

**VITAL ASSETS: HUMAN CAPITAL IN FEDERAL
ECONOMIC REGULATORY AGENCIES**

HEARING

BEFORE THE

OVERSIGHT OF GOVERNMENT MANAGEMENT,
RESTRUCTURING, AND THE DISTRICT OF COLUMBIA
SUBCOMMITTEE

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
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VITAL ASSETS: HUMAN CAPITAL IN FEDERAL ECONOMIC REGULATORY AGENCIES

TUESDAY, APRIL 23, 2002

U.S. SENATE,
OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING,
AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:03 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Richard J. Durbin, Chairman of the Subcommittee, presiding.

Present: Senators Durbin and Voinovich.

OPENING STATEMENT OF SENATOR DURBIN

Senator DURBIN. Good morning. This hearing will come to order. I am pleased to welcome you to this hearing before the Senate Subcommittee on Oversight of Government Management. We will focus on "Vital Assets: Human Capital in Federal Economic Regulatory Agencies."

Since his arrival in the Senate, my colleague and friend, George Voinovich, has really championed and tackled the critical issue of the human capital crisis facing our Federal workforce. Despite the change in party leadership on this Subcommittee, we have maintained our focus on this important part of our agenda and I have given Senator Voinovich my assurance that we will continue to. I share his belief that this is an essential part of our responsibility and I am welcoming not only his participation, but his leadership here.

Today's hearing is devoted to examining the problem in the context of our country's economic regulatory agencies, particularly if the SEC and the Department of Commerce are equipped to accomplish their missions. Do they have the right staff in the right places with the right skills doing the right things to meet their responsibilities? Can the SEC protect and maintain the fiduciary trust of the investing public? With the continuing expansion of world globalization, can the Commerce Department fulfill its duty to represent our inventors and sustainers of commerce in what I see as an increasingly hostile and challenging trade environment?

These two agencies are vital to my home State of Illinois, as I am sure they are to Ohio. Many have referred to the Chicago financial institutions as the "other Wall Street." The Board of Options Exchange and the Chicago Stock Exchange, both regulated by the SEC, play a vital role in the economy of my State.

Similarly, where would this country be without its domestic steel industry? The Department of Commerce and the U.S. Trade Representative's Office are on the front lines of the battle to save this industry that is really vital to our economy and our national security.

In 1990, the GAO issued its high risk list, identifying particular vulnerabilities across the government susceptible to waste, fraud, abuse, and mismanagement. The GAO has regularly reported on agencies' progress in correcting the deficiencies that led to the high risk designation. In March 2000, the GAO reported that the ability of the Commerce Department and two other trade agencies to monitor and enforce trade agreements is limited. The GAO attributed the problems to the agency's lack of sufficient numbers of experienced staff.

According to GAO, agencies have not identified at this point the full scope of their workload and the number of types of resources they need to perform their task, the availability of resources, the role of individual agencies, and such. As a result, the government is not reaping the full benefits of its trade agreements to increase U.S. market access abroad. The GAO recommended the Secretary of Commerce work with other agencies to develop a workable management strategy to address this situation.

GAO also recently noted the security markets have undergone tremendous change over the last decade and the SEC faces growing regulatory and oversight challenges to stay abreast of these advances. The most recent highly publicized collapse of Enron has increased the pressure on the SEC to ensure that investors receive accurate, meaningful financial disclosure, an important part of the SEC's mission. According to the Investment Company Institute, in 1980, fewer than 10 percent of U.S. households owned mutual funds. Today, at least 50 percent invest in markets. This raises the question, is the SEC ready and able to handle this massive increase in its workload?

I look forward to hearing from the GAO, the SEC, and the Department of Commerce this morning about the progress that has been made toward resolving this, and now I would like to recognize my colleague, Senator Voinovich, for an opening statement.

OPENING STATEMENT OF SENATOR VOINOVICH

Senator VOINOVICH. Thank you, Senator Durbin. I thank all of you for coming. This is the tenth hearing that the Subcommittee has held over the past 3 years on the human capital challenges confronting the Federal Government and the second one since Senator Durbin became the Chairman. Mr. Chairman, I want to thank you for holding this hearing and for your continuing interest in this subject that is very important, I think, to the future of our country.

I happen to believe that human capital management is the most important issue facing our government today. The issues that will be examined today are a microcosm of a larger systemic human capital challenge facing the Federal Government. Even though half of the workforce will be eligible for retirement within the next 5 years, I am confident that our human capital crisis can be alleviated with the right combination of legislation, sound leadership

and guidance from the administration, and improved management within each agency, but we need action now.

On the legislative front, the goal of my proposed human capital legislation, S. 1603 and S. 1639, which I introduced on behalf of the administration, is to give the agencies the management flexibilities, the tools that they need to improve performance and accountability. I am glad that the President has taken an active role in this. I told him that the chickens were going to come home to roost during his administration and if he did not get on this, he would have more embarrassing moments like he had recently with the INS.

I am also pleased, Mr. Chairman, that the President nominated Mark Everson to be Deputy Director for Management at OMB. This is the first time OMB will have someone in this particular position, although Sean O'Keefe did have a great deal of management oversight responsibility. Nonetheless, this nomination is long overdue.

In order to address the human capital crisis at the agency level, senior executives must find creative ways to link human capital planning into the budget and strategic planning process. This linkage will enable agencies to identify staffing shortages at mission critical positions so they can conduct a more targeted recruitment effort. It will also help agencies better to train employees that need skills that need to be improved.

However, reliable evidence suggests that most agencies still have a long way to go. For instance, in January, the General Accounting Office released its high risk series, as the Chairman has mentioned. Over the past several years, the roles and responsibilities of our trade agencies have increased in scope and technical complexity. The Department of Commerce maintains a database of nearly 300 international trade agreements to which the United States is a participant. These include NAFTA, 26 WTO agreements, 238 bilateral agreements with individual countries, and the number of agreements continues to grow. In fact, the Senate recently ratified an agreement with Jordan and agreements with Chile and Singapore are now in negotiation.

Unfortunately, the staffing levels and work years have not kept pace with this workload. This combination raises doubts about our ability to monitor our trade relations and indicate that human capital management should be a top priority for our trade agencies, and I have mentioned this to Don Evans on several occasions and indicated, Mr. Chairman, that we were going to have him in here to talk about it.

I believe there is a direct relationship between the human capital challenges at the Federal agencies that regulate and monitor trade and the ad hoc legislation that has been introduced to supercede our existing trade laws. For example, the quota bills designed to limit foreign steel imports that have been proposed in recent years, in my opinion, are a reflection of the frustration with the perceived lack of enforcement of existing trade laws.

While I am sympathetic with the steelworkers' sense of frustration about the industry and its plight, I think those quota bills were an inappropriate response, but I can certainly understand why they felt the way that they did. That is one of the reasons why

I urged the Secretary of Commerce to move forward with the Section 201 investigation in the steel industry. One of the things that really bothers me about the Section 201 investigation is how it is sometimes characterized as purely political. The fact is, that the Section 201 investigation is a safeguard action that is authorized under GATT, NAFTA, and out into agreements under their laws, we have the authority to look and respond to surges that occur that significantly threaten our industries. So they finally went ahead and did it and then put some tariffs down.

But a lot of this goes back to the sense of frustration, I think, of people throughout this country that we are not enforcing those laws. Mr. Aldonas, I am interested to see what you are doing about that.

