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*Before the Financial Services Committee*  
*Subcommittee on Monetary Policy and Trade*  
*U.S. House of Representatives*  
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Mr. Chairman, Ranking Member Moore, and Members of the Subcommittee, thank you for the invitation to share the Department of Defense's role in the Committee on Foreign Investment in the United States (CFIUS) and the national security risks to America arising from inbound foreign direct investment. The protection of our national security innovation base from strategic competitors, in the national security realm like China and Russia, is an increasingly important priority of the Department and I appreciate the opportunity to speak with you this morning.

The Department of Defense strongly supports modernization of the CFIUS process to ensure that the inter-agency Committee has the authorities required to address the evolving risks to our national security from transactions that are currently uncovered. We are thankful for the strong leadership of Congressman Pittenger on this issue and appreciate the bipartisan support for the Foreign Investment Risk Review Modernization Act (FIRRMA), H.R. 4311, 115<sup>th</sup> Cong. (2017). The Department shares Congress's trepidations about strategic competitors' use of predatory economics and believes FIRRMA will take many positive steps to address these concerns. To quote Secretary of Defense James Mattis, stating this Department's position, in his letter of support, the "DoD depends on critical, foundational, and emerging technologies to maintain military readiness and preserve our technological advantage over potential adversaries. FIRRMA would help close related gaps..."

As the National Security Strategy and the National Defense Strategy make clear, the Department's direction is to compete, deter, and win alongside our allies and partners in conflict and preserve peace through strength. Our defense industrial base is an extension of our military force structure. Only a defense industrial base that is robust, secure, and resilient, is able to support the needs of our military, innovate to retain our technological edge, surge when necessary, and keep our systems

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safe in cyberspace. As the Deputy Assistant Secretary for Manufacturing and Industrial Base Policy, my role within the Department of Defense is to ensure the United States maintains a superior industrial base that supports the Secretary's three priorities, namely (1) enhancing warfighter lethality, (2) strengthening alliances and attracting new partners, and (3) reforming the Department's business practices. In this capacity, I represent the Department in the inter-agency CFIUS process.

I've spent the last seventeen years working at the intersection of national security, industry, and finance, in both the private and public sectors. It is important that this bill not be considered an additional regulation on business. Under this bill, the United States should and will likely continue to welcome the vast majority of foreign investment that does not present any threat to our national security. Rather, this bill, should be considered a whole-of-government response to a critical national security challenge — an insurance policy on the hundreds of billions of dollars per year we invest in our defense industrial base. Most importantly, this bill will help safeguard our sons and daughters who volunteer to step into harm's way, armed with the weapons that our industrial base produces.

### **Challenge to Technological Advantage**

Simply put, the United States military fights and wins wars through the unmatched performance of our men and women in uniform and our superior military technology. Knowing this, our competitors are aggressively attempting to diminish our technological advantage through a multi-faceted strategy by targeting and acquiring the very technologies that are critical to our military success now and in the future. China, in particular, publicly articulates its policy of civil-military integration, which ties into its intentions to become the world leader in science and technology and to modernize its military in part by strengthening the industrial base that supports it.<sup>1</sup> These plans are backed by hundreds of billions of dollars in Chinese state funding. For example, China's efforts to create an indigenous semiconductor

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<sup>1</sup> Please see China's "Report on the Work of Government, 2016"

capability alone enjoy approximately \$150 billion in state-connected funding.<sup>2</sup> In addition to semiconductors, our long-term strategic competitors have a clear focus in investing in the critical future technologies that are foundational for both commercial and military applications: artificial intelligence, autonomous vehicles, robotics, augmented reality, directed energy, and hypersonics. We see a notable increase in Chinese interest in each of these nascent technology areas, with Chinese entities participating in about 16% of all U.S. venture deals in 2015, up from a 6% average participation rate during 2010-2015.<sup>3</sup>

While some facets of our competitors' strategy, like industrial espionage and cyber theft, are clearly illegal, other approaches, including technology and business know-how transferred through acquisition in U.S. companies, may not be. Acquiring or investing in U.S. companies offers an opportunity for our competitors to gain access and control over technologies with potential military applications, enabling them to create their own indigenous capabilities, eroding our technological edge, and ultimately our military advantage. Additionally, some investments in the U.S. may also limit the availability of certain capabilities within the U.S. industrial base, potentially depriving our warfighters of access to important technological solutions needed to maintain our overmatch on the battlefield. We believe that the loss of critical technology to a competitor can inflict irreparable damage on our national security in the long-term.

