific Research  
and Training Network on Trade**

**Ethical Distance and Difference  
in Bilateral Trade**

*Bala Ramasamy*

*Matthew C.H. Yeung*

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## Ethical Distance and Difference in Bilateral Trade

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# Ethical Distance and Difference in Bilateral Trade

## Abstract

Cultural, institutional, and psychic distances between countries are critical determinants of bilateral trade. In this paper we examine if ethical distance and difference between an exporting country and an importing country matter in international trade. Ethics in international trade is important because purchasing, exports, marketing and sales activities are more likely to involve unethical behaviors like bribery and corruption. The focus of the paper is on the similarities and differences in ethical behaviors between a trade dyad (an importing and an exporting country). We ask if variations in perceived ethics among the protagonists help or hinder bilateral trade. More specifically, we examine if countries that are ethical trade more or less with other similar countries. Using data from 53 countries that participated in the World Values Survey, we show that the closer the ethical distance between countries the greater the trade. We also find that the ethicality of importers matter more than exporters as a determinant of bilateral trade.

**Keywords:** Ethics, Ethical Distance, Ethical Difference, Determinants of International Trade, Cultural Distance

**JEL Codes:** F11, F13, M14

# Ethical Distance and Difference in Bilateral Trade

## 1. Introduction

International trade has been an engine of global economic growth for centuries and in particular, over the last 50 years. Countries affected severely by the 2008 Global Financial Crisis like the United States (US), Japan and Germany resorted to exports as a conduit to scramble out of the economic malaise. It is not surprising then that international trade researchers have been pre-occupied with the determinants of international trade. Trade theorists have explained trade directions based on factor endowments (postulated by Heckscher-Ohlin) and economies of scale in differentiated products (postulated by new trade theorists like Krugman, Helpman and others). While the former explained trade between developed and developing countries, the latter provided insights into intra-industry trade among countries with similar factor endowments (Salvatore, 2001). More recently, there has been a surge in research unveiling other country level differences that could add to our understanding of those factors that stand as drivers of bilateral trade as well as its obstacles. These studies tend to focus on the institutional distances that exist between countries, defined in a broader context as, “*humanly devised constraints that structure political, economic and social interaction... [and that] provide the incentive structure of an economy...*” (North, 1991, p. 97).

Thus, previous studies have considered formal factors including regulatory, political and economic institutions, as well as informal factors like social norms, beliefs and values. These institutional differences among countries contribute to the intangible transaction costs and may explain why bilateral trade continues to be dominated by similar countries (Rauch, 2001; Helpman, et. al., 2008). Given that a range of factors have been considered in the past - from currency unions (Rose, 2000) to the Dalai Lama effect (Fuchs and Klann, 2010) – the objective of this paper is to extend further the search for meaningful determinants of international trade. We focus our attention on the similarities and differences in ethical behaviors between a trade dyad (an importing and an exporting country) and ask if variations in perceived ethics among the protagonists help or hinder bilateral trade. Ethics in international trade is important because purchasing, exports, marketing and sales activities are more likely to involve unethical behaviors like bribery and corruption (Transparency International, 2006; Baughn, et. al., 2010). Intuitively, one could argue that both sides of the trade dyad would prefer having a trustworthy and ethical trade partner so that some risks are minimized. This leads us to examine if *ethical difference* matters. Furthermore, disagreements may result from cultures applying dissimilar moral/ethical values to business activities (e.g. difference in attitudes towards bribery, sustainable development, etc.), which leads us to examine if the relative *ethical distance* matter. In the next section we review the literature on the determinants of international trade, paying particular attention to the softer drivers of trade and the rationale for our hypotheses. In section 3, the data and methodology employed are discussed, followed by a discussion of the results of our analysis. Finally, in section 5, we conclude by proposing some implications of our findings.

## 2. Determinants of bilateral trade and proposed hypotheses

Differences that exist between countries motivate firms to trade across borders, just as differences among individuals forces exchange. Early international trade theories tend to explain the sources of differences – whether due to differences in factor productivity (David Ricardo) or in factor endowments (Heckscher-Ohlin). Newer trade theories however emphasize similarities between countries to explain the nature of trade. In particular, economies of scale advantages and the desire for greater varieties are reasons given for greater intra-industry trade (Helpman and Krugman, 1985; Krugman, 1980). Intra-industry trade is likely to be larger among countries of similar size and factor proportions, as evidenced by trade among Western European countries (Greenaway and Milner, 1986).

The tradition of identifying commonalities among countries to explain bilateral trade has been a focus of attention in recent years. The underlying logic behind the reason why countries that are more similar tend to trade more with each other is transaction costs. Bae and Salomon (2010) suggests that various distances among countries, whether political, regulatory, economic, cultural or cognitive are manifested in the “liability of foreignness” (Hymer, 1960) which results in an increase of various costs including coordination, knowledge transfer, labour and legal costs for the trading firm. To minimize this liability, international exchange tends to take place among firms from more similar countries. Thus, countries that share a common border, a common language, a common history (eg. colonial master), a common currency and a common political system have a greater likelihood of trading more with each other (Frankel, et. al., 1998). It can be argued however, that these commonalities stem from the similarities in values, behavior and attitudes (or in a general sense, culture) of the people in the two countries. Lewer and Van den Berg (2007) for instance, found that religious similarity (which implies a similar value system) could encourage international trade by enhancing the network effects within members of a common religion. Scholars from the Uppsala school (Johanson and Vahlne, 1977) have argued that economic exchange relies on the transfer of information, which in turn is based on some implicit symbols and values. Thus, managers would find it much easier to deal with counterparts from countries that are closer in terms of psychic distance (Siegel, et. al., 2008).

