

**Testimony of E. Michael O'Malley
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**Before the Senate Committee on Banking, Housing, and Urban Affairs
"Threats Posed by State-Owned and State-Supported Enterprises to Public Transportation"**

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Chairman Crapo, Ranking Member Brown, and members of the Committee, thank you for the opportunity to testify today on the threats facing public transportation systems from foreign state-owned and state-supported enterprises, an issue that is of critical importance to the railway supply industry and the Nation. My name is Mike O'Malley and I serve as president of the Railway Supply Institute (RSI), an international trade association representing more than 200 companies involved in the manufacture or delivery of goods and services in the locomotive, freight railcar, maintenance of way, communications and signaling, and passenger rail industries. RSI members provide critical products to Class I and short line railroads, shippers, Amtrak, and commuter and transit authorities nationwide. We work with these customers to create new products or services that drive enhancements in both safety and efficiency across their rail networks.

Introduction

The rail system of the United States is one of our country's greatest assets, covering more than 140,000 miles and carrying forty percent of America's intercity freight, including 111 million tons of hazardous materials. It also transports millions of passengers every day—from small transit systems to large commuter authorities to intercity service provided by Amtrak or other entities. These systems are supported by an extensive, domestic railway supply industry that has been a dynamic and vital part of the U.S. economy for over 200 years, encompassing 125,000 jobs across all 50 states and paying an average wage 40% higher than the national average.¹ Without this robust domestic rail supply industry, our nation's passenger and freight railroads simply could not meet their customers' needs.

Unfortunately, over the past decade our industry has witnessed substantial intervention in the global rail marketplace from non-market economy foreign governments. Most notably, the People's Republic of China – working through state-owned enterprises (SOEs) like CRRC – has identified rail manufacturing as a strategic market sector and made clear their intention to “conquer” the global rolling stock market.² Backed by the full resources of the Chinese government, CRRC and its affiliates have leveraged direct subsidies, state-backed financing, and below-market loans to secure more than \$2.6 billion in railcar contracts at far below market rate for transit agencies in Boston, Chicago, Los Angeles and Philadelphia. These manipulative incursions into the U.S. market present both national and economic security risks. There is ample evidence illustrating the Chinese government's willingness to use industrial espionage, hacking, intellectual property theft, and more to achieve its global objectives, giving us every reason to

¹ Tracking the Power of Rail Supply, The Economic Impact of Railway Suppliers in the U.S. <https://www.rsiweb.org/Files/EIS%202018/RSI-Infographic%20FINAL.pdf>

² @CRRC_global, “Following CRRC's entry to Jamaica, our products are now offered to 104 countries and regions. So far, 83% of all rail products in the world are operated by #CRRC or are CRRC ones. How long will it take for us conquering the remaining 17%?” Twitter, January 11, 2018.

be concerned about their involvement with critical rail infrastructure and the technology that supports it.

Thankfully, Congress has recognized this threat and begun taking proactive efforts to address it. In a time when consensus on major issues facing the nation seems as difficult as ever, both houses of Congress and the President united on a bipartisan basis to take strong, proactive action last year to address this threat. But the threat remains, so it is critical that Congress and the Administration continue to scrutinize CRRC's unfair practices, ensure that the Transportation Infrastructure Vehicle Security Act (TIVSA) is implemented quickly as intended, and enact future policies that will discourage CRRC from further undermining the U.S. railcar manufacturing market. For example, this committee can help ensure that Congress approves a long-term infrastructure bill that gives passenger rail agencies – and the suppliers that support them – the resources they need to make sustainable investments right here in the United States. Members of this committee have undoubtedly been given a whole host of reasons why an infrastructure bill is important to our future, but I would like to offer one more – American rail supply manufacturers absolutely depend on it. The best way to encourage investment in American jobs and rolling stock manufacturing is to increase investments in passenger rail and provide the certainty associated with a long-term bill.

My goal with this testimony is to provide a comprehensive picture of CRRC's targeting of the U.S. rail market, discuss the industry's outlook moving forward, and to offer policy recommendations that would further enhance the economic and national security of U.S. rail infrastructure against foreign government interests.

Chinese SOEs Present an Imminent Threat to the Global Rail Industry

CRRC is the product of a state-directed merger in 2014 between China's two largest state-owned rail companies, China South Locomotive & Rolling Stock Corporation (CSR) and China North Locomotive & Rolling Stock Corporation (CNR). That merger, coupled with hundreds of millions of dollars in support from the Chinese government, has allowed CRRC to quickly establish itself as the largest producer of rail rolling stock in the world. In 2018, CRRC claimed to have over 180,000 employees with revenues exceeding \$37 billion USD³, more than that of its three largest competitors combined. As an SOE, CRRC benefits from the full resources of the Chinese government and has been repeatedly used to spearhead political initiatives driven by the Chinese Communist Party (CCP). The 'Made in China 2025' plan explicitly lists rail as one of ten sectors that China is targeting for global domination over the next five years. Similarly, CRRC has been at the forefront of the Belt & Road Initiative, receiving virtually unlimited support from the Chinese government to finance strategic rail infrastructure projects across the globe.