As equally important an issue is the Federal Government's ability to oversee the financial markets. The Securities and Exchange Commission plays an absolutely vital role in protecting investors and maintaining the integrity of those markets. Without consumer confidence provided by the SEC, the U.S. capital markets would not be the envy of the world. Similarly, the workforce challenges at Commerce, the SEC workload began to outgrow its resources some time ago.

I commend Mr. McConnell and the SEC for recognizing their pay problems. Furthermore, the agency recommended a new pay scale that unfortunately was not fully funded. As a result, a lot of SEC staff have left for jobs in other Federal financial regulatory agencies because the pay was better in those agencies. I am interested in knowing what impact a new pay system will have on SEC staff turnover, and I understand there is some disagreement between the NTEU about where those pay scales ought to be adjusted.

I am anxious to hear from our witnesses today. It is funny. I recently met with the local official that runs the INS office in Cleveland and I was really impressed with him. He has about 174 people working for him. This office runs a special hiring program, Mr. Chairman, that allows them to expedite the hiring process for applicants who have graduated with a 3.5 average or better.

During the course of our conversation, I asked him, "How do the applicants know if they have a job?" He said, "Well, we tell them that they are qualified." "But," I said, "when can you officially hire them and give them a start date?" He replied, "Well, about 9 months later." That is how long it takes them to do the background checks and everything. I said, "Well, how many of the applicants do you hire?" He said, "Not very many." Mr. Chairman, I find it utterly ridiculous that it takes 9 months to hire a highly qualified applicant for a Federal job.

Thank you, Mr. Chairman.

[The opening prepared statement of Senator Voinovich follows:]

PREPARED OPENING STATEMENT OF SENATOR VOINOVICH

Good morning, thank you all for coming. Today the Subcommittee on Oversight of Government Management is meeting to examine how the human capital crisis is affecting our Federal economic regulatory agencies and their ability to monitor and enforce our trade agreements and oversee our complex financial markets.

This is the 10th hearing that this Subcommittee has held over the past 3 years on the human capital challenges confronting the Federal Government, and the second one since Senator Durbin became the Chairman. Mr. Chairman, I want to

thank you for holding this hearing and for your continued partnership in examining this critical issue.

Human capital management is the most important issue facing the Federal Government. The issues that will be examined today are a microcosm of larger systemic human capital challenges. Even though half the Federal workforce will be eligible for retirement within the next 5 years, I am confident that our human capital crisis can be alleviated with the right combination of legislation, sound leadership and guidance from the administration, and improved management within each agency. But, let there be no doubt, the time for action is upon us.

On the legislative front, the goal of my proposed human capital legislation S. 1603, and S. 1639, which I introduced on behalf of the Bush Administration, is to give agencies the management flexibility, tools and training necessary to improve performance and accountability.

Thankfully, the President has taken an active role in human capital as well. President Bush's comprehensive management agenda has the right blend of proposals to help improve government performance. I was extremely pleased to learn that the President nominated Mark Everson to be Deputy Director of Management at OMB. Mr. Everson will be a strong addition to the President's management team, which includes OMB Director Mitch Daniels and OPM Director Kay James. With the appointment of Mr. Everson, I am increasingly optimistic that human capital reform can be enacted this year.

In order to address the human capital crisis at the agency level, senior executives must find creative ways to link human capital planning into the budget and strategic planning processes. This important linkage will enable agencies to identify staffing shortages in mission critical positions so that they can conduct a more targeted recruitment effort. This process will also allow agencies to design better training programs for employees in need of updating their skill sets, thus helping the agency meet its strategic objectives.

However, reliable evidence suggests that most agencies still have a long way to go. For instance, in January 2001, the General Accounting Office released its report *High Risk Series: An Update*, which states that, "A lack of sufficient numbers of experienced staff with the right expertise limits the ability of the Department of Commerce, U.S. Trade Representative, and the Department of Agriculture to monitor and enforce trade agreements."

Over the past several years, the roles and responsibilities of our trade agencies have increased in scope and technical complexity. The Department of Commerce maintains a database of nearly 300 international trade agreements to which the United States is a participant. These include NAFTA, 26 WTO agreements and 238 bilateral agreements with individual countries, and the number of agreements continues to grow. The Senate recently ratified an agreement with Jordan, and agreements with Chile and Singapore are in negotiation.

Unfortunately, the staffing levels and work years have not kept pace with this increased workload. This combination raises doubts about our ability to monitor our trade relations, and indicate that human capital management should be a top priority for our trade agencies. To me, it is clear that we simply do not have enough people to enforce our trade laws.

I believe that there is a direct relationship between the human capital challenges at the Federal agencies that regulate and monitor trade and the ad hoc legislation that has been introduced to supercede our existing trade laws. For example, the quota bills designed to limit foreign steel imports that have been proposed in recent years are a reflection of frustration with the perceived lax-enforcement of existing trade laws. While I am sympathetic with the steelworkers sense of frustration with what is happening to their industry, I think that quota bills were and are an inappropriate response because they would violate our trade agreement.

In order to maintain the benefits of free trade and prevent a breakdown of international trade, it is critical that we address our trade concerns within the existing trade law framework. This is exactly what President Bush did when he initiated an investigation regarding the damage being done by the recent surge in steel imports. Acting under Section 201 of the Trade Act of 1974, the President initiated a series of actions that culminated in the implementation of certain safeguards to help the steel industry weather a flood of foreign steel. The key here is that the President acted within the parameters of our trade agreement when he initiated this safeguard action.

I am concerned that the widespread perception that we are not enforcing our trade laws is going to led to more efforts to restrict trade outside the framework of our trade agreements. If we can't convince and assure Americans that we are enforcing the rules, we will end up with legislation that violates our trade agreements and prompts retaliation and trade wars and that would certainly diminish the fruits

of free trade. If we want free trade, we must have fair trade, and in order to do so, we must have the right people with the right skills at our trade agencies to enforce those laws.

Mr. Chairman, as you well know, my Ohio constituents working in every industry have a vested interest in the human capital challenges facing our trade agencies. Nowhere is this more true than in the automotive and steel industries which both face strong foreign competition. Therefore, I am very interested in learning from Mr. Aldonas how the Department of Commerce is addressing these challenges.

An equally important issue is the Federal Government's ability to oversee the financial markets, which form the foundation of our economy. The Securities and Exchange Commission plays an absolutely vital role of protecting investors and maintaining the integrity of the financial markets. Without the consumer confidence provided by the SEC, the U.S. Capital markets would not be the envy of the world. Similar to the workforce challenges at the Department of Commerce, in the 1990's, the SEC workload began to outgrow its resources.

This trend was based on several factors including growing stock market trading and mutual fund transactions, financial innovations, emerging technologies that allowed for an explosion of Internet trading, and the globalization of our markets. Furthermore, the collapse of Enron begs the question of whether or not our government has the adequate staff to ensure transparency and regulatory compliance. Combining these factors with staff turnover that reached twice the rate of the rest of government, it became evident that the SEC needed to make dramatic improvements in their workforce planning process.

On January 16, 2002, the President signed *The Investor and Capital Markets Fee Relief Act*. This law includes provisions that permit the SEC to raise salaries for certain employees to the levels of other Federal financial regulators such as the Federal Deposit Insurance Corporation and the Federal Reserve, whose pay exceeds their SEC counterparts. I am interested in sharing the SEC's opinion on the funding issues surrounding their new salary schedule, their methods and timelines for implementation, and how they plan to recruit and retain more staff to help them accomplish their mission.