Indeed, the importance of having shared values among business partners has been extensively researched in the exchange theory literature both at the consumer and firm level. A general consensus on ethical values between two parties decreases the distance between firms. Morgan and Hunt (1994, p. 22) defined “shared values” as “the extent to which partners have beliefs in common about what behaviors, goals, and policies are important or unimportant, appropriate or inappropriate, and right or wrong”. Several studies find that having shared values increases trust and commitment among parties (Dwyer, et. al., 1987; Morgan and Hunt, 1994). Carter (2000) examined the ethical issues surrounding the relationships between 88 paired United States’ buyers and their foreign suppliers and suggested that the gap between a buyer's and supplier's perceptions of unethical behavior (deceitful practices) on either side would negatively influence the relationship. Sharing a similar ethical view, on the other hand led to a satisfactory buyer-supplier relationship. The seminal work by Guiso, et. al. (2009, p. 1098) on intra-European Union trade found that “a one-standard-deviation increase in the importer’s trust toward the exporter raises exports by 10%”. The level of trust, according to these



authors, can be explained by shared culture, religion, ethnicity as well as somatic distances, among others.

The arguments above propose that dyads with shared ethical values trade more with each other because of lowered transaction cost. The proposition is more likely to hold when both parties are ethically righteous. In contrast, the previous studies on exchange between dyads that are lower on ethical standards are limited. Countries with lower ethical standards may have no choice but to trade with partners of similar ethical standards. In the study on China's outward Foreign Direct Investment (OFDI), Child and Rodriguez (2009) claimed that Chinese firms prefer to invest in countries with similar opaque political environment (eg. Angola, Democratic Republic of Congo etc.) - and by implication dubious ethical practices. Recent empirical findings by Ramasamy, et. al. (2011) confirm the smaller liability of foreignness faced by Chinese firms in such foreign locations. The propensity that firms from a country acting unethically (for instance, providing bribes) in international transactions reflects the attitude towards ethical practices at home (Baughn et.al., 2010). Similarly, there is also a greater likelihood that tolerance towards unethical practices in the host country is condoned at home (Sung, 2005). In a study of bribes in international transactions among 29 countries, Baughn et. al. (2010) found that in countries where corruption is tolerated, bribery tends to be carried over to partner countries. These limited findings tend to imply that exchange between parties that are equally unethical may also be significant.

Since the international trade between two countries is the sum of trade relationships between exporters and importers, we hypothesize that:

H1. The larger the ethical distance between dyad members, the smaller the bilateral trade among the two parties.

Unlike culture, the ethical position of a country vis-à-vis its exchange partner should also influence bilateral trade. While studies that consider cultural and psychic factors (Kogut and Singh, 1988; Dow and Karunaratna, 2006; Xu and Shenkar, 2002) could only measure the distance between countries, the relative position was ignored as the construct was unable to define "good" or "bad" culture. Siegel et. al. (2008) attempted to consider the directional (or signed) nature of culture but fails to provide any justification for their results. Guiso et. al. (2009) study of trust (a construct that could imply direction) in bilateral trade considered only a one-way relationship i.e. the degree to which the exports of country j to country i is affected by the level of trust among citizens in country i for citizens in country j. In this paper however, the relative position of ethics can be implied. In other words, we wish to consider trade relationships between countries with similar and different level of relative ethics.

Relatively speaking, previous research has put a greater emphasis on the ethicality of the seller compared to the ethical behavior of the seller (Fukukawa, 2003). Consumer based studies confirm the notion that buyers prefer ethical over unethical sellers. Creyer and Ross's (1997) survey study of 280 parents concluded that firms' ethicality is an important factor consumers consider when making purchasing decisions. Ethical firms are rewarded with higher prices while those with lower ethical standards are penalized with lower prices. Similarly, Ingram, Skinner and Taylor (2005) analyzed 334 adult consumers and found that consumers' perceptions regarding the ethicality of a firm are positively related to satisfaction, which in turn has a positive impact on future purchasing

intentions. Gundlach and Murphy (1993) examined the ethical foundation of exchange and concluded that ethical precepts are especially important for guiding the buyer-seller relationship beyond the formal contract. Thus, they concluded that firms should sensitize their salespeople, purchasing personnel, and other marketing department employees to their ethical duties in order to move towards more relational exchanges. While Smith and Barclay (1997)'s study does not directly deal with a specific ethical behavior of the salesperson, they do suggest that salesperson behavior (e.g. honesty, ethical standard, opportunistic behavior, etc) can directly influence the buyer's perceptions. Similarly, Roman and Ruiz (2005) observed that the ethical behavior of retail salespersons affects the quality of the relationship and the degree of satisfaction consumers experienced. In a MORI survey of 12,000 consumers across 12 European countries in 2000, 70% of consumers considered the sellers' commitment to social responsibility as an important factor when making a purchase, while one in five people were willing to pay more for products from firms that were socially and environmentally responsible ([www.csreurope.org](http://www.csreurope.org)). These findings reflect the importance of ethical behavior of firms in the exchange between consumers and firms, implying that the ethical (selling) firms tend to receive more business.