All evidence suggests that CRRC is driven by these national policy objectives, not market principles, making it impossible for other companies to compete on a level playing field. In fact, CRRC's own bylaws explicitly direct the company to seek guidance from the CCP on significant matters affecting the company's operations.⁴ The company has also demonstrated a history of intellectual property theft and serious questions have been raised about its labor practices. As a 2017 U.S.-China Economic and Security Review Commission report noted, CRRC's predecessor companies forced technology transfer agreements on many of the world's leading rail companies, which Chinese engineers then adapted

³ CRRC Company Profile, <https://www.crrcgc.cc/g5141.aspx>

⁴ "CRRC Corporation Limited Articles of Association," CRRC Corporation Limited, at 70. <http://www.crrcgc.cc/Portals/73/Uploads/Files/2018/6-4/636637164457871915.pdf>

through a process China has termed “digestion and re-innovation.”⁵ A recent NBC news report also linked CRRC to the use of child labor in Madagascar—producing component parts for the same railcars it is now assembling in the United States.⁶

In recent years, CRRC’s pattern of underbidding has become one of our industry’s greatest challenges. Since 2014, CRRC and its affiliates have leveraged state-backed financing and below-market loan rates to secure more than \$2.6 billion in railcar contracts for transit agencies in Boston, Chicago, Los Angeles and Philadelphia. The company has won these contracts by as much as thirty percent below the next lowest bid, suggesting that these are hardly market-based offerings and that they would not be possible without the support of massive subsidies from the Chinese government.

Emboldened by winning those contracts, CRRC moved on to target America’s largest and most security-sensitive cities as well. In March 2018, the Metropolitan Transit Authority (MTA) of New York announced that CRRC was among the winners of a “Genius Grant Transit Challenge,” which challenged companies to develop innovative solutions to improve New York City’s subway system. Despite the absence of any ongoing procurements, CRRC committed to invest \$50 million of its own funds to develop the city’s next generation subway car, prompting 15 bipartisan members of the New York congressional delegation to raise concerns with the MTA directly.⁷ Here in Washington, D.C., CRRC announced its intent to bid on the Washington Metropolitan Transit Authority (WMATA)’s ongoing rolling stock procurement, prompting members of Congress, including two who serve on this committee, to once again raise concerns directly with WMATA.⁸ These concerns that were echoed again just last month by Secretary of State Mike Pompeo in an address before the National Governors Association.⁹

These concerns are certainly warranted. National security experts have consistently raised the alarm about the ability of CRRC to leverage the technologies on these railcars for espionage or other illicit activities.¹⁰ Many of these trains will contain or interact with Wi-Fi systems, automatic train control, automatic passenger counters, surveillance cameras, and other Internet of Things (IoT) technology that are thoroughly integrated into the information and communications technology infrastructure of transit authorities, all designed and built by a company controlled by the CCP and the Government of China.

CRRC a Threat to U.S. Jobs & Economic Security

Unlike its competitors, CRRC has established assembly operations—not traditional manufacturing operations—to complete these contracts, hiring far fewer employees than comparable plants run by railcar manufacturers that have heavily invested here in America for decades. CRRC constructs the cars in China and then ships them to the U.S. for final assembly. As a result, U.S. components and labor are far more limited than those utilized by their competitors. By contrast, most of the other major rolling

⁵ U.S.-China Economic and Security Review Commission, China’s High Speed Rail Diplomacy, February 21, 2017.

<https://www.uscc.gov/sites/default/files/Research/China's%20High%20Speed%20Rail%20Diplomacy.pdf>

⁶ NBC News, ‘Zone Rouge’: An army of children toils in African mines, November 18, 2019. <https://www.nbcnews.com/news/all/army-children-toil-african-mica-mines-n1082916>

⁷ Letter to Metropolitan Transit Authority, May 21, 2019. https://kathleenrice.house.gov/uploadedfiles/20190521_mtaletter.pdf

⁸ Letter to Washington Metropolitan Transit Authority, January 18, 2019. <https://www.scribd.com/document/397856431/WMATA-Cyber-Concerns-8000-Series-Rail-Car-RFP>

⁹ Secretary Pompeo remarks to National Governors Association 2020 Winter Meeting, February 8, 2020.

<https://www.youtube.com/watch?v=g1BbswU3i10>

¹⁰ The Hill, Opinion - Defense bill must protect U.S. rail system against Chinese cyber intrusions, David N. Senty & Mark S. Sparkman, 2 October 2019. <https://thehill.com/opinion/cybersecurity/463704-defense-bill-must-protect-us-rail-system-against-chinese-cyber>

stock manufacturers here in the United States source the vast majority of their components domestically, often significantly exceeding minimum Buy America requirements.