In addition to this legislation, the SEC has initiated a special study to evaluate the Commission's operations, efficiency, productivity, and resources. I commend Chairman Pitt for recognizing the human capital challenges facing the SEC and for taking a proactive stance to solve them. I hope that the findings of the SEC study will provide the Commission with long-term solutions to their workforce challenges.

With over 11 years of experience at the SEC, I am sure that Mr. McConnell, will make a valuable contribution to our discussion.

Thank you, Mr. Chairman. I look forward to a lively and informative discussion with our witnesses.

Senator DURBIN. Thank you, Senator Voinovich.

I want to welcome our first panel. Loren Yager is the Director of International Affairs and Trade with the U.S. General Accounting Office. Thank you, Mr. Yager.

Richard Hillman is the Director of Financial Markets and Community Investment with GAO.

Grant Aldonas is the Under Secretary for International Trade, Head of the International Trade Administration at the U.S. Department of Commerce. I want to thank Mr. Aldonas for working closely with my staff during his former tenure as majority trade counsel to the Senate Finance Committee Chairman, Senator Roth. I welcome you back to these familiar halls and appreciate your coming here today.

Mr. ALDONAS. Thank you.

Senator DURBIN. Jim McConnell is the Executive Director of the Securities and Exchange Commission.

Edward Blansitt is the Deputy Inspector General for the U.S. Department of Commerce.

Thank you for coming. It is customary in this Subcommittee to swear in all witnesses, so if you would please stand and raise your right hand. Do you swear the testimony you are about to give is

the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. YAGER. I do.

Mr. HILLMAN. I do.

Mr. ALDONAS. I do.

Mr. MCCONNELL. I do.

Mr. BLANSITT. I do.

Senator DURBIN. Thank you. Let the record note that the witnesses answered in the affirmative. Your written statement will be made part of the record in its entirety, and if you would be kind enough now to summarize your statement in about 5 minutes, we would appreciate it.

Mr. Yager, if you would start.

TESTIMONY OF LOREN YAGER,¹ DIRECTOR OF INTERNATIONAL AFFAIRS AND TRADE, U.S. GENERAL ACCOUNTING OFFICE

Mr. YAGER. Thank you. Good morning, Mr. Chairman, Senator Voinovich. I am pleased to have another opportunity to appear before this Subcommittee, particularly on the topic of human capital, where the Subcommittee has taken such a leadership role.

For the past 3 decades international trade has grown at more than twice the rate of U.S. GDP and this trade is governed by a wide variety of trade agreements. U.S. Government efforts to monitor and enforce these trade agreements involve at least 17 Federal agencies, with three key agencies, the Office of the U.S. Trade Representative and the Departments of Commerce and Agriculture, having significant roles.

The primary message of my testimony this morning is that despite the recent efforts of agency officials, there will continue to be significant human capital challenges at these three trade agencies in the coming years. Specifically this morning, I will discuss three things: The workload issues facing the key trade agencies, the changes that these agencies have made in the last few years, and finally, a few specific challenges for these particular agencies.

First, let me provide a few illustrations of why the workload continues to increase. One is that the United States is now a party to at least 300 USTR negotiated agreements and many of these agreements have been negotiated in only the last 10 years.

A second aspect of the workload is that there is a rapidly growing number of nations that are party to the trade agreements. Including countries such as China in the WTO significantly increases the requirements for monitoring and enforcement.

The third illustration of the increasing workload is that the agencies' dispute settlement caseload continues to grow. While these far-reaching agreements have substantially increased rights for U.S. exporters, they have also increased U.S. obligations to other nations.

The second major topic that I will cover is the changes that the trade agencies have made since our March 2000 report. At that time, we reported that the three key trade agencies' human capital

¹The prepared statement of Mr. Hillman and Mr. Yager with attached charts appears in the Appendix on page 43.

capabilities had not kept pace with their increasing monitoring and enforcement workload. This work requires a mixture of economic, technical, and legal analysis, and staff levels at the three key agencies had been flat or declining in the years before our report. As a result, we found at that time that the United States was unable to maximize the benefits from the trade agreements.

I am pleased to report that the trade agencies have made significant efforts in the last 2 years to address these challenges. For example, the three agencies have additional funded positions and have had some significant success in filling those positions. In addition, the agencies have made other efforts, such as investing in people and increasing the attention to recruitment, which indicates a greater understanding of the role of the human capital function.

The final issue that I will cover is the remaining challenges for these agencies. One is the issue of recruitment. This is difficult for the trade agencies because they need to hire trade experts and specialists for many of the positions, again, including economists, attorneys with litigation experience, and individuals with industry and regional expertise. This is particularly true at USTR, where they place a premium on staff with highly specialized skills.

Retention also continues to be a problem at the trade agencies. For example, attrition at USTR is 17 percent annually, which is more than three times the governmentwide rate, and the rate at Commerce's Import Administration is more than double the governmentwide rate.

A final challenge is the demand for staff expertise generated by the huge increase in volume and intensity of ongoing negotiations, including the Doha Development Round of the WTO, the Free Trade Area of the Americas, and a number of bilateral and other agreements.

Mr. Chairman, I believe this is a particularly important time to focus on the human capital challenges at the trade agencies. On the one hand, the leadership of these agencies has made significant efforts to address some of these problems. On the other hand, the enormous volume of ongoing negotiations demonstrate one of the themes that is frequently brought before this Subcommittee, that the human capital challenges in the Federal Government have been developing for a long time and will not be quickly or easily addressed.

Mr. Chairman, this concludes my testimony and I would be happy to answer any questions that you or Senator Voinovich have.

Senator DURBIN. Thank you, Mr. Yager. Mr. Hillman.

TESTIMONY OF RICHARD HILLMAN,¹ DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GENERAL ACCOUNTING OFFICE

Mr. HILLMAN. Thank you. The leadership provided by this Subcommittee and the Senate Committee on Governmental Affairs has been especially important in focusing attention on the Federal Government's human capital challenges and I appreciate the oppor-

¹The prepared statement of Mr. Hillman and Mr. Yager with attached charts appears in the Appendix on page 43.

tunity to appear here today to discuss the serious human capital challenges facing the SEC.

My statement today will address three specific human capital challenges. Specifically, I will discuss SEC's workload and staffing challenges, the effects of the workload and staffing imbalances on SEC's ability to fulfill its mission, and finally, describe other factors that affect the fulfillment of the SEC's mission.

Regarding my first point on SEC's workload and staffing challenges, we documented in a recently-issued report on SEC's operations that over the last decade, securities markets have experienced unprecedented growth and change. Technology has fundamentally changed the way markets operate and how investors access the markets. In addition, the markets have become more international and legislative changes have resulted in a regulatory framework that requires increased coordination amongst financial regulators and requires that SEC regulate a greater range of products and participants.

Moreover, the recent sudden collapse of Enron and other corporate failures have stimulated an intense debate on the need for broad-based reform in such areas as financial reporting and accounting standards, oversight of the accounting profession, and the corporate governance, all of which could have significant repercussions on SEC's role and oversight challenges.

Further, as stated in our March 2000 report, we found that SEC's ability to fulfill its mission has become increasingly strained due in part to imbalances between workload and staff resources. As I have illustrated in this middle chart before you, the larger and more active and more complex markets just discussed have resulted in an increased aggregate workload at the SEC, including more filings, complaints, inquiries, investigations, examinations, and inspections.

The dotted line indicates SEC's combined workload—the increasing line indicates SEC's combined workload in these areas and it has continued to grow at a rapid rate throughout the decade while staff resources, represented by the more flat line, has grown little. As a result, SEC has been challenged to keep up with this increasing workload since about 1996.