Similar to the survey findings listed above, an imbalance of power could also exist in a B2B relationship. In general, market conditions impose a higher ethical expectation on suppliers. Previous research suggests that firms should (not) display a certain kind of ethical (unethical) behavior to improve (destroy) the B2B relationship. Moberg and Speh (2003) suggested that exchange partners in most supply chains are involved in a plethora of interactions and therefore the opportunity to act in a less-than-ethical manner always exists. Their study revealed that the occurrence of questionable business practices is significantly related to the overall quality of relationship between trading partners. Exchange theory at the firm level suggests that suppliers' satisfaction and buyers who trust their suppliers are more likely to be committed to future exchange relationships (Morgan and Hunt, 1994). Similarly, members of a dyad are less likely to be satisfied with their relationship if one believes the other cannot be confidently relied upon (Thibaut and Kelley, 1959). Not surprisingly, supplier selection criteria often include the ethical behavior of the supplier. Indeed, an increasing number of firms have made ethics and compliance a factor in supplier selection (Eltantawy, et. al., 2009). Thus, sellers that are ethically responsible are likely to receive more orders. In an international trade context, we hypothesize that:

H2: A relatively stronger ethical position of exporting countries (i.e. relatively more ethical sellers) favors greater trade.

As mentioned earlier, the ethicality of the buyer in the dyad has received relatively less attention (Carrigan and Attalla, 2001). Most studies in this area tend to focus on the ethicality of the consumer (Vitell, 2003; Vitell and Muncy, 2005). Nevertheless, in some countries, it is common practice for suppliers to be subjected to requests for 'hello money' in one form or another, and frequently required to make payments and provide services that are considered to be outside acceptable business practice. This is particularly true if the relationship is asymmetric i.e. the stronger partner (usually the buyer) has the power to exploit the relationship and impose conditions that are favourable to them (Kumar et. al., 1995). In a trading relationship (i.e. B2B), Inks, et. al. (2004) found that buyers and sellers differ when it comes to their perception of ethical behavior and its impact on their relationship. They found that buyers are more sensitive than sellers when

it comes to questionable practices like gift giving. Such practices can have a negative effect on the choice of suppliers (Trawick, et. al., 1989). Thus, the ethical behavior of the purchasing manager for instance, can influence how the buyer is viewed by suppliers and other external parties (Dobler and Burt, 1996; Carter, 2000). If the purchasing manager engages in unethical practices, it can compromise the firm's overall competitiveness, for example when substandard inputs are purchased in exchange for kickbacks (Turner, et. al, 1994). This is amplified when the purchase involves foreign suppliers where ethical standards may vary (Husted, et. al., 1996; Carter, 2000). Long term relationships can be established when the buyer is more ethical. The principles of Fair Trade also encourage a respectful relationship between producers and buyers. Thus we can hypothesize that:

H3: A relatively stronger ethical position of importing countries (i.e. relatively more ethical buyers) favors greater trade.

### 3. Data and methodology

#### 3.1 Sample and data

Our analysis is based on country-level data from four sources: the World Values Survey (WVS), United Nation's Comtrade database (Comtrade), World Bank's World Development Indicators (WDI) and the Center for International Prospective Studies' geographical and distance databases (CEPII).

We use four question items from the latest WVS (2005-2008) to construct the measure of national ethics. Each of the four question items asks if a questionable conduct is justifiable or unjustifiable on a Likert scale from 1 to 10 where 1 represents never justifiable and 10 represents always justifiable. These questions have been used by a number of researchers to measure ethical behavior at the individual level (for example, Parboteeah, et. al., 2005 and Guiso, et. al., 2009). The question instrument and the four questionable conducts are listed in Table 1.

**Table 1. National ethics: Instruments**

Question: please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between:	
Questionable conducts	Scale 1,2,...5,.....10
1. Claiming government benefits to which you are not entitled	
2. Avoiding a fare on public transport	
3. Cheating on taxes if you have a chance	
4. Someone accepting a bribe in the course of their duties	
Scale: (1 = Never justifiable; 10 = Always Justifiable)	

The WVS database is based on interviews of at least 980 individuals in each of the 53 participating countries during the 2005-2008 wave. Given the Likert scale specified by the WVS, low scores imply higher ethical standards, and vice versa. For easier interpretation later, we reversed the scales such that a higher value of national ethics

indicates a relatively more ethical country. We use the country mean score of each of the four selected question items to measure the  $i$ th dimensional national ethics of the reporting country ( $Ethics_{ir}$ ) and partner country ( $Ethics_{ip}$ ), respectively.  $Ethics_{ir}$ - and  $Ethics_{ip}$  are then used to compute the two measures for testing the proposed hypotheses.

Ethical distance ( $Edist_{rp}$ ) measures the distance of national ethics between reporting country  $r$  and partner country  $p$ . The measure imitates the computational procedure that Kogut and Singh (1988) used to compute the cultural distance index, given by:

$$Edist_{rp} = \frac{\left[ \sum_{i=1}^k \frac{[(Ethics)_{ir} - Ethics_{ip}]^2}{V_i} \right]}{k}$$

where  $k=4$ , representing the number of question items;  $V_i$  represents the grand variance of the  $i$ th dimension. Higher scores on  $Edist_{rp}$  imply that country  $r$  and country  $p$  are very different in the ways they justify questionable conducts.  $Edist_{rp}$  does not indicate whether or not one country is more/less ethical than their trading partner.

Relative ethical position ( $Epost_{rp}$ ) measures the difference in the national ethics between trading partners and is given by:

$$Epost_{rp} = \frac{\left[ \sum_{i=1}^k \frac{(Ethics_{ir} - Ethics_{ip})}{\sqrt{\frac{V_{ir}}{n_{ir}} + \frac{V_{ip}}{n_{ip}}}} \right]}{k}$$

where  $V_{ir}$  and  $V_{ip}$  represent the variance of the  $i$ th dimension for country  $r$  and country  $p$ , respectively.  $Epost_{rp}$  indicates the relative position of the paired countries where a positive/negative  $Epost_{rp}$  indicates country  $r$  is more/less ethical than country  $p$ .