To date CRRC has established two assembly facilities in Springfield, MA and Chicago, IL, and based on media reports these facilities have just 200 employees in total.¹¹ This illustrates the clear distinction between the type of American manufacturing that federal and state passenger rail investments are designed to produce and assembly operations of the CRRC. To be clear, we do understand the value those jobs bring to their communities, but the fact is that they came at a cost. A study from Oxford Economics estimated that for every job CRRC creates here in the United States to assemble passenger railcars, between three and five jobs are eliminated elsewhere in the domestic supply chain.¹² Oxford estimated that this could result in the loss of as many as 5,100 U.S. jobs and \$330 million in GDP in the passenger railcar market alone if action was not taken. It is not a coincidence that passenger railcar manufacturing plants near Chicago and in Philadelphia closed in recent years after their local authorities awarded contracts to CRRC.

Evidence that CRRC Intends to Use Passenger Rail as a Foray into Freight Manufacturing

Equally concerning is the prospect of CRRC utilizing its existing beachhead in passenger railcar assembly to move into the freight rail sector. There they could build freight railcars used to transport sensitive military equipment, hazardous materials, critical commodities, and more. As many former military and intelligence officials have repeatedly noted, there are substantial risks in allowing a Chinese SOE to build, operate, or otherwise involve itself in the manufacture or assembly of those freight railcars. During times of war, the U.S. rail network is critical to our military's ability to deploy assets quickly and decisively. Other witnesses for this hearing will provide more detail on this subject, but given these strategic threats and China's growing military capacity, we should take great care in deciding who we rely on for military readiness. As the Department of Defense Office of Industrial Policy noted in a 2018 report, "The decline in the U.S. manufacturing industry...creates a variety of risks for America's manufacturing and defense industrial base and, by extension, for DoD's ability to support national defense."¹³

Because freight rail is funded almost entirely with non-public funds, there are no federal content standards as we see in passenger rail, and thus nothing preventing CRRC from aggressively targeting domestic railcar and component manufacturers using non-market tactics. CRRC's penetration of the freight market could therefore happen very quickly and with virtually no transparency. This would have a devastating effect on our country's ability to manufacture and deliver freight railcars independently.

The experience of the Australian market serves as perhaps the best example of what can happen in the freight rail sector. In a period of less than ten years, the Australia's freight railcar manufacturing was rapidly overtaken by CRRC and its predecessor companies as it systematically drove its competition out of the market. Today, there is no meaningful producer of freight rail rolling stock in Australia and thus

¹¹ Boston Business Journal, Lights off at CRRC's Springfield train car factory? Company execs say it could happen, October 10, 2019. <https://www.bizjournals.com/boston/news/2019/10/10/lights-off-at-crrcs-springfield-train-car-factory.html>

¹² Oxford Economics, Assessing How Foreign State-Owned Enterprises' U.S.-based Operations Disrupt U.S. Jobs, June 2019. <https://www.oxfordeconomics.com/recent-releases/assessing-how-foreign-state-owned-enterprises-us-based-operations-disrupt-us-job>

¹³ U.S. Department of Defense, Assessing and Strengthening the Manufacturing and Defense Industrial Base and Supply Chain Resiliency of the United States, September 2018. <https://media.defense.gov/2018/Oct/05/2002048904/-1/-1/1/ASSESSING-AND-STRENGTHENING-THE-MANUFACTURING-AND%20DEFENSE-INDUSTRIAL-BASE-AND-SUPPLY-CHAIN-RESILIENCY.PDF>

China is effectively the sole supplier. Independent research has suggested that similar actions in the United States could result in the loss of as many as 65,000 U.S. jobs and \$6.5 billion in GDP.¹⁴

While CRRC has recently claimed they have no interest in the freight segment of the market, their actions show otherwise. In 2014, CRRC entered into a now-defunct joint venture with a Chinese holding company and a U.S. firm to launch Vertex Rail Corporation, a freight railcar assembly facility located in Wilmington, North Carolina. Despite nearly 100 members of the House and Senate raising national security concerns with the investment, it was ultimately allowed to move forward.¹⁵ While that venture closed in November 2018, there is little doubt that the U.S. market remains a prime target. In fact, there are indications that CRRC is already establishing a presence in Canada with the intent to import freight cars into the U.S. market.

Current Actions & Policy Recommendations

RSI and our members are grateful for the actions policymakers have taken thus far to mitigate CRRC's threat. Beginning with successful efforts to reform the Committee on Foreign Investment in the United States (CFIUS), Congress passed the Foreign Investment Risk Review Modernization Act (FIRREA) in 2018. This gives future Administrations the tools needed to thoroughly review transactions like those of CRRC and Vertex moving forward and take appropriate steps to block those transactions if they are deemed a threat to national security.

The passage of the Transit Infrastructure Vehicle Security Act (TIVSA) is also an important step forward. This legislation will block any federal funds from being used to subsidize CRRC's activities in the future, ensuring that CRRC is unable to further leverage American taxpayer funds to underbid its competition. It also institutes much-needed cybersecurity standards that will help limit the national security risks associated with CRRC's existing or future contracts.

These legislative achievements are important steps for the industry, but it is essential that we not get complacent in the wake of China's clear desire to overtake our industry. We offer the following recommendations for policymakers to continue to be proactive in countering this threat:

- 1. The Federal Transit Administration (FTA) should immediately communicate with its grantees on TIVSA to ensure compliance with this new law.** We have heard some suggestion that there is confusion regarding what this bill does. To us, lawmakers were clear in passing this legislation that there are significant national and economic security risks associated with awarding a contract to CRRC and that federal funds should not be used to award a contract to a Chinese SOE. Yet CRRC has said that it will continue to aggressively bid on contracts.¹⁶ As leaders of this committee have so clearly articulated, it is essential that the FTA communicate to transit agencies to ensure prompt compliance with Congress' intent in passing this legislation as part of the National Defense Authorization Act.
- 2. Congress should pass a long-term infrastructure bill with robust passenger rail funding levels to ensure that states and localities can make smart, sustainable investments for the future.**

¹⁴ Oxford Economics, *Will We Derail US Freight Rolling Stock Production?*, May 2017, at 24. <https://www.oxfordeconomics.com/recent-releases/will-we-derail-us-freight-rolling-stock-production>

¹⁵ Letter to U.S. Department of Treasury, July 15, 2016. <https://lipinski.house.gov/uploads/CFIUS%20Letter%20to%20Treasury.pdf>

¹⁶ New England Public Radio, *Capitol Hill Deal Keeps Springfield's CRRC Rail Car Factory Rolling*, Dec. 12, 2019. <https://www.nepr.net/post/capitol-hill-deal-keeps-springfields-crcc-rail-car-factory-rolling#stream/0>

CRRC's success in winning federal and state transit contracts has been fueled by their ability to come in at below-market prices by leveraging government subsidies, under procurement rules that often require transit agencies to award contracts to the lowest bidder. People are increasingly recognizing the benefits of passenger rail and states and localities are making rolling stock investments to support it, but predictable, dedicated and sustainable sources of federal funding are needed.

3. **Pass legislation or direct the U.S. Department of Transportation to ensure strict Buy America compliance, spurring domestic jobs and limiting the ability of foreign SOEs to game the system.** By design, Buy America laws were written to ensure that taxpayer dollars made available for constructing and sustaining our public transportation systems would flow back into the U.S. economy and discourage the outsourcing of these manufacturing jobs to other countries. Unfortunately, RSI believes that the U.S. Department of Transportation currently lacks adequate resources to ensure strict compliance with Buy America provisions across the country. Congress should direct USDOT to exercise stricter oversight to help keep grant funding in the United States and spur the domestic jobs critical to maintaining a strong American manufacturing base.
4. **Create additional safeguards for the freight industry.** While TIVSA was a vital step forward that will help level the playing field in the domestic passenger railcar market, the freight sector remains at risk. RSI will be working this year with members of Congress to identify legislation that could help establish appropriate standards for freight railcar manufacturing so we can ensure that CRRC does not wipe out the market in the same way they did in Australia. Given actions already taken by CRRC and the criticality of freight rail networks for national security and military deployment capabilities, we must act quickly.

I will make one final point. Given the global nature of this threat, many of our allies are now following the lead of U.S. policymakers to address the issue in other markets as well. In Europe, for example, the European Commission is actively exploring ways to address the threat. The Association of the European Rail Supply Industry (UNIFE) recently issued a call to action given the expansion of China's state-owned rail suppliers, citing "the threat to European rail suppliers and the 400,000 jobs they represent due to unequal competition and state subsidies to Chinese players."¹⁷ We encourage the U.S. Congress and Administration to work with our allies across the globe to unite in the effort to ensure a market-driven railway supply sector free from SOE interference.

Conclusion

RSI members will continue investing and doing all we can to support our passenger agency customers in serving the mobility and economic development needs of communities across the country, but we cannot compete with an entire country in a marketplace distorted by Chinese government subsidies. We appreciate the opportunity to provide these recommendations on critical issues affecting our industry and will continue working with Members of Congress to formulate policies that enhance rail safety,

¹⁷ UNIFE, A Call for Urgent Action: The Fast Expansion of China's State-Owned Rail Suppliers, November 2019.

security and efficiency. Thank you for the opportunity to testify and I would be happy to answer any questions that you may have.