### **Department of Defense Role in CFIUS**

CFIUS is designed to address the national security risks arising from foreign investments that could result in foreign control of a U.S. business. Of the defined factors to be considered when

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<sup>2</sup> "Ensuring Long Term U.S. Leadership in Semiconductors." Executive Office of the President, President's Council of Advisors on Science & Technology, January 2017. Retrieved at [https://obamawhitehouse.archives.gov/sites/default/files/microsites/ostp/PCAST/pcast\\_ensuring\\_long-term\\_us\\_leadership\\_in\\_semiconductors.pdf](https://obamawhitehouse.archives.gov/sites/default/files/microsites/ostp/PCAST/pcast_ensuring_long-term_us_leadership_in_semiconductors.pdf)

<sup>3</sup> Michael Brown and Pavneet Singh, "China's Technology Transfer Strategy: How Chinese Investments in Emerging Technology Enable a Strategic Competitor to Access the Crown Jewels of U.S. Innovation", Defense Innovation Unit Experimental, January 2018

determining the requirements of national security under the current Foreign Investment and National Security Act (FINSAs) statute, several are directly related to defense, military requirements, and technological leadership as it relates to national security. In addition, seven of the fifteen coordinators of the National Security Threat Assessment (NSTA), which is relied upon in every CFIUS case, are DoD intelligence organizations. Moreover, the Defense Intelligence Agency (DIA) makes the statutorily required assessment of the risk of diversion of defense critical technology.

As one of nine voting members of CFIUS, DoD provides significant input related to the impact of foreign investment on U.S. defense requirements and readiness, military competitiveness, and critical technology development, among other things. As such, DoD has been the co-lead alongside the Department of Treasury on a yearly average of 44% of all CFIUS cases filed since 2012, the highest percentage of any Committee member other than Treasury.

### **Examples of Limitations of CFIUS**

Since CFIUS was first instituted in the 1970's, our competitors have discovered methods beyond the Committee's authorities and successfully acquire U.S. technologies and critical business know-how. Our national security competitors' ability to evolve, outpaces our ability to adapt under the current statutory and regulatory system. What's more, the current CFIUS authorities only cover some of the relevant transactions because deals that do not result in a foreign controlling interest are beyond its jurisdiction. There are other transaction types, such as certain joint ventures, and non-passive, non-controlling investments, that can pose national security concerns, such as transferring technology and critical capabilities. Additionally, the purchases of real estate by a foreign person provides opportunities to potentially establish a persistent presence near sensitive facilities, which would currently fall outside of CFIUS's scope to review.

### **CFIUS Modernization Needed**

The Department of Defense does not view CFIUS as a panacea. Instead, it is part of a layered defense that can, along with export controls and other regulatory mechanisms, stem the flow of critical technologies to our competitors. In order to do that, however, CFIUS's authorities need to adjust to keep pace with the rapid change of technology and nimble, long-term competitors.

The Department is particularly supportive of the proposed adjustments in the FIRRMA legislation that gives CFIUS the discretion to broaden the scope of covered transactions to include certain contributions of intellectual property with associated support by a U.S. critical technology company to a foreign person through a joint venture or other similar arrangement. In addition, the Department appreciates the inclusion of foreign purchases or leases of certain real estate located in close proximity to sensitive facilities and the bill's recognition that enhanced international cooperation is necessary to ensure important technology does not flow to our competitors through our allies and partners.

## **Conclusion**

Let me add one important point as I conclude my remarks. While the Department of Defense believes defensive measures like CFIUS modernization are necessary, they alone are not sufficient for winning a technology race with our long-term strategic competitors. We must be proactive to ensure we improve our technology and innovation base because our future economic security will be a key determinant of our national security.

I would like to close with another statement from Secretary Mattis in his letter of support: "I strongly support the Foreign Investment Risk Review Modernization Act of 2017 (FIRRMA). The Department of Defense (DoD) continues to support foreign investment, consistent with the protection of national security. However, as the national security landscape changes, the existing process and authorities must be updated."

Thank you very much for the opportunity to testify on this important topic. I look forward to working with this Committee on improving and advancing FIRRMA.