### 3.2 Variables and specifications

In order to estimate the effects of  $Edist_{rp}$  and  $Epost_{rp}$  we employ a version of the standard gravity model specified by Gassebner, et. al. (2010), modified from Rose (2004) to fit the following equations:

$$\ln(exports_{rp}) = c + \beta_1 \ln(gdp_r) + \beta_2 \ln(gdp_c) + \beta_3 lock_r + \beta_4 lock_p + \beta_5 contig_{rp} + \beta_6 \ln(dist_{rp}) + \gamma' X_{rp} + \lambda_d Edist_{rp} + e_{rp} \quad \text{Eq.1}$$

$$\ln(imports_{rp}) = c + \beta_1 \ln(gdp_r) + \beta_2 \ln(gdp_c) + \beta_3 lock_r + \beta_4 lock_p + \beta_5 contig_{rp} + \beta_6 \ln(dist_{rp}) + \gamma' X_{rp} + \lambda_d Edist_{rp} + e_{rp} \quad \text{Eq.2}$$

$$\ln(exports_{rp}) = c + \beta_1 \ln(gdp_r) + \beta_2 \ln(gdp_c) + \beta_3 lock_r + \beta_4 lock_p + \beta_5 contig_{rp} + \beta_6 \ln(dist_{rp}) + \gamma' X_{rp} + \lambda_d Epost_{rp} + e_{rp} \quad \text{Eq.3}$$

$$\ln(imports_{rp}) = c + \beta_1 \ln(gdp_r) + \beta_2 \ln(gdp_c) + \beta_3 lock_r + \beta_4 lock_p + \beta_5 contig_{rp} + \beta_6 \ln(dist_{rp}) + \gamma' X_{rp} + \lambda_d Epost_{rp} + e_{rp} \quad \text{Eq.4}$$

Where:

$exports_{rp}$  represents the real exports from country  $r$  (reporting country) to country  $p$  (partner country) deflated by the US GDP deflator,

$imports_{rp}$  represents the real imports of country  $r$  (reporting country) from country  $p$  (partner country) deflated by the US GDP deflator,  
 $gdp_{rp}$  is the product of the two trading countries' real GDP,  
 $gdp_{pc}$  is the product of the two trading countries' real GDP per capita,  
 $lock_r$  is a dummy variable indicating whether country  $r$  is a landlocked country,  
 $lock_p$  is a dummy variable indicating whether country  $p$  is a landlocked country,  
 $contig_{rp}$  is a dummy variable indicating whether the two trading countries share a common border,  
 $dist_{jk}$  is the geographical distance between the two trading countries' most populated cities;  
 $X_{rp}$  is a set of controlling variables comprising the following: a dummy variable taking a value of one if the two trading countries share the same official language (*comlang*), a dummy variable taking a value of one if the two trading countries were in a colonial relationship (*colony*), a dummy variable for a common colonizer after 1945 (*comcol*), a dummy variable for colonial relationships after 1945 (*col45*), and a dummy variable taking a value of one if the two trading countries are or were part of the same nation (*smcrt*), and  $e_{rp}$  is the error term.

To match the data collection period of the WVS (2005-2008), time-varying variables (GDP and trade variables) are the average units of the same period measured at 2005 constant dollar<sup>1</sup>. The descriptions of the variables and data sources are shown in Table 2.

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<sup>1</sup> For example,  $GDP_{rp} = (GDP_{r,2005} \times GDP_{p,2005} + GDP_{r,2006} \times GDP_{p,2006} + GDP_{r,2007} \times GDP_{p,2007} + GDP_{r,2008} \times GDP_{p,2008})/4$ ;  $GDP_{r,year}$  and  $GDP_{p,year}$  are measured at the constant dollars of year 2005.

**Table 2: Variables and sources of data**

Variables	Description	Source
$exports_{rp}$	Real average exports (2005-2008) from the reporting country $r$ to the partner country $p$ measured at constant (2005) US dollars	Comtrade
$imports_{rp}$	Real average imports (2005-2008) of the reporting country $r$ from the partner country $p$ measured at constant (2005) US dollars	Comtrade
$gdp_{rp}$	The product of the average real GDP (2005~2008) of country $r$ and country $p$ measured at constant (2005) US dollars	WDI
$gdpc_{rp}$	The product of the average real GDP per capita (2005~2008) of country $r$ and country $p$ measured at constant (2005) US dollars	WDI
$lock_r$	1=the importing country $r$ is a landlocked country; 0=otherwise	CEPII
$lock_p$	1=the exporting country $p$ is a landlocked country; 0=otherwise	CEPII
$contig_{rp}$	1=the trading countries share a common border; 0=otherwise	CEPII
$dist_{rp}$	The geographical distance between the trading countries	CEPII
$comlang_{rp}$	1=the trading countries share a common language; 0=otherwise	CEPII
$colony_{rp}$	1=the trading countries were once in a colonial relationship; 0=otherwise	CEPII
$comcol_{rp}$	1=the trading countries had a common coloniser; 0=otherwise	CEPII
$col45_{rp}$	1=the trading countries had a common colonizer after 1945	CEPII
$smerty_{rp}$	1=the trading countries are or were part of the same nation; 0=otherwise	CEPII
$E_{dist}_{rp}$	Measuring the similarity/dissimilarity in national ethics between country $r$ and country $p$	WVS
$E_{post}_{rp}$	Measuring the difference /indifference between country $r$ and country $p$	WVS

The gravity model has been commonly used in identifying the determinants of bilateral trade. The model has an excellent empirical fit and is based on robust theoretical foundations (Anderson and van Wincoop, 2003). In equation 1 and 3 where the real exports is the dependent variable, the reporting country  $r$  is the exporter and the partner country  $p$  is the importer; in equation 2 and 4 where the real imports is the dependent variable, the reporting country  $r$  is the importer and the partner country  $p$  is the exporter.

