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*CONGRESSIONAL TESTIMONY*

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**China's Indigenous Innovation Trade  
and Investment Policies: How Great a  
Threat?**

**Testimony before the  
Committee on Foreign Affairs  
Subcommittee on Terrorism, Nonproliferation  
and Trade  
United States House of Representatives**

**March 9, 2011  
2:00 PM**

**Peter Brookes  
Senior Fellow  
The Heritage Foundation**

Mr. Chairman, Members of the Committee:

Good afternoon. My name is Peter Brookes. I am a Senior Fellow at The Heritage Foundation.

The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation or any other organization I am associated with.

It is a pleasure to appear before you today to discuss China's policy of Indigenous Innovation as a foreign affairs specialist and observer of, and participant in, U.S.-China relations for some 15 years now.

There is no question that China today poses a significant set of challenges for the United States and the international community. While its regional and global aspirations appear to be quite extensive, it has been reticent in publicly stating its grand ambitions.

Nevertheless, we can observe a number of behaviors on the part of the Chinese that indicate that Beijing expects to see itself at, or near, the top of the international pecking order at some point in the not too distant future.

As a result, we are faced with a number of current and potential problems posed by the Chinese that arise from their seeming ambitions to be a major power politically, economically, and militarily.

For instance, there is good reason to be concerned about China's military buildup, the political and social freedoms for its 1.3 billion people, and its role in environmental degradation, to name a few.

But China's role in international economics and trade are also a concern, especially issues revolving around its export-driven economy, trade imbalances, market access for foreign firms and the convertibility and value of its currency, the yuan.

These issues are all well known to the Members of the Committee.

Today, the question is specifically on China's controversial policy of Indigenous Innovation.

While there are differing definitions of the policy, generally it might be considered the giving of preferential treatment to locally developed technology in Chinese government procurement. (Chinese government procurement is estimated at some \$105 billion annually—and may be significantly higher due to the influx of additional central government stimulus money.)

In order to be considered "locally developed," the Chinese government has to certify that the technology involved in the product was developed, re-innovated, or co-innovated in China, potentially blocking out the participation of foreign competitors.

In exchange for participating in sharing or co-developing their technology, often with State-Owned Enterprises, foreign firms are given access to current and future business opportunities in China's market.

For all practical purposes, the Indigenous Innovation policy is an effort on the part of Beijing to gain access to foreign intellectual property to improve China's commercial competitiveness at home and abroad.

Some would suggest that the Indigenous Innovation policy is a blatant Chinese attempt to quickly catch up with, and surpass, countries with more advanced technology. I do not think there is any doubt about this.

Indeed, while some date the formal policy to 2006, in fact, Chinese efforts to gain access to advanced technology from foreign firms goes back quite some time, whether the transfer of the targeted technology was "voluntary," coerced, copied, reverse-engineered, bought, or simply stolen.

China's Indigenous Innovation policy, in its many variations and guises, is in my view an unfair practice that disadvantages the foreign firms that are subjected to it. It inhibits market access of foreign firms and it is also a threat to our economic competitiveness.

Even if companies decline to send their best technology to China for fear of losing it through any number of means, technology that falls into Chinese hands may lead to competition in low-cost, mid-level technology markets that exist in many parts of the world.

And while there are competing views on the matter, it is unclear whether the transfer of low and mid-levels of technology from foreign firms will allow China to ultimately move from its place as a dominant manufacturer to a high-technology innovator.

That, of course, is China's goal.

Finally, while there are U.S. policies and measures in place, we must also be wary of how any technology transfer—domestic or foreign—might affect our national security in light of China's military modernization.

The bottom line: While Indigenous Innovation is one way for China to gain access to desirable foreign technology, the fact is that protecting high-technology intellectual property in China has been, is, and will be a significant challenge for foreign firms.

Beijing is bent on China becoming an advanced technology economy as quickly as possible, and is putting a significant amount of resources into the effort, from spending on research and development to industrial espionage, using human assets or cyber operations.

As such, we should *not* expect the Chinese threat to American technology—including sensitive defense sector technology—to abate anytime soon.

The question, of course, is what can be done?

First, it is my belief that firms could choose not to do business in the Chinese market—this, of course, is a private-sector, corporate decision that government should not interfere with.

It is clear that business engenders a certain bit of risk wherever it is conducted and firms should be aware of the threat to their intellectual property while doing business in China.

Second, it should be a priority for the U.S. government to get the Chinese government—or any other government—to walk back policies that make technology transfer a condition for access to its market.

But even if we were to see some backtracking on China's Indigenous Innovation policy, we would certainly continue to see the Chinese develop new ways, in addition to other means currently in use, to get access to foreign technology.

