

Scared enough? How terrorism threats affect US-Canadian business ties

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Introduction

The common geographic space and close trade relations Americans and Canadians share were forever changed after the terrorist attacks on the USA on September 11, 2001. Increases in security were the new order of the day, but it remains to be seen exactly what these continuing changes mean for firms that conduct business across the USA–Canada border. Our goal is to provoke thought and reflection on an issue that, despite touching all governments, firms and individuals in the two countries, has received relatively limited attention in academia. Our paper explores how terrorism and security issues affect industries, firms and executives in the highly integrated neighboring economies of Canada and the USA.

The economic and institutional convergence brought about by higher levels of integration may lead to reduced uncertainty for firms (Pasquero, 2000). A direct implication is that terrorism contributes to elevated and sustained levels of uncertainty that could prove disruptive for bi- or multilateral economic exchanges between and among countries sharing close economic ties. Empirical studies have shown that terrorism reduces the volume of trade between countries (Nitsch and Schumacher, 2004), and terrorism and internal/external conflict have an effect on trade comparable to a 30 per cent tariff (Blomberg and Hess, 2006). Still, only a limited number of academics are addressing issues related to terrorism and firms, especially in the North American context.

We begin by examining global terrorism and security matters from a managerial perspective, a preoccupation for executives globally. We then focus on what this preoccupation implies specifically for North America by drawing upon the historical evolution of its economic integration. We elucidate the shift toward increased security through industry, firm and executive reactions to 9/11, a shift that did not detract from the Canada–USA integration but rather revealed its true depth. Finally, we conclude that, despite the dramatic impact of terrorism and the increased security environment, Canada and the USA remain a deeply integrated economic space.

A general perception of terrorism and security issues

Terrorism has plagued the global arena, at least, since biblical times. Despite the advances of modernity, we are daily reminded in the media of the security threats to which neither technological betterment nor bromides about the global village can make us immune. It is no surprise, then, that terrorism presents a serious concern for today's executives.

While armed conflicts have declined since 1999 (Stockholm International Peace Research Institute, 2007), worldwide terrorism has increased, although about half of all terrorist acts remain geographically concentrated in Iraq and Afghanistan (Office of the Coordinator for

Counterterrorism, 2007). Furthermore, between 1968 and 2007, 1,255 terrorist groups perpetrated 34,079 acts, resulting in > 50,000 fatalities (National Memorial Institute for the Prevention of Terrorism, 2007). Nonetheless, studying the threat of terrorism and preparing for an act and its effects have not been high priorities for executives on the international stage: traditional firm security-related preoccupations have focused on corporate physical security since the World War I era (Fayol, 1979). This limited focus is changing, however, partly because of the globalization of both economic activity and actual security threats. Two surveys list terrorism among executives' preoccupations. The main findings are highlighted in Table I. The first survey, administered by the Economist Intelligence Unit (2006), focused on the ways organizations prepare for the management of catastrophic risk. In this survey, 53 per cent of respondents considered terrorism a risk of at least medium significance, and eight per cent considered the risk of very high significance. A second survey, the 2007 PricewaterhouseCoopers Annual Global CEO Survey, found that 50 per cent of respondents acknowledged terrorism as a concern for their company, and 17 per cent elevated terrorism to an extreme concern. However, companies' expenditures to mitigate the risk of terrorism were not in proportion to their concern (PricewaterhouseCoopers, 2007). The same survey also shows that chief executive officers (CEOs) from Asia-Pacific feel this threat more acutely than their international counterparts.

An interesting conclusion from these surveys is that terrorism, despite the risks it poses to global value chains and the relative importance ascribed to it by CEOs, is not a high-ranking concern. Both surveys found that, globally, the top two CEO preoccupations were related to finding and keeping talent and dealing with regulatory challenges to doing business. This apparent ambivalence about terrorism exists despite a context of increasingly globalized economic activity, but what does it mean for close trade partners like Canada and the USA?

The North American experience

North American economic integration has been driven primarily by the trade-related preoccupations of industry and firms from the bottom up (Cimon and Rebolledo, 2004). Although this process ultimately culminated in NAFTA, it has largely ignored common political institutions, as Canada and the USA wish to remain as independent as possible in the political arena.