The proposed hypotheses have the following implications for the coefficient estimates:

- Hypothesis 1 implies  $\lambda_a$  and  $\lambda_b$  to be negative.
- Hypothesis 2 implies  $\lambda_c$  to be positive
- Hypothesis 3 implies  $\lambda_d$  to be positive.

The fitted models of equation 1 to 4 with all the r.h.s. variables were checked for the presence of:

- (a) multicollinearity (VIF>10),
- (b) heteroskedasticity (rejecting the null in the White test) and
- (c) normality of the error term (examining the histogram of the error term).

(a) and (b) were detected but were remedied by removing one GDP variable and by applying White's heteroskedasticity-consistent estimator, respectively. To avoid multicollinearity,  $\ln(gdpc_{rp})$  was dropped as it was highly correlated with  $\ln(gdp_{rp})$ . The final fitted models provide very neat specifications after the above remedies.

#### 4. Results of analysis and discussion

Table 3 reports the empirical results obtained by using all the available observations. Collectively, the high  $R^2$ s indicate that, roughly 75% variations in the dependent variables can explain the variations of bilateral trade. Most of the standard gravity variables have the expected signs and significant at least at the 10% level. Size of GDP, distance, sharing a common border, language and colonial history for example are all significant in explaining trade relationships. Landlocked countries have a negative effect on exports due to their geography. The links with the former colonial power and being part of the same country are not significant in explaining export or import relationships. By and large, our results are consistent with those of Gassebner et. al. (2010), taking into account the limitation of countries covered by the WVS. Turning now to the variables that are the focus of this study, we find that the ethical distance between the exporter and the importer is indeed significant and negative. Edist is significant at the 1% level for the export equation (Equation 1) and at the 10% level for the import equation (Equation 2). H1 is thus supported, implying that there is more trade when the two trading partners are of similar national ethics or countries having shared ethical values.

Despite the clear empirical evidence in Table 3 that ethical distance matter in international trade, there may be doubts as to whether our measure is capturing some other distances between countries. One such distance is culture. Indeed, as explained earlier, cultural distance has been shown to be a significant barrier to bilateral trade (for example, Guiso et. al., 2009; Dow and Karunaratna, 2006). The influence of culture on ethical decision making is also well established (Srnrka, 2000). In fact, cultural familiarity variables like geographic distance, common language, religion and colonial past are standard variables in gravity equations (De Groot, et. al., 2004; Frankel, 1997; Frankel and Rose, 2002). Linders et. al. (2005) however, correctly differentiates cultural familiarity from cultural similarity. While the former “only requires acquaintance between cultures ... [the latter] requires shared norms and values’ (Linders et. al., 2005:2). While the cultural familiarity factors have been captured by the gravity variables, the most common measure of cultural similarity is Hofstede’s five dimensions of culture (Bae and Salomon, 2010). So, the next logical step is to investigate the relationship between cultural similarities and national ethics and the relationship between ethical distance and cultural distance. More specifically, we examined if Hofstede’s national culture dimensions are related to national ethics.

Crane and Matten (2010) suggested that Hofstede’s dimensions can be used to explain certain differences in ethical decision-making because people from different cultural backgrounds are likely to have different beliefs about right and wrong, and will inevitably lead to variations in ethical decision-making across nations. The correlations between national ethics and Hofstede’s five cultural dimensions are reported in Table 4.