Third, when appropriate and an available remedy, the United States, in concert with others, should bring Chinese trade policies and practices before the World Trade Organization (WTO) for remediation.

In the case of Indigenous Innovation, there are questions as to whether China could be rightfully brought before the WTO due to its ongoing failure to negotiate an agreement regarding government procurement.

Mr. Chairman, thank you for the opportunity to present my views on this vexing matter that faces foreign firms, especially those of the United States, doing business in China. I am happy to answer your questions.

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**United States House of Representatives  
Committee on Foreign Affairs**

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<b>1. Name:</b>		<b>Organization or organizations you are representing:</b>	
Peter Brookes		None	
<b>3. Date of Committee hearing:</b>			
March 9, 2011			
<b>4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>		<b>5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>	
<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
<b>6. If you answered yes to either Item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.</b>			
None, although I am representing no organization, I am an employee of The Heritage Foundation and a Commissioner with the US-China Economic and Security Review Commission.			
<b>7. Signature:</b>			
			

*Please attach a copy of this form to your written testimony.*

## **Peter Brookes**

Senior Fellow, National Security Affairs and Chung Ju-Yung Fellow for Policy Studies in the Douglas and Sarah Allison Center for Foreign Policy Studies.

As senior fellow for national security affairs, Peter Brookes develops and communicates The Heritage Foundation's stance on foreign and defense policy through his research and writing, media and public appearances and congressional testimony.

Brookes also is Heritage's Chung Ju-Yung fellow for policy studies. He is serving his third term as a congressionally appointed member of the U.S.-China Economic and Security Review Commission.

He previously served in the administration of President George W. Bush as deputy assistant secretary of defense for Asian and Pacific affairs. In this post, he was responsible for U.S. defense policy for 38 countries and five bilateral defense alliances in Asia.

Since joining Heritage in 2002, Brookes has developed a major presence in the print media with more than 300 published articles in dozens of newspapers, journals and magazines. Many of the world's most-read newspapers and magazines have quoted him. As a columnist for the *New York Post*, Brookes reaches the audience of one of the nation's largest newspapers.

His column also runs in the Boston Herald and his writings are posted by a variety of news and opinion sites. Brookes is a contributing editor for *Townhall Magazine* and author of the book "A Devil's Triangle: Terrorism, Weapons of Mass Destruction and Rogue States" (Rowman & Littlefield, 2005; paperback, 2007).

He also is a force in the electronic media, with nearly 1,500 appearances as a commentator on television and radio – among them ABC, NBC, CBS, Fox News Channel, CNN, MSNBC, CNBC, NPR, BBC, CBC, VOA, Al Hurra and Radio Free Asia. Brookes has guest-hosted on XM satellite radio and for talk radio programs in major markets.

On Capitol Hill, Brookes has testified numerous times in the Senate and the House, both as a public official and a private citizen. He is a frequent public speaker around the country and the world, making more than 200 addresses in over 15 nations. He has spoken as part of the State Department's public diplomacy programs in Japan, Germany, Australia, Poland, Austria, Ukraine, Fiji and Papua New Guinea.

Prior to the George W. Bush administration, Brookes was a professional staff member with the House International Relations Committee. He also served with the CIA and the State Department at the United Nations. In the private sector, he worked in the defense and intelligence industries.

A decorated Navy veteran, Brookes served on active duty in Latin America, Asia and the Middle East in aviation and intelligence billets. He has more than 1,300 flight hours aboard the Navy's EP-3 reconnaissance aircraft.

Brookes, now a retired Navy commander, served as a reservist with the National Security Agency, Defense Intelligence Agency, Naval Intelligence, the Joint Chiefs of Staff and the Office of the Vice President, working as an intelligence analyst, strategic debriefer, Russian language interpreter, defense attaché, policy adviser and associate professor at the Joint Military Intelligence College.

Brookes has visited more than 50 countries on five continents and was an international election observer in Indonesia and Cambodia. He served in political positions at the local, state and national level, including helping draft the foreign policy platform for the 2000 Republican National Convention in Philadelphia. He advised the 2000 and 2004 Bush-Cheney campaigns on foreign policy and briefed 2008 presidential candidates.

Brookes is pursuing a doctorate at Georgetown University. He is a graduate of the U.S. Naval Academy (B.S.); the Defense Language Institute (Russian); the Naval War College; and the Johns Hopkins University (M.A.). He also has taught at the National Defense University and studied German and Polish.

Among Brookes' awards and honors are the Navy League of New York's Frank Knox Media Award; Joint Service Commendation Medal; Navy Commendation Medal (three awards); Navy Achievement Medal; Defense Language Institute's Kellogg Award; the Joint Chiefs of Staff service badge; and Naval Aviation Observer wings.

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