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# A ring fence won't build national champions

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The CNOOC-Nexen review has gone into overtime. While an extension of the review process isn't unusual, the question is whether the playbook has changed. There's a danger that, with the clock running down, improvisation has taken over.

Conventional wisdom is that, while the deal will be approved, the government is working out an announcement that will include signals to forestall any future attempt to acquire a Canadian oil and gas company that's even larger than Nexen.

This middle-way solution is increasingly cited by analysts as the preferred outcome and, notably, also by leaders of businesses that might fall into the "too big to be bought" category. A compromise of this sort would have appeal to a government caught between the free-market instinct of an open investment regime and its sensitivity to public opinion (which is against the deal).

The rationale for creating a ring fence around "prize assets" is usually framed in terms of having national champions. Under this logic, protecting Canadian firms from majority control by foreign entities allows these companies to become world-leading entities, with all of the attendant benefits domestically.

It's not clear whether such a ring fence would apply to only state-owned firms and, more controversially, to just Chinese entities. Given that reservations about CNOOC-Nexen clearly have to do with Chinese state ownership, it seems likely that China will be singled out.

A better way would be to not build a ring fence at all. The idea that foreign investment restrictions can be a tool to build national champions is deeply flawed. Rejecting CNOOC's proposed investment won't make a national champion of Nexen, and prohibiting the acquisition of even larger Canadian oil and gas companies will simply leave them where they are – as mid-ranking players. I'm sympathetic to the idea that Canada needs national champions. But the idea of cultivating them through protection (in trade or investment) is outdated.

The key to creating globally significant companies is scale, and the only ways to achieve scale are through organic growth or through mergers and acquisitions. Given the small size of the Canadian market, domestic firms must be given every opportunity to grow abroad. Already, the sales of foreign affiliates of Canadian firms have exceeded the value of domestic exports. Thus we have a strong interest in ensuring that the investment regimes of other countries are as open as possible. We harm our interests by imposing unnecessary restrictions on foreign companies looking to invest in Canada.

Economic orthodoxy in the West is very much against the idea of national champions, and conservative governments in particular have steered clear from such talk. So it would be ironic if the CNOOC-Nexen deal resulted in a new set of investment restrictions that, in effect, pick winners. But all governments are faced with decisions that can influence the development of national champions, and there are opportunities across a range of economic and social policies that can help foster clusters of globally significant companies in Canada.

An opportunity was missed a few years ago when there was a bidding war for Inco. At the end of a convoluted series of offers and counteroffers, two bidders were left standing – Vale of Brazil and Teck Resources of Vancouver. Vale was the much bigger player, and Teck's offer came as a surprise. Since the acquisition was subject to government review, Ottawa had a chance to weigh in. Support for Teck would have resulted in a much enlarged Canadian company ranking in the top five of global mining giants.

But Vale prevailed, and another Canadian icon went into foreign hands. To be sure, Teck is Canada's largest diversified mining company and still a global player, but an opportunity for a "national champion" to enter the top tier of mining companies was missed.

The point of this example is not to bemoan foreign ownership but to bring clarity to the goal of building national champions. Blocking foreign investment in and of itself won't create globally significant Canadian companies. By the same token, a purely hands-off approach to market transactions is no guarantee of success. If this sounds complicated, it's because economic statecraft is complicated. Beware of those who would boil it down to just a few easy rules.

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