**Table 3. Results of estimations**

Equation 1. Dependent Variable: ln(exports)				Equation 2. Dependent Variable: ln(imports)			
	<i>Coeff.</i>	<i>Std. Error</i>	<i>Std. Coeff.</i>		<i>Coeff.</i>	<i>Std. Error</i>	<i>Std. Coeff.</i>
<i>Constant</i>	-33.016***	0.971	NA	<i>Constant</i>	-30.406***	0.883	NA
<i>ln(GDP<sub>it</sub>)</i>	1.172***	0.017	0.813	<i>ln(GDP<sub>it</sub>)</i>	1.111***	0.016	0.819
<i>lock<sub>r</sub></i>	-1.581***	0.202	-0.117	<i>lock<sub>r</sub></i>	-0.517***	0.135	-0.043
<i>lock<sub>p</sub></i>	0.051	0.137	0.004	<i>lock<sub>p</sub></i>	-1.379***	0.162	-0.111
<i>contig<sub>it</sub></i>	0.709***	0.187	0.031	<i>contig<sub>it</sub></i>	0.684***	0.160	0.031
<i>ln(dist<sub>it</sub>)</i>	-1.114***	0.046	-0.244	<i>ln(dist<sub>it</sub>)</i>	-1.012***	0.040	-0.230
<i>comlang<sub>it</sub></i>	0.5***	0.142	0.036	<i>comlang<sub>it</sub></i>	0.364***	0.123	0.028
<i>colony<sub>it</sub></i>	-0.062	0.201	-0.003	<i>colony<sub>it</sub></i>	-0.095	0.184	-0.004
<i>comcol<sub>it</sub></i>	1.196***	0.301	0.046	<i>comcol<sub>it</sub></i>	0.867***	0.289	0.035
<i>colH5<sub>it</sub></i>	0.873**	0.343	0.025	<i>colH5<sub>it</sub></i>	0.808***	0.279	0.024
<i>smctry<sub>it</sub></i>	1.09*	0.634	0.017	<i>smctry<sub>it</sub></i>	0.598	0.669	0.010
<i>E<sub>dist</sub><sub>it</sub></i>	-0.039***	0.015	-0.024	<i>E<sub>dist</sub><sub>it</sub></i>	-0.026*	0.015	-0.017
R <sup>2</sup> =0.747	<i>Adj. R<sup>2</sup>=0.746</i>			R <sup>2</sup> =0.784	<i>Adj. R<sup>2</sup>=0.783</i>		
n=2656	<i>S.E. of regression=2.028</i>			n=2665	<i>S.E. of regression=1.789</i>		
Equation 3. Dependent Variable: ln(exports)				Equation 4. Dependent Variable: ln(imports)			
	<i>Coeff.</i>	<i>Std. Error</i>	<i>Std. Coeff.</i>		<i>Coeff.</i>	<i>Std. Error</i>	<i>Std. Coeff.</i>
<i>Constant</i>	-33.277***	0.948	NA	<i>Constant</i>	-30.596***	0.867	NA
<i>ln(GDP<sub>it</sub>)</i>	1.176***	0.017	0.815	<i>ln(GDP<sub>it</sub>)</i>	1.113***	0.016	0.821
<i>lock<sub>r</sub></i>	-1.59***	0.202	-0.118	<i>lock<sub>r</sub></i>	-0.524***	0.135	-0.043
<i>lock<sub>p</sub></i>	0.056	0.138	0.004	<i>lock<sub>p</sub></i>	-1.372***	0.162	-0.110
<i>contig<sub>it</sub></i>	0.704***	0.186	0.031	<i>contig<sub>it</sub></i>	0.681***	0.160	0.031
<i>ln(dist<sub>it</sub>)</i>	-1.114***	0.046	-0.244	<i>ln(dist<sub>it</sub>)</i>	-1.012***	0.040	-0.230
<i>comlang<sub>it</sub></i>	0.531***	0.142	0.039	<i>comlang<sub>it</sub></i>	0.385***	0.123	0.029
<i>colony<sub>it</sub></i>	-0.074	0.205	-0.003	<i>colony<sub>it</sub></i>	-0.103	0.187	-0.005
<i>comcol<sub>it</sub></i>	1.19***	0.299	0.045	<i>comcol<sub>it</sub></i>	0.861***	0.289	0.035
<i>colH5<sub>it</sub></i>	0.882**	0.345	0.025	<i>colH5<sub>it</sub></i>	0.815***	0.281	0.024
<i>smctry<sub>it</sub></i>	1.079*	0.625	0.017	<i>smctry<sub>it</sub></i>	0.593	0.661	0.010
<i>E<sub>post</sub><sub>it</sub></i>	0.004	0.004	0.009	<i>E<sub>post</sub><sub>it</sub></i>	0.004	0.004	0.011
R <sup>2</sup> =0.747	<i>Adj. R<sup>2</sup>=0.746</i>			R <sup>2</sup> =0.784	<i>Adj. R<sup>2</sup>=0.783</i>		
n=2656	<i>S.E. of regression=2.030</i>			n=2665	<i>S.E. of regression=1.790</i>		

\*\*\*, \*\* and \* denote 1%, 5% and 10% significance level, respectively.

**Table 4. Correlation between ethics and culture**

Culture Dimensions	Correlation between ethics and culture	Correlation between ethical distance and cultural distance
Power distance	0.557***	0.226***
Individualism/Collectivism	-0.408***	-0.031
Masculinity/Femininity	-0.145	0.069
Uncertainty Avoidance	0.216	0.100
Long term Orientation	-0.011	-0.057

Among the five cultural dimensions, national ethics is significantly correlated with only two dimensions - Power Distance Index (PDI) (-0.557, significant at the 1% level) and



Individualism/Collectivism Index (IDV) (0.408, significant at the 5% level). Hence, societies with higher power distance are relatively less ethical while collectivist societies are relatively more ethical, a result that is quite consistent with Forsyth, O’Boyle and McDaniel, 2008. The only significant correlation between ethical distance and distances of the five cultural dimensions is PDI (i.e. measured as by  $PDI_{rp} = (PDI_r - PDI_p)^2$ ). The correlation coefficient is 0.226, significant at the 1% level. These results suggest that ethical distance and cultural distance are only weakly related. Nevertheless, we added  $PDI_{rp}$  into equations 1 and 2 to control for the effect  $PDI_{rp}$  on trade between country r and p. Results show that the significance of ethical distance and ethical position remains unchanged. The coefficient of  $PDI_{rp}$  is positive and significant at the 5% level. Thus, our measure of ethical distance goes beyond cultural distance, and so our results provide a great deal of support to H1.

Turning now to H2 and H3 and the issue of relative ethical position, we find that the fitted equations 3 and 4 shows that  $Epost_{rp}$  is not significant despite the fact that they have the correct signs (see Table 3). Therefore, H2 and H3 do not seem to find support from our analysis. One reason for the insignificant result could be due to the cancelling out of trade among partners of different ethical standards. In other words, although ethical exporters should get more orders from all types of ethical partners, those with lower ethical standards may not match the exporters’ selection criteria. Similarly, ethical importers should always be favored by all types of partners but those partners with relatively lower ethical standards may not be preferred by ethical importers. These findings question the values for being ethical from both the importers and exporters’ standpoints and lead us to examine the interactions between ethical/unethical importers and ethical/unethical exports further.