The close economic ties between the USA and Canada have existed since colonial times. From the American Revolution on, merchants from both countries engaged in commercial relationships. Both economies have always had – or worked actively toward fostering – close trade ties, as evidenced by the following:

Table I Executives perceptions of terrorism

Item	PwC (2007)	EIU (2006)
Concern with terrorism	Fifty per cent of respondents: at least somewhat concerned	Fifty-three per cent of respondents: at least as a somewhat significant risk
Top concerns	1. Overregulation 2. Availability of key skills 3. Low cost competition	1. Human capital risk 2. Regulatory risk 3. Reputational risk
Concern immediately above terrorism	Intellectual property rights	Political risk
Concern immediately below terrorism	Inadequacy of infrastructure	Natural hazard risk
Rank of terrorism over all other concerns mentioned in the survey	11th out of 17 items	10th out of 13 items
Number of respondents	1,084	225
Location of respondents	Europe, Asia-Pacific, Americas, Middle East and Africa	Europe, Asia-Pacific, Americas

Sources: Adapted from PricewaterhouseCoopers, Economist Intelligence Unit

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- the Reciprocity Treaty (1854-1866);
- the unsuccessful agreements of 1891 and 1911;
- the Auto Pact (1965-2001);
- the Canada-USA Free Trade Agreement (1988); and
- the North American Free Trade Agreement (1994).

The historical trend toward a sustained and deep economic relationship between these two countries has prevailed, despite some hiccups caused by events like the War of 1812, the 1837-1838 rebellion in Canada, the Civil War and the Great Depression. For example, NAFTA alone increased trade among member nations by a factor of 198 per cent between 1993 and 2006 ([Office of the USA Trade Representative, 2007](#)). This finding is in line with recent research on free trade agreements that shows they promote trade between relatively similar partners to mutual advantage ([Kono, 2007](#)); the USA and Canada are, of course, culturally similar, and both have highly skilled and educated workforces.

Security concerns for North American business

Public support for the removal of the border between the USA and Canada had been growing in the decade before 9/11. From 1990 to 2000, support for this option grew from 24 to 35 per cent in Canada and from 46 to 50 per cent in the USA ([Nevitte, 2003](#)). However, although North America was neither immune nor blind to terrorism, it, nonetheless, caught everyone off guard. Immediately following the 9/11 attacks, the Canada–USA border was closed, sparking a series of temporary plant shutdowns in both countries, as just-in-time processes did not allow for sufficient inventories to sustain operations. In the year following the attacks, air traffic came to a halt, and border crossings dwindled to a trickle, and yet border wait times skyrocketed to unheard of lengths, sometimes to more than five times those prior to 9/11 ([Department of Foreign Affairs and International Trade, 2003](#)). These changes marked the end of what had until then been aptly called “the longest unprotected border in the world”. Security on both sides of the border increased sharply, leading to unprecedented measures that disrupted the supply chains of transborder firms often representing over CA\$1.5 billion in daily trade.

Reactions from both sides of the 49th parallel took form in a spate of disjointed and incremental initiatives such as the coordination of immigration-related policies. This eventually paved the way for an increased level of coordination through programs like NEXUS, which facilitates customs procedures for frequent travelers between Canada and the USA, and for the implementation of the Western Hemisphere Travel Initiative, which makes passports mandatory for traveling between the two countries. Although border security has become a major concern for Canada and the USA, as evidenced by the implementation of “smart borders” and security measures such as Free and Secure Trade program, the enduring North American trade flows affirm the close relationship between the two countries ([Blank *et al.*, 2004](#)).

Integrated value chains

In addition to the increased exchange brought about by free trade, there exists a trend toward more global value chain integration ([Lapointe and Cimon, 2009](#)). Despite

heightened post 9/11 security, two events demonstrate that value chains are not only integrated across the border but joined at a level deeper than that of a mere sustained trade relationship: the 2003 blackout and the mad cow scare.

The 2003 blackout. On August 14th, 2003, millions of Americans and Canadians lost power. A regional failure in Northern Ohio, through a cascade of events, led to a general failure in the grid system affecting an estimated 50 million people in the Northeastern USA and Ontario and estimated to cost both economies over \$10 billion ([USA-Canada Power System Outage Task Force, 2004](#), p. 1). This event underscored the high level of interconnectedness and interdependency between the USA and Canada, and both governments announced the creation of a joint task force to look into this matter on August 15, 2003 ([USA-Canada Power System Outage Task Force, 2004](#), p. 1).

The mad cow scare. The transborder implications of the mad cow scare illustrate how highly integrated the food production and distribution systems of Canada and the USA are. According to the Centers for Disease Control and Prevention, a total of 14 cases of mad cow disease were reported from 1993 to April 2007 ([Center for Disease Control and Prevention, 2007](#)). After an initial Canadian case of a cow imported from the UK, a USA case of a cow imported from Canada surfaced in 2003 ([Center for Disease Control and Prevention, 2007](#)). The scare had profound repercussions on both sides of the border. Canadian cattle prices dropped dramatically, and the USA experienced serious supply problems, outcomes that serve as yet further demonstrations of the high level of integration in food products.

Both the 2003 blackout and the mad cow scare affirmed that security increases at the border following 9/11 did not undermine the integration of the Canadian and USA economies. Industries, firms and executives remain acutely aware of this interconnectedness while bearing the weight of increased security.