When we reviewed this workload on an activity basis, as this third chart shows, we found that over the last decade, staffing within the various areas of SEC's regulatory oversight grew from between 9 percent to 166 percent, while workload in those same areas grew from 60 to 264 percent. As the figure illustrates, these disparities exist across all key SEC activities, as the increase in SEC's workload has substantially outpaced the increases in SEC's staff.

Although industry officials complimented SEC's regulatory regulations of the industry, given its staff size and budget, both SEC and industry officials identified several challenges that SEC faces. Let me just mention one.

SEC's staff which review corporate filings are now reviewing those filings less frequently and less completely as their workload increases. The number of corporate filings has grown at an unprecedented rate of 60 percent, while staff responsible for reviewing those filings has grown at a rate of 29 percent. As a result, SEC

reviewed only 8 percent of all filings submitted in 2000 and reviewed about 16 percent, or only half of its annual goal of reviewing 30 to 35 percent of annual reports.

Regarding my third point on challenges facing the SEC, we found that in addition to the staff and workload imbalances, other factors also contribute to the challenges SEC is currently facing. SEC officials said that although additional resources could help to do more, additional resources alone would not help SEC address its high turnover, which continues to be a challenge for the agency.

As discussed in our 2001 report on SEC's human capital practices, about one-third of SEC's staff left the agency between 1998 and 2000. By 2001, this number has increased to 40 percent. SEC's turnover rate for attorneys, accountants, and examiners averaged 15 percent in 2000, more than twice the rate for comparable positions governmentwide. Although the rate had decreased to 9 percent in 2001, turnover at SEC was still higher than the rate governmentwide.

Further, because of its high turnover and its inability to hire new staff quickly, about 250 positions remained unfilled in September 2001, which represents about 8.5 percent of SEC's authorized positions.

In summary, although SEC's workload and staffing imbalances have challenged SEC's ability to protect investors and maintain the integrity of the securities markets, SEC has generally managed the gap between workload and staff by determining what basic statutorily mandated duties it could accomplish with existing resource levels. This approach, while practical, has forced SEC's activities to be largely reactive rather than proactive.

For instance, SEC has not put mechanisms in place to identify what it must do to address emerging and evolving issues. Although SEC has a strategic plan and has periodically adjusted staffing or program priorities to fulfill its basic obligations, it has not engaged in a much-needed systematic reevaluation of its programs and activities in light of current and emerging challenges.

Given the regulatory pressures facing SEC and its human capital challenges, it is clear that SEC could benefit from some additional funding. However, a comprehensive agency-wide planning effort, including planning for use of technology to leverage available resources, could help SEC better determine the optimum human capital and funding needed to fulfill its mission.

Thank you, Mr. Chairman.

Senator DURBIN. Thanks, Mr. Hillman. Mr. Aldonas.

TESTIMONY OF GRANT ALDONAS,¹ UNDER SECRETARY FOR INTERNATIONAL TRADE, HEAD, INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

Mr. ALDONAS. Thank you, Mr. Chairman and Senator Voinovich. First of all, I appreciate the Subcommittee's interest and oversight. One of the lessons I drew from my experience on the Finance Committee was how critical it was for Congress and the executive to be engaged in an active dialogue about the management of our resources downtown, where I am now. Particularly, it helps us set

¹The prepared statement of Mr. Aldonas appears in the Appendix on page 61.

priorities that are consistent with what Congress has authorized as well as ensure that we focus our efforts, and so I welcome the interest, particularly with respect to ITA.

The other thing I want to say to begin with is I have spent about 22 years in Washington, in a past incarnation in the Foreign Service and as a trade negotiator at USTR and then in private practice for many years and then with the Senate. Now I have the opportunity to work with dedicated professionals in the International Trade Administration, and I have to say I am enormously proud to serve with this group of people.

Loren's comments about the challenges we face are real. There is no doubt that we have one heck of a challenge ahead of us. I think that is particularly true given what we have seen in terms of the increase of trade agreements, but also the challenges we have in trying to level the playing field, as both you and the Ranking Member Voinovich referred to, particularly with respect to steel.

Most of that comes home to roost in the International Trade Administration. Our friends at USTR are the lead negotiators. Generally, a lot of the compliance work and a lot of the analytical work comes to ITA, and certainly enforcement of our trade laws is squarely within the province of the International Trade Administration.

My point simply is, Mr. Chairman, that I work with a group of people that are dedicated to serving America's interest and are doing their best. We have made what I think are significant efforts to try to cope with the resource issues at the International Trade Administration, and I want to divide my comments two ways.

The first thing is, and this really started in the last administration, as well, there was a real effort at the time of the passage of Permanent Normal Trade Relations with China to ramp up the ability of the Commerce Department to deal not only with trade agreements, but also to deal with the potential enforcement issues we face under our own trade remedy laws. That started the ball rolling. We are benefitting from that now.

At this juncture, we have, in fact, virtually all of the personnel that were authorized in fiscal year 2001. The fiscal year 2003 budget has again asked for an increase in these areas, recognizing that the President has introduced a very aggressive trade agenda. That starts with trade promotion authority and the ability to negotiate new trade agreements. We are going to be in a position, hopefully, to conclude within the next 3 years a new multilateral round of trade negotiations within the framework of the WTO as well as the long-awaited Free Trade Agreement of the Americas. That will certainly raise the onus on the International Trade Administration to step up to the plate.

Now, both of you have had the opportunity to talk with Secretary Evans. Both he and the President believe that promises made are promises that have to be kept, and accountability on compliance definitely starts with the President and the Secretary. What they have asked us to do is make sure that not only are we instituting the sorts of administrative and management measures that will help us ensure compliance, but that we are trying to solve problems, and here I want to come to the point about steel.

Unfortunately, as you suggested, Mr. Chairman, too often in the past, I think the principal means of addressing steel was simply through the antidumping and countervailing duty laws, and we had fallen into the habit of what I would view as simply prosecuting the cases. What the President and Secretary Evans asked us to do was actually try and solve the underlying problems.

Again, that raises the ante in terms of what the folks in ITA have to do, particularly in Import Administration in this instance. But it is essential to renewing the bargain on trade with the American public. Both the President and the Secretary understand unless we show up every day with compliance on our mind, with leveling the playing field on our mind, we are not going to have the support of the American public for trade promotion authority which is before the Senate or for the trade liberalizing agenda that is important to our economic future.

Beyond that, I am happy to respond to any questions you have, Mr. Chairman and Senator Voinovich, and certainly pleased to be here. I do welcome the opportunity and certainly welcome the interest in ITA's functions. Thank you.

Senator DURBIN. Thanks a lot. Mr. McConnell.

**TESTIMONY OF JAMES M. McCONNELL,¹ EXECUTIVE
DIRECTOR, U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. McCONNELL. Thank you, Chairman Durbin and Senator Voinovich. I appreciate the opportunity to testify before you today on behalf of the Securities and Exchange Commission to discuss critical resource and staffing issues that the Commission faces in its oversight of our financial markets. At the outset, I want to thank this Subcommittee and its staff for the tremendous support it has given the Commission.

The events of September 11, the bankruptcy of Enron, and the indictment of Arthur Andersen have all tested the strength and spirit of our economy, our capital markets, and, indeed, our country. In light of these events and explosive industry growth, the Commission must have the resources it needs to fulfill its multiple missions and maintain the public's confidence in our capital markets.