We attempted an alternative modeling strategy to unveil the effect of ethical difference on trade. First, we divided the 53 countries in our sample into two categories based on the median of the mean of the four questions in the national ethics instrument. Countries above the median are categorized as “More Ethical”<sup>2</sup> while countries below the median are categorized as “Less Ethical”<sup>3</sup>. Second, based on these categories, we are able to arbitrarily identify bilateral trade of countries with different ethical positions. We created dummy variables for each of the possible trade relationship, using the export (import) from an ethical partner to an ethical importer (exporter) as the reference group. Tables 5a and 5b show a visual explanation of the various dummies. Finally, the  $Epost_{rp}$  in Equations 3 and 4 were replaced with the respective dummies one after another to consider the effect of the relative ethical positions of the exporter and the importer on bilateral trade. Results of this exercise are reported in Table 6.

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<sup>2</sup> Twenty seven economies belong to this category: Australia, Bulgaria, Canada, Switzerland, Cyprus, Egypt, Ethiopia, Finland, Germany, Great Britain, Georgia, Ghana, Hong Kong, China; Indonesia, Italy, Jordan, Japan, Republic of Korea, Morocco, Netherlands, Norway, New Zealand, Poland, Romania, Turkey, United States and Vietnam.

<sup>3</sup> Twenty six economies belong to this category: Andorra, Argentina, Burkina Faso, Brazil, Chile, China, Spain, France, Guatemala, India, Iran, Moldova, Mexico, Mali, Malaysia, Russian Federation, Rwanda, Serbia, Slovenia, Sweden, Thailand, Trinidad & Tobago, Ukraine, Uruguay, South Africa and Zambia.

**Table 5a. Dummy variables for export function**

		Importer	
		More Ethical	Less Ethical
E x p o r t e r	Less Ethical	D1	D3
	More Ethical	Reference group	D4

**Table 5b. Dummy variables for import function**

		Exporter	
		More Ethical	Less Ethical
I m p o r t e r	Less Ethical	D5	D7
	More Ethical	Reference group	D8

All our dummies were significant at the 1% level and negative indicating that relative ethical positions matter in international trade. Table 6 shows that trade among unethical partners is the lowest (the coefficient of D3 and D7 is the most negative in the corresponding fitted equation). This acts as a robustness test for our findings on the importance of ethical distance and provides a further condition on our previous results of Edist. More specifically, smaller distances in ethics among partners increase trade, only when exporters and importers are relatively more ethical.

Trade among ethically asymmetric partners is relatively lower, irrespective of their ethical positions. As shown in Table 6, D1, D4, D5 and D8 (dummies representing trade relationship among ethically asymmetric partners) are negative relative to the reference group. However, the ethicality of the importer matters more in trade than the ethicality of the exporter. This important point is shown in Tables 7a and 7b which extracts the coefficients of the dummies from Table 6 and presented in a 2x2 matrix for further interpretation. Table 7a shows that a more ethical position of the importer can result in a relatively higher level of exports irrespective of the ethical position of the exporter (the coefficients are larger indicating a smaller decrease in exports). Similarly, in Table 7b, imports are larger when the importer is more ethical. Thus, the ethicality of the importer is more dominant as a determinant of trade. In other words, H3 has greater support than H2.

Table 6. The effects of ethical positions dummies on bilateral trade

Equation 3a. Dependent Variable: ln(exports)			
	<i>Coeff.</i>	<i>Std. Error</i>	<i>p-value</i>
<i>Constant</i>	-32.373***	0.941	0.000
<i>ln(GDP<sub>np</sub>)</i>	1.156***	0.017	0.000
<i>lock<sub>r</sub></i>	-1.577***	0.197	0.000
<i>lock<sub>p</sub></i>	0.088	0.136	0.519
<i>contig<sub>sp</sub></i>	0.893***	0.188	0.000
<i>ln(dist<sub>np</sub>)</i>	-1.051***	0.046	0.000
<i>comlang<sub>np</sub></i>	0.511***	0.143	0.000
<i>colony<sub>np</sub></i>	-0.072	0.211	0.732
<i>comcol<sub>np</sub></i>	1.144***	0.306	0.000
<i>col45<sub>np</sub></i>	0.872**	0.366	0.017
<i>smctry<sub>np</sub></i>	1.348**	0.629	0.032
<i>D1</i>	-0.451***	0.103	0.000
<i>D3</i>	-0.893***	0.115	0.000
<i>D4</i>	-0.499***	0.094	0.000
<i>R</i> <sup>2</sup> =0.753	<i>Adj. R</i> <sup>2</sup> =0.751		
<i>n</i> =2656	<i>S.E. of regression</i> =2.001		
Equation 4a. Dependent Variable: ln(imports)			
	<i>Coeff.</i>	<i>Std. Error</i>	<i>p-value</i>
<i>Constant</i>	-29.938***	0.855	0.000
<i>ln(GDP<sub>np</sub>)</i>	1.098***	0.015	0.000
<i>lock<sub>r</sub></i>	-0.476***	0.133	0.000
<i>lock<sub>p</sub></i>	-1.365***	0.160	0.000
<i>contig<sub>sp</sub></i>	0.833***	0.160	0.000
<i>ln(dist<sub>np</sub>)</i>	-0.959***	0.040	0.000
<i>comlang<sub>np</sub></i>	0.363***	0.124	0.003
<i>colony<sub>np</sub></i>	-0.096	0.192	0.618
<i>comcol<sub>np</sub></i>	0.830***	0.293	0.005
<i>col45<sub>np</sub></i>	0.808***	0.298	0.007
<i>smctry<sub>np</sub></i>	0.819	0.682	0.230
<i>D5</i>	-0.406***	0.082	0.000
<i>D7</i>	-0.705***	0.101	0.000
<i>D8</i>	-0.317***	0.087	0.000
<i>R</i> <sup>2</sup> =0.788	<i>Adj. R</i> <sup>2</sup> =0.787		
<i>n</i> =2665	<i>S.E. of regression</i> =1.775		