Industries, firms and executives in the “new” North American environment

According to the Conference Board of Canada, the trade volume between Canada and the USA has not diminished since 9/11 ([Goldfarb, 2007b](#)) and cross-border investments remain robust. According to the United Nations Conference on Trade and Development ([United Nations Conference on Trade and Development, 2010](#)), average cross-border mergers and acquisitions activity, both sales and purchases of firms, between the USA and Canada, was just under US\$64 billion for the 1990-2000 period, but climbed to US\$262.8 billion for the 2004-2006 period. Similarly, for foreign direct investment (FDI), both inward and outward, the average over the 1990-2000 period stood at US\$202 billion but increased to US\$260 billion over the 2003-2006 period. The cross-border stock of FDI grew from US\$825 billion in 1990 to US\$2,600 billion in 2000 and climbed further still to US\$4,173 billion in 2006, an increase in share of GDP from an average share of combined GDP of 7.1 to 15.8 per cent, which reflects the increasing integration of the economies.

Nonetheless, as in the global arena, security was not on the radar of North American business prior to 9/11. For example, in his comprehensive review of Canada's role in North American integration, [Hoberg \(2000\)](#), like most of the pre-9/11 literature on the subject, fails to address security and terrorism-related issues. Since 9/11, however, security has become an unavoidable issue and a foremost concern in North America, as evidenced by the

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Security and Prosperity Partnership of North America, signed in 2005 and expected by some to evolve into a common Canada–USA security perimeter. Accordingly, there have been reactions at the industry, firm and executive levels, but given their *ad hoc* nature, they do not necessarily – or may only indirectly – address this trade-off between tightened security and increased flow of trade.

Industry-level reactions

One of the main implications of the post 9/11 security environment is increased pressure on the manufacturing sector and particularly on the transport industry and fresh food exports (Goldfarb, 2007b). Firms are moving away from just-in-time delivery and maintaining larger inventories to prevent temporary shutdowns (Goldfarb, 2007a). Goldfarb further points out that export intensity and truck transportation dependency are important indices of the industries affected by a thicker border, especially sectors that trade non-finished goods that serve as links in one or many industry supply chains. So, while trade in raw materials softens, parts trade between Canada and the USA is growing, as the USA sends more finished goods into Canada (Goldfarb and Beckman, 2007). Such firm-level implications suggest that further exploration is needed to understand how firms deal, if at all, with these industry-wide trends.

Firm-level reactions

Exporting firms are generally more capital- and skill-intensive than non-exporting firms (Bernard *et al.*, 2007: 110). As such, firms that have greater technological intensity, advertising intensity and internationalization are more likely to seek global integration (Kobrin, 1991) by actively securing access to specific sources of knowledge (Cimon, 2004) and geographical markets. North American firms demonstrate similar behavior. Prior to the 9/11 attacks, intra-country industry located in Canada and the USA remained weakly affected by further economic integration. Along the same lines, free trade between Canada and the USA did cause some short-term displacement in economic activity, but the gains have been more important over the long term. Post 9/11, industries like real estate may have been marginally affected, as terrorism may have some bearing on housing preferences for some individuals (Roe *et al.*, 2005). Although terrorism's impact on North American industry has yet to be thoroughly investigated, the Italian experience suggests that terrorism reduces the number of firms operating in the area where attacks occurred. Nonetheless, despite the high local impact of terrorism and the relatively low aggregate impact, the effects of trade regulations are not diminished by terrorism. For example, with regard to NAFTA, the rules of origin clauses may negatively affect firm competitiveness (Georges, 2008; Sawyer, 2001), while government ownership restrictions may deter entry in some markets. These abiding effects of trade regulation result from the tendency of firms that operate internationally to have a high degree of national responsiveness, maybe even higher than at the regional level, as demonstrated by their reactions to environmental issues (Rugman, 1998). In fact, Buckley *et al.* (2003) found that the strategic responses of firms to regional economic integration differed depending on whether or not they are inside these regions and that these differences depended strongly on the country of origin.

A direct implication is that the way firms deal with security issues is consistent with the way they assess the impact of changes in their “non-economic environment” (Kobrin *et al.*, 1980). Firms tend to adopt a three-pronged strategy in response to security issues:

1. securing people;
2. securing the core business; and
3. securing networks (Shrader and McConnell, 2002).

This stance suggests that firms remain reactive rather than proactive, responding on a need-only basis to often costly government mandates to heighten security. So far, Canadian and American firms have absorbed the bulk of the increase in security costs (Goldfarb, 2007b) by undertaking a number of changes in trading behaviors. For example, trucking companies have abandoned cross-border routes, leaving their loads at the border for a recipient nation’s company to pick them up, while truckers have been shifting between border crossings or crossing in off-peak hours, and providers of logistical services are increasingly turning to rail transport. In fact, some firms have even reverted to their pre-CUSFTA behavior (Goldfarb, 2007a).

Executives, business advocacy groups and consumers

Although Canadian executives estimate that several days are required for their firms to recover from a major disaster, it is interesting to note that they do not consider terrorism to be a top threat for their organization, although their employees do, according to a 2006 *Environics Communications study* (2006). Rather, CEOs feel that information technology disasters, fires and burglaries are the most important threats. Indeed, only 24 per cent of executives of US firms deem terrorism a threat to business operations outside the USA and Canada. Still, 50 per cent of Canadian executives feel the Federal Government should do more to protect their business in the event of a disaster, thus placing security concerns squarely on the shoulders of government. According to a Chubb International Risk Survey, CEOs generally feel that competition and rising fuel costs are the biggest financial threats to their company (Chubb, 2007).

For their part, business advocacy groups in Canada and the USA feel concerned enough to address the business aspects of security- and terrorism-related matters. The *Canadian Council of Chief Executives* (2003) has called for increasing the openness of North America’s internal borders, while, simultaneously, securing the external borders from outside threats. In doing so, they call for using the *Smart Borders Declaration* from 2001 and transforming the internal border into “an effective but shared checkpoint within an integrated economic space” (Canadian Council of Chief Executives, 2003, p. 5). This arrangement, they contend, is important to maintain simultaneous access to and trade flows between internal markets and, to this end, they are actively lobbying the government. On the American side, the Business Round Table states that, while terrorism means added security costs for firms, the main thrust for dealing with this threat should come from governmental authorities. For them, terrorism is a risk that should be managed, and they acknowledge that threat management and assessment may take place with the assistance of the private sector. For example, they created a secure network to facilitate communication between executives and top government officials in the event of a major

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national crisis. These actions are consistent with the claim that Canada is concerned with its economic security, while the USA focuses on national homeland security.

But what about consumers? After all, they drive the demand for products and services! Indeed, consumers, too, are no strangers to security concerns, as “messages aimed at enhancing perception of national superiority would be successful in connecting with American consumers these days” given that national security has become an important concern for US consumers (Lee *et al.*, 2003, p. 504).

Conclusion

While executives operating globally are aware of terrorism, it is not a main concern for them, as they seem to regard it as a fairly low-level risk. In North America, while 9/11 did elevate security concerns to high-ranking priorities for the Canada–USA relationship, it did not annul nor even hinder the historic, deep integration of the two countries. The cross-border cohesion brought upon by NAFTA may have precluded disintegration in trade and other cross-border activities because economic agents were so intertwined that disentangling them may have done more harm than good. Additionally, the 2003 blackout and the mad cow scare serve as reminders of this highly integrated and interdependent economic space. While overall trade has not seemed to suffer from the fallout of 9/11, industries that depend on export and trucking have been affected. Firms have been forced to adopt numerous security measures, and managing the associated costs have sometimes led to a resurgence of pre-free trade behaviors, which decrease the benefits that accrue from economic integration. Although North American executives do not report much concern about terrorism and its consequences, business advocacy groups are pushing for better border management (mostly in Canada) and a better linkage between business security and national security (mostly in the USA).

Implications for academics and policymakers

Academics and policymakers need to better explain and assist in managing the continuing integration and interdependencies between Canada and the USA. It is becoming increasingly important to address these matters in light of the tension between increases in border security that may offset gains brought by the CUSFTA and NAFTA (Goldfarb, 2007a) and calls to governments to minimize non-security-related constraints to maintain these gains.

We are now at a crossroads in the journey of North American economic integration. The geographic explosion of the value chain will remain a challenge on both sides of the border: “Goods often cross the border repeatedly as value is added at each production stage” (Goldfarb, 2007b, p. 4). The tragic events of 9/11 are reminders that while Canada and the USA do trade in the classical sense, it is more accurate to say that they build “stuff” together. It is thus paramount to mitigate policy effects that impede cross-border flows and to address the challenges faced by the increasingly taxed and insufficient infrastructure that makes these flows possible and, in an ideal world, seamless.

Implications for firms

A direct result of free trade has been an increase in productivity, especially for Canada, but assessing both between- and within-industry effects and between-firm effects has proved difficult, probably even more so when security is factored in and a range of state and non-state actors interact. Security issues negatively affect the gains from free trade, especially when states need to better coordinate their response to security issues. North America was always able to deal with its internal differences because it focused on the outside as a threat; the inward shifting of the threat perception since 9/11 underscored the fact that North America is far from having homogeneous interests. Careful considerations should be put into policy shifts, security related or otherwise, as they affect firms’ strategies and day-to-day operations.

Keywords:

Strategic management,
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