The Commission currently oversees an estimated 8,000 brokerage firms employing nearly 700,000 brokers; 7,500 investment advisors with approximately \$20 trillion in assets under management; 34,000 investment company portfolios; and over 17,000 reporting companies. The Commission also has oversight responsibilities for 9 registered securities exchanges, the National Association of Securities Dealers, the National Futures Association, 13 registered clearing agencies, and the Municipal Securities Rule-making Board.

The Commission today faces some of the most complex and difficult issues it has ever considered. New technologies, new participants, and new financial products are reshaping our markets. Our markets also are becoming increasingly global and they are taking steps to shed their long-held membership status and are moving to becoming publicly held entities.

¹The prepared statement of Mr. McConnell appears in the Appendix on page 69.

We are a Nation of investors. In 1980, only 5.7 percent of Americans owned mutual funds. Today, some 93 million shareholders representing 52 percent of U.S. households hold mutual funds. Our Nation's investors have an unprecedented stake in our markets. Whether through college savings plans or retirement accounts, our collective stake in U.S. markets continues to grow and we are increasingly dependent on those markets. It is now more important than ever that the SEC remain vigilant in policing and maintaining the integrity and transparency of the securities markets.

Unfortunately, at the very time the challenges facing the Commission have grown, the Commission has been subject to extremely high attrition. Perhaps the single largest barrier to the Commission's effective recruitment and retention efforts was eliminated with the recent enactment of pay parity. This critical legislation does not mean, nor should it, that SEC employees will be paid at the level of the private sector. It does, however, redress the obvious disparity that previously existed between SEC employees and employees of the Federal bank regulatory agencies. Pay parity, when fully funded on a permanent basis, will help the Commission retain its talented and experienced staff.

The legislation had the added benefit of establishing a stable, long-term funding source for the Commission, even after the meaningful fee relief it provided. In fiscal year 2003, the Commission will collect approximately \$1.3 billion in securities-related fees. After fully funding pay parity and the additional positions we have requested for fiscal year 2003, the Commission will still collect over \$750 million more than our budget.

The Subcommittee has raised the issue of whether or not our government has adequate staff to monitor publicly traded companies. I commend the Subcommittee for tackling such a critical issue. In fact, the Commission itself is engaged in a comprehensive review of the SEC's resource needs and operations. When Chairman Pitt came to the SEC last fall, he expressed his intention to perform an in-depth review of the Commission's operations, effectiveness, and resource needs in time for the fiscal year 2003 budget process. The extraordinary events of the past 8 months, including the destruction of our Northeast Regional Office, made any contemplative review of our resource needs impossible until recently.

Last month, Chairman Pitt announced the commencement of the special study he committed to with the results to be part of the fiscal year 2004 budget process. The study is also a direct result of the findings of the General Accounting Office as set forth in two of its recent reports on certain aspects of the SEC's operations.

For more than a decade, the Commission's human capital agenda has been dominated by compensation issues, including aggressive use of the authorities available under Title V. Pay parity, the GAO reports, our internal special study, and these hearings will move us to a more comprehensive approach to the human capital issues that are this Subcommittee's topic of concern.

Thank you for this opportunity and I ask that my formal testimony be included in the record. I will be pleased to answer any questions.

Senator DURBIN. Thanks, Mr. McConnell. Mr. Blansitt.

**TESTIMONY OF EDWARD L. BLANSITT,¹ DEPUTY INSPECTOR
GENERAL, U.S. DEPARTMENT OF COMMERCE**

Mr. BLANSITT. Thank you, Mr. Chairman and Senator Voinovich. I appreciate the opportunity to appear before you to discuss the Department of Commerce Office of Inspector General's work related to the Department's International Trade Administration.

As part of a comprehensive planning process performed during the summer of 2001, the Office of Inspector General sought to identify those areas and activities of the Department of Commerce that we believe are most in need of our attention. As we reported in our September 2001 "Semiannual Report to the Congress," we identified the need to increase international compliance with trade agreements and expand market access for American exporters as one of the top 10 management challenges facing the Department of Commerce. We made this determination based on the fact that trade compliance was, among other factors, a critical component of the Nation's overall trade agenda and a priority of the Secretary.

In March 2002, we issued our initial report dealing with the International Trade Administration's trade compliance efforts. Within ITA, compliance is handled by three units, Market Access and Compliance, Trade Development, and the U.S. and Foreign Commercial Service.

The Commerce Department reorganized its international economic policy and market access staff in July 1996 to give greater focus to market access and trade compliance issues and at that time created the Market Access and Compliance Unit within ITA that houses the Trade Compliance Center. Our review focused on the activities of the center in an effort to determine whether its management of the trade agreement compliance process was efficient, effective, and responsive to client needs.

The Trade Compliance Center is the Department's focal point for trade compliance, provides information about trade agreements, and helps U.S. businesses understand their rights and gain market opportunities. The center's budget and staffing levels remained relatively constant from the date of its creation in fiscal year 1996 until fiscal year 2001. In fiscal year 2001, ITA received a \$12.8 million increase to fund a compliance initiative for Market Access and Compliance and Import Administration.

We conducted our review of the Trade Compliance Center just as it was expanding and found that the trade agreement and compliance work needed to be better coordinated within ITA and that collaboration between ITA's operating units should improve.

We recommended a number of actions that ITA management should take to address these problems, including development of guidance that clearly delineates the role of the Trade Compliance Center. After we completed our field work, the center developed and distributed a trade compliance manual to all ITA staff. That manual explains how the compliance program works and outlined the roles of the various ITA components, but it should be strengthened to provide more definitive guidance to staff in determining when to coordinate with the center.

¹The prepared statement of Mr. Blansitt appears in the Appendix on page 80.

Our review also identified the need for a central ITA-wide database of trade compliance work. ITA management has advised us that it moved to a consolidated database of compliance and market access cases in February 2002 and that the monthly compliance reports to the Secretary received clearance from all four of its operating units. However, because the consolidated database did not address all of our concerns, we have asked ITA to look at further consolidation of its database.

Our report also examined performance measures proposed by ITA for assessing the effectiveness of its trade compliance activities and noted that although some adjustments are still needed, the compliance complaint process has improved since the Trade Compliance Center began handling such matters in 1997. The staff's knowledge and experience have grown and the results achieved by the compliance teams have enhanced ITA's effort to increase access to foreign markets in compliance with trade agreements.

Because of the importance of trade compliance and market access to the success of U.S. exporters, we as an office intend that our recently completed report be only the first in a series of reviews to be conducted in this area.

This concludes my prepared statement, Mr. Chairman, and I will be happy to answer any questions.

Senator DURBIN. Thanks, Mr. Blansitt.

Mr. McConnell, I was born in the town of East St. Louis, Illinois. It was a great place to grow up in, but it is a town that has had more than its share of problems. One of the national news stories that came out about 10 or 15 years ago was that the police department in East St. Louis had reached the point where all of the police cars had broken down. None of them were on the street. Incidentally, someone ended up suing the city and ended up with the deed to city hall. So things were not going well in my old hometown.

But, as I reflected on this hearing, I recalled the sad situation of a police department in a little town in downstate Illinois when you could not even put cars on the street, and the challenges that you face now at the SEC. Certainly, you have not reached that level, but—

Mr. McCONNELL. Thank you. [Laughter.]

Senator DURBIN. You have given us clear warning signs here about what is happening at your agency. If we had this hearing and Enron had never occurred, it would be worrisome. But after Enron occurred and we saw the damage done, not just to the employees, the pensioners, and the investors in that company, but to the overall economy and our confidence in our economy, as I read and listen to your testimony, it is a wake-up call.

For example, let us talk about the attrition rate that you face now at the SEC. Clearly, you are losing good people to better paying jobs. Can you give me some kind of idea of what you are up against, what you are competing with in terms of the skills of good people, what they can be paid at the SEC and what they make in the private sector?

Mr. McCONNELL. Yes, I can. We need to hire, to conduct our mission, highly skilled attorneys, accountants, and examiners that, ideally, and we seek out most frequently people with experience in

the industry. That industry routinely pays multiples of the salaries that are associated with government service.

Senator DURBIN. Give me an idea. You have got a bright young lawyer coming out of law school. You want that lawyer on the SEC staff. What do you typically offer to pay that lawyer?

Mr. McCONNELL. That bright young lawyer is a little bit easier to deal with. We pay them typically the GS-11, high steps, which is \$50,000, \$60,000—something like that. That bright young lawyer could perhaps make at a firm twice that, right out of school. But that lawyer still wants to come to the SEC for a period of time. It is like graduate school.

Senator DURBIN. Sure.

Mr. McCONNELL. So we still can attract those people. They do not stay. We used to try and hope that they stayed 3 years. It has gotten to the point where it is down to 2 years or less. Our cases can routinely take longer than that. A financial fraud case is enormously complex, time consuming, and can take a lot of time, and we might have multiple people working on the same case over time. It is very inefficient.

Senator DURBIN. How about accountants?

Mr. McCONNELL. Accountants, typically, we will only hire seasoned accountants that have been in the industry, have actually been in the public accounting profession for some time. We have just found that bringing in entry-level accountants has not worked well for us, so we try to bring them in at the higher levels and that is very difficult.

Senator DURBIN. What do you offer the typical accountant with some experience?

Mr. McCONNELL. Typically, we offer a GS-14 salary, \$70,000, \$80,000 range.

Senator DURBIN. Is that competitive with the private sector?

Mr. McCONNELL. It is not competitive. We have probably had more difficulty hiring accountants than any other single segment of our workforce. In the accounting profession, certainly you can add to your resume by coming to the SEC if you are in public accounting. It is not the same sort of experience that you get if you are a young attorney and learning the securities laws at the SEC.

Senator DURBIN. What is the turnover on accountants? You talked about the young attorneys staying around for 2 years or less. What about accountants?

Mr. McCONNELL. Accountants, we have had similar turnover problems. It has been double the governmentwide average. We have had in the past accountants, 10 or 12 percent turnover. Right now, we are actually experiencing, and this is maybe not part of your question, but we are experiencing a pretty good situation right now. The combination of pay parity having passed, behavior has changed somewhat, and in the market conditions. We are able to attract and retain people a little bit better right now. I say that, one extent, because this is a very good opportunity for us to take care of a lot of the problems that we have had in recent years with respect to bringing in the best people to regulate the securities markets.

Senator DURBIN. Do you use student loan forgiveness as an incentive for retention or recruiting?

Mr. McCONNELL. We have not employed that to date.

Senator DURBIN. I might just add, parenthetically, that I believe in that, but I have come to realize since we have applied it to the U.S. Senate agencies that it is a difficult thing to set up standards for. It makes sense, but who receives it and who does not can be an issue.

Mr. McCONNELL. Right.

Senator DURBIN. What does that say about morale at the agency? As we are in our first year now on some of these Senate agencies, the managers of these different agencies are addressing it in many different ways, and at the end of the year, we are going to take a look at it and see if it has had any value to us.

Mr. McCONNELL. You are absolutely right. We encounter that same experience in dealing with a lot of the Title V authorities, the recruitment bonuses, retention allowances, relocation costs. We are aggressive users of those authorities now, but they have a cost. The people who do not receive it are not very happy, and I do not blame them necessarily, but you just cannot give it to everybody. You have to make very tough choices and you have to use criteria that people understand are fair and that is not an easy thing to do.

Senator DURBIN. I would just conclude, and certainly there are a lot of questions that could be asked here, but when we think about what we now expect of your agency after Enron, you are our last chance, the last hope for the average investor that there is going to be an honest cop on the beat who is going to take a look at all those filings and blow the whistle if some company is up to the tricks of Enron or something else that endangers the corporation as well as its investors and pensioners. And yet, as much as we are counting on you as cops on the beat, we are not giving you the squad cars that you need to cover the territory, just using that analogy.

Mr. Aldonas, I guess the same thing could be said when it comes to the trade agreements. I am a person who votes for trade agreements. I believe in them. But Senator Voinovich and I were standing at the same rallies and at the same meetings bemoaning what happened to the steel industry here. When we believe several countries turned on the United States, dumping their product, we voted for trade agreements saying, well, if that ever happens, we are going to come roaring back at you. There is a law here, and you have to follow it.

Well, if you look what happened over the course of several years, the law was not followed very carefully or closely and the losers turned out to be a lot of steel companies and a lot of steelworkers and a lot of local economies that were devastated by it. You are seeing a dramatic increase in trade agreements and questions being raised.

I notice this morning's BNA reports that the WTO has seen a huge jump in the number of new dumping investigations in the second half of 2001. From July 1 to December 31, over 180 cases were initiated by WTO members. The United States was only second behind India. We filed 35 cases, mostly against China, South Africa, Brazil, Japan, and Venezuela. It is no surprise that, with the exclusion of South Africa, these other countries were all major steel producers, incidentally.

Mr. ALDONAS. Right.

Senator DURBIN. Of the 180 cases filed, China seems to be the most targeted, with 25 complaints filed against it. Now, I voted for the Permanent Normal Trade Relations with China. I believe there is a great opportunity here. But clearly, we are going to have to prove our mettle here in dealing with China that we are going to stand for fair trade and fight for it. Do you have the troops to engage in that fight?

Mr. ALDONAS. Yes, I think we do. Let me divide it into two sides, Mr. Chairman. One, on the market access side, we have doubled the size of the China office and we have improved the scope of the activities in-country, as well. We are going to pay an awful lot of attention to it. One of the things the Secretary has asked me to do is ensure that both our export promotion and our compliance activities focus on those areas where we have opened up new markets so that we are not losing in the implementation what we have tried to gain at the negotiating table.

That is why over the course of the last 3 weeks I spent a lot of time in China, starting with Beijing, Shanghai, Guangzhou, Shenzhen, and Hong Kong, really preaching the message of WTO implementation. I took a Congressional staff delegation with me to underscore the oversight responsibilities of Congress and that there was no daylight between Congress and the executive on this. Secretary Evans is there repeating that message at a much higher level, meeting with the leadership of China to underscore for them that this is, without a doubt, how Congress is going to measure our trade relationship with China.

Senator DURBIN. But do you have the resources to make that promise stick, to say to the Chinese, we are ready to go toe-to-toe when we feel that American companies and workers are the losers? Do you have the men and women you need to make that work?

Mr. ALDONAS. I believe, particularly with the request we have made for fiscal year 2003, that we will get there. With the compliance initiative that started in 2001, I think we are staffed up to start to grapple with these issues. But we recognize that we are going to need more in light of the ongoing negotiations and then still maintain a focus on China. That is why we have asked for more both in market access and compliance as well as Import Administration.

Mr. Chairman, if you do not mind, I want to come back to the second part of this, which is not just the challenge of securing market access in China but ensuring that we are also grappling with those instances when China and other countries undermine the international trading system by dumping their products in the U.S. market, and as far as I am concerned, exporting their unemployment here to the devastation of an awful lot of steel companies as well as a lot of other companies in the United States.

On that front, again, we have had a fairly significant increase in the amount of personnel. The real issue in Import Administration, more often than not, is retention. We have problems with our retention rate there that parallel what you see at the SEC or a number of the other agencies. They are very high.

Part of that is the nature of the work, which is very difficult. It is challenging. You spend a lot of time away from home. There is

also the fact that once you have learned the skills inside Import Administration, there is a real attraction in the private sector to go out and join a law firm or work as a paralegal and you can earn an awful lot more than you can at the Commerce Department. So there are issues that we have to grapple with on the retention side.

But at this moment, I think we are fairly well staffed up. And, in fact, as a result of the steel decision, what we did was accelerate the hiring process in Import Administration because they are now doing double duty. We are not only handling the regular workload in terms of the countervailing duty and antidumping actions, we are actually handling the implementation of the Section 201 action, as well.

So we have tried to accelerate all that and I feel comfortable we are up to staff now. I think time will tell over the course of this year whether we can sustain that. I look forward to the support for the fiscal year 2003 initiative to make sure that we do keep topping up here and are capable of grappling with the issues in front of us.

Senator DURBIN. Thank you. My time has expired, but I want to ask Mr. Yager, just in conclusion to this round of questions, you have heard these responses from Mr. McConnell and Mr. Aldonas about the challenges they face in their staffing. Is this what the GAO also concluded from your study?

Mr. YAGER. Yes, Mr. Chairman. We looked back, and I think particularly with the International Trade Administration, there were a couple of initiatives in the year 2001 which do seem to be exactly targeted at the kind of expertise that you would need. I think there was one, the overseas compliance program, where they added a significant number of staff. And in addition to that, there was the import surge monitoring group that was plussed up in 2001. I am not sure whether they did anticipate the kind of demand for those personnel, but certainly that would pay off at this point with the kind of safeguard actions and things like that that are now underway.

With regard to the SEC, I would have to say Mr. Hillman is responsible for that area.

Senator DURBIN. Mr. Hillman.

Mr. HILLMAN. And at the SEC, there continue to be serious turnover problems, although Mr. McConnell says things are getting better as the economy gets better. At the time of our study, there were 250 vacant positions at the SEC, or about 8.5 percent of their staff resources. That is a serious shortfall that needs to be corrected. They need to also explore innovative ways to attract senior level staff and bring in information technology expertise to better position itself to oversee the evolving securities markets. Each of these areas, I believe that the SEC is challenged and SEC is attempting to meet that challenge.

Senator DURBIN. It would seem to me, though, that the luck or good experience at the governmental level is countercyclical, that if we are dealing with a recession, if we have a business downturn, there are going to be more lawyers, and accountants, and skilled people available to consider public service, working for the government. Now, as the economy turns around, there is more business activity, there is more need for the SEC to be watching more closely. These same people are going to be lured away because the new companies and new business opportunities pay them a lot more.

That seems to put us in a terrible bind in terms of maintaining continuity here.

Senator VOINOVICH.

Senator VOINOVICH. I think that I agree with what you just said. I am glad to know that you are concentrating on China because I have been meeting on an ongoing basis with businesses in Ohio and the biggest complaint I am hearing now is from China. So the very people that were for Normal Trade Relations with China are the ones that are most bitterly complaining about it.

I really think that it is important that you notify the citizens of this country of your actions so that people know that something is happening in this area. Because I sense growing frustration with my constituency in Ohio. For instance, I met a gentleman in the foundry business, who produces a casting for \$3,000 in O'Leary, Ohio. Now, that same casting is being imported from China at \$1,500. This gentleman has been in business for about 35 years and he is panicked, and I sympathize with him because this is his whole business. I asked him to get back to me with some specific examples, stating how other Ohio businesses have similar experiences which I will share with you because I think it is important for you to know the issues that hard working American businesses are faced with.

Mr. ALDONAS. I would appreciate it if you would.

Senator VOINOVICH. There is a lot of anecdotal evidence out there. However, I would like to get at the real things that make a difference.

I am asking all of our witnesses to explore our options to improve the system to deliver better results. I have introduced legislation and the administration has legislation to try and deal with some of the problems that your agencies experience. I am interested in knowing what additional tools you need to get the job done. David Walker has said that if agencies used the incentive package properly that most of our problems could be taken care of. Agencies must use the incentives that are actually available, and in order to do so, they must devise a strategic workforce plan stating when the flexibilities should be used.

Which leads to my first question, do you feel that your respective agencies have the budget to get the job done? And then the next thing, it would be what other additional tools would you need in order to accomplish your missing, and I would also like you to comment on the retention issues facing your agency.

I am interested in learning how agencies can overcome the retention problems especially since employees often leave the Federal Government after 4 or 5 years for more lucrative positions in the private sector.

In your testimony Mr. McConnell, you stated that 52 percent of the American public invests in the market today, and after Enron, a lot of them are skeptical about it. So I would just like to have you all comment on your agencies budget and the use of human resource tools needed to help accomplish your agency's mission.

Mr. ALDONAS. If I could start, Senator Voinovich, in terms of the tools that are needed, one thing I think would be helpful is to follow closely the implementation of the President's management agenda, in part because it really does focus on the human capital

concerns that are foremost in the minds of both the Chairman and Senator Voinovich. What we are doing in response to the President's directive is trying to identify the issues within the agency that would allow us to focus our resources on the hottest issues.

I think for a long time, it is fair to say that at least in ITA, we have not really traced whether or not our resources are dedicated to the growing sectors of the economy and the hottest issues of time and what we have put together as a restructuring plan that we submitted to OMB really does reflect that. But I think it is going to require interest and oversight from Congress to ensure that these changes get made over time as a practical matter and I would invite your help with our authorizing Subcommittee as well as the appropriators to ensure that they understand the importance of what we are trying to achieve, to get the resources to the right place within our own framework at the Department of Commerce.

Mr. YAGER. Senator Voinovich, I think that I would like to add a little bit to that. There are also additional improvements that can be made within the context of the current flexibilities and I think that there has been a guide that was just produced by GAO in March, a model of strategic human capital management, and there are a number of critical success factors listed in that guide which would provide guidance to Commerce as well as USTR and the Department of Agriculture's group that handles international issues.

So, for example, things like investments in people, data-driven human capital approaches, integration and alignment, I think a lot of those critical success factors, we could use those and take a look at these agencies and they could make some progress with the current flexibilities.

I think they are moving in the right direction from the levels at which they originally were, where they did not understand and did not fully take advantage of the human capital function. They are moving the right way, but there is more that they can do in these critical success factors. Whether it is the GAO report or whether it is OPM's or others, there is a lot of information out there that could help them.

Senator VOINOVICH. When the budgets are presented and the Office of Management and Budget submits them, are you aware of any earmarking that would specify funding for human resource incentives to help the agencies deal with the human capital crisis? From what I understand, a lot of this is just kind of hidden. It is a line item and you have no idea what it is going to be used for. It seems to me that if you came up with a different format that tracked where the money was being spent, that it might give the Members of Congress a better understanding of how important this is.

Mr. ALDONAS. That is a good point. I know even from my perspective internally, looking at the roll-up of the numbers, it never, in my mind, accurately reflects what we are trying to do with the money. So I imagine from the consumer's point of view here in Congress, it is that much more difficult.

For example, we put the priority on our people in this first budget at the Commerce Department under Secretary Evans and asked for another \$1.2 million in training to address some of the reten-

tion issues that we faced. I know what the money is for. I am not sure that the roll-up actually reflects that is the goal that we are trying to achieve, and so I like the idea of trying to provide greater focus because it would give, I think, the folks who have to make the decision up here a better sense of how we plan to spend the money and whether it is really addressing the issues that we are facing down at the Commerce Department.

Senator VOINOVICH. One of the things that I observe around here is that there really is not anybody that is lobbying for human capital. If there is a program that brings money into a community then it is easy to lobby for the funding. It is hardware. You have got the manufacturers that are lobbying very hard to buy the goods, Congressmen, Senators wanting it because it provides jobs. However, no one really lobbies for the people doing the work. It seems to me that agencies have to make the human capital case themselves. It is important and agencies have to let us know how Congress can help.

Mr. McConnell, there is a lot of speculation that had SEC had the right number of people, that Enron might not have occurred. What is your reaction to that statement?

Mr. McCONNELL. Well, we have tried to deal with that by—we do not really know. I mean, had we had more people, had we been doing our job differently, it is possible that we would have caught an Enron. But I am not saying that just by adding more people we could have precluded that or that there is not another Enron out there.

We need to examine very closely how our disclosure system is working and that is what we are doing as part of our special study. Do we have the right people? Are we looking at the right things? Is the disclosure we are receiving from companies the right sort of disclosures that would help us with Enrons? The answers to those questions will help us then focus our resource needs, our resources requests, on doing just exactly that, trying to make sure that we are doing the best we can to preclude that from happening in the future.

Senator VOINOVICH. I am interested in your opinion on how we can entice employees to stay in the government. Should we look at the pay schedule for the Senior Executive Service? One of the things that we have observed is that 70 to 75 percent of the people in the Senior Executive Service get the same pay.

There is a lot of discussion centering on recruitment and retention incentives but should we also be exploring pay comparability and SES pay compression also? How important, in your opinion, is it for us to deal with certain human resource incentives in addition to pay comparability and pay compression?

Sometimes, there is a tendency to support a flower-of-the-month proposal, but it seems to me, that if you do not have a competitive pay schedule and you do not deal with the compression problem, then you can not effectively deal with the other issues either. Except perhaps to say that people in mission critical positions are going to get a higher salary. However, this often leaves a feeling of inequality throughout the organization. Can you comment on that?

Mr. MCCONNELL. I think there is no doubt that both compression and the failure of the Federal Government to keep up with the private sector have caused us serious problems with recruitment and retention. The SEC is perhaps in an enviable position right now of being able to implement a whole new pay system. While it is not going to be quite private sector-like, we will have substantial increases. We will be able to stretch out the pay scale to a much higher level—we will not be facing the same cap that current Federal employees face. Our cap will be in the \$200,000 range because it will be capped at the Vice President's salary.

So we will be able to put together a system that might, in fact, form some sort of a test of what could be done within the Federal Government. We are doing this under Title V. We are working closely with OPM. They are actually being quite helpful and are quite eager to see what we are doing, to see what sorts of things we come up with will be useful going forward for a problem that everybody recognizes is a very serious one.

Senator VOINOVICH. It is interesting, you mentioned that, even with the new pay schedule, the SEC will collect \$700 million more than what the fees are. So the \$700 million is going to go into the general fund, is that right?

Mr. MCCONNELL. Well, the \$700 million actually is available to offset other appropriations. That total amount of \$1.3 billion that we will collect next fiscal year is available to our Appropriations Committees as an offset. So it is used during that fiscal year for whatever other Commerce-Justice-State activities they choose.

Senator VOINOVICH. But the point is that fees collected by the SEC, also subsidize a portion of the other part of the agency's budget.

Mr. MCCONNELL. Yes, sir, that is correct.

Senator VOINOVICH. And your customers could say, we are giving you all this money and you say you cannot get the job done, but you are not spending all the money we are giving you. You are giving it to somebody else. Why are you not spending all that money to do the work you are supposed to be doing?

Mr. MCCONNELL. They have made that note to us, actually. [Laughter.]

Senator VOINOVICH. I think it is something we ought to be looking at.

Mr. ALDONAS. Senator Voinovich, if I could just add, it is more of a personal reflection. I spent a good share of my time when I was in private practice as the hiring partner at a major law firm here in Washington, DC, and I was a bidder for services that both Mr. McConnell and I now buy at the SEC and the Commerce Department. We liked to talk a lot in our firm about the quality of life and a variety of other things, but you know, at the end of the day, when you are trying to attract that top graduate out of law school or a seasoned accountant or even paralegals and clerical staff, it boils down to the money.

I think we do need to take a hard look at pay scales because you are trying to not only attract people and retain them, there is a lot of value from public service that people derive. There is a real attraction to working at the Commerce Department in the International Trade Administration because of the experience that they

get and because of the nature of the work and the sense that you are wearing a white hat, frankly, because you are working for the U.S. Government on issues that are important to our economy. But that does not compensate for everything.

Senator VOINOVICH. Thank you.

Senator DURBIN. Thank you, Senator Voinovich.

I have a question or two to ask and then I am going to ask my colleague here if I can turn over the gavel to him because I have to run downstairs for a meeting and I will try to return for the second panel, too. But let me just try to address a couple points, if I can, before I leave here.

Mr. Aldonas, one of the things that the GAO told us was that they had learned in your agency from people working there that you may have to shift resources away from trade compliance to meet the increased workload in conducting negotiations. Let me tell you why that troubles me and why it is topical in the Senate.

We are being asked to give the President trade promotion authority to enter into new trade agreements. I have been reluctant to do that in the past because I think Congress has an important role to play here. But let us assume for a minute that it is going to pass and discuss what it means. We are now reaching the point where we are moving forward, or can move forward if this passes, at a faster pace to negotiate more trade agreements around the world. Many of us believe that expanded trade of the right circumstances is good for the United States and for the other country, as well.

But if what we are hearing from you and the GAO is that as we are putting more time and resources into negotiations and more trade agreements, we are taking resources away from trade compliance, then the conclusion that I reach is we ought to slow down our pace, because if we cannot enforce the law, in other words, pass treaties that protect American businesses and workers, why in the world are we in such a headlong race to increase the number of trading opportunities for countries who can come into the United States unfettered by any legal requirements because we do not have any cops on the beat?

Mr. ALDONAS. Mr. Chairman, actually, we agree with you. That is why, in taking a look at our staffing, we felt it was going to be inadequate based on the structure we had when the Bush Administration came into office, and that is why as a part of the first budget request we could make, fiscal year 2003, we did ask for an additional 33 people in market access and compliance and an additional 40 in Import Administration, precisely because we knew we were going into a fairly aggressive year of trade negotiations, both in the WTO and the FTAA.

What is not commonly understood is that while USTR leads the negotiations, frequently on issues that are peculiarly within our province, like things like antidumping, countervailing duties and safeguards, the Commerce Department is the lead negotiator, and as a consequence, we felt we had to get staffed up quickly, not only to deal with the WTO but the FTAA and the possibility of other bilateral agreements.

But I agree with you fundamentally. We cannot be in a position where we are shifting resources away from compliance to engage

in further negotiations. Those compliance jobs are part of the infrastructure of what makes the system run and keeps the playing field level.

Senator DURBIN. So if we are making a commitment to a trade agreement, we have to say to the American people, the workers and the businesses, we are also making a commitment to putting people in place to enforce it.

Mr. ALDONAS. Absolutely. Fundamentally, you cannot keep a bargain with the American public about trade if you are not doing that, as far as I am concerned.

Senator DURBIN. Mr