**Table 7a. Exports and ethical position**

		Importer	
		More Ethical	Less Ethical
Exporter	Less Ethical	-0.451*** (282)	-0.893*** (98)
	More Ethical	Reference group (455)	-0.499*** (247)

**Table 7b. Imports and ethical position**

		Exporter	
		More Ethical	Less Ethical
Importer	Less Ethical	-0.406*** (226)	-0.705*** (117)
	More Ethical	Reference group (434)	-0.317*** (329)

*Note: Values in brackets are trade flows in 100 million USD.*

A plausible explanation as to why the ethicality of importers matter more is the role of trust in trade. Yu et. al. (2011) explained that the demand for greater trust in the importer by the exporter is because of the fear of default in payment by the importer. Similarly in our case, the ethicality of the importer matters more so that they can be trusted in fulfilling their part of the bargain. Importers can generate a lower level of trust among sellers if they threaten to switch their business to another party unless they can get a better deal (Casson, 1990). This is especially so if the exporter has invested a great deal in meeting the specific needs and requirement of the buyer (Bianchi and Saleh, 2010). Indeed, the literature in the area of industrial marketing and management have been relatively successful in discovering the importance of supplier’s ethics as a criterion of sourcing decisions and as a way to satisfy the buyers (Trawick, et. al., 1981). However, assuming that most markets are very much a buyer’s market, the purchasing agent’s ethics has received less attention from industrial marketers and managers. However, in a dated study (see Ferrell and Weaver, 1978), 75% of the salespeople indicated that buyers who followed ethical purchasing practices are of critical importance. Our findings that importers’ ethics matter more, recognizes the need for professional certification, and a code of purchasing ethics. This also serves as a call for a renewed interest in the purchasing agents’ ethics.

## 5. Conclusions

International trade has been an engine of economic growth for more than a century. As a result, research that discover determinants that drive trade relationships have dominated the field of international trade. These determinants range from factor endowments to political relationships. Our research can be considered an extension to those studies that considered trust as a determinant of international trade. Guiso et. al. (2009) found that

lower bilateral trust between the exporter and the importer can lead to less trade and investment. Yu et. al. (2011) extended the analysis and found that institutional quality and trust can act as substitutes such that as institutional quality increases the effect of trust on trade diminishes. Nevertheless, all exchanges are based on trust (Kotler, 2003) and ethical conduct is mandatory to establish trust (Srnrka, 2004). When ethical values among exchange partners are compatible, trust is established and persistent relationships would be the outcome (Ahmed, *et. al.*, 2003; Ferrel, *et. al.*, 1989). Given the varied ethical standards that exist among countries, how could compatibility be encouraged? Although culture (for instance, religion) plays an important role in influencing ethics (Parboteeah, *et. al.*, 2008), in this paper we showed how, even when controlled for cultural similarity and familiarity, ethical distance still mattered. This implies that while time invariance factors that are embedded in culture cannot be changed by trading partners, compatibility in ethical standards can be agreed on through mutual agreements.

One effective avenue for mutual agreement is a commonly designed code of conducts. Previous studies that compared ethical ideologies of managers in a cross-cultural environment (for example, Vitell and Patwardhan, 2008; Singh, *et. al.*, 2007) suggested that codifying desirable vs. undesirable behaviors in a joint venture partnership may contribute towards the reduction of unethical behavior. A similar code, agreed by both parties, in a trading relationship may produce the desired outcome. This is particularly effective when the institutional quality is lacking (Yu *et. al.*, 2011). Our findings also suggest that it is in the interest of policy-makers to consider ways and means by which ethical standards can be raised to that of partner countries. Since a large number of countries in our “Less Ethical” list comprise of developing or emerging markets, efforts at raising ethical standards through education and better enforcement of the legal system can help in the economic development process by encouraging greater trade.

Despite our findings and their implications, the study is subject to several limitations. These are directly related to the measure of our national ethics. First, relying on four instruments to measure national ethics may be quite limiting. Furthermore, these instruments tend to judge the ethical intention of individuals, rather than their actual behavior. Second, our sample countries are limited by the number of countries covered by the World Values Survey. Third, a single standard of ethics for a whole country may mask the variance that may exist at the firm level. In other words, if a country is categorized as unethical, it does not imply that all traders in the country have such standards. Future research could address these weaknesses. For instance, a better measure of national ethics – one that considers other instruments that include the ethical intention of managers and government officials – could be considered. Using a combination of data sources (for instance World Economic Forum’s Global Competitiveness Report and Transparency International’s Corruption Perception Index) to develop a more wholesome indicator could also be considered (Schwartz and Weber, 2006). Better indicators could then be used to confirm our findings. Nevertheless, despite these limitations, we hope that our findings add to the body of knowledge on ethics and international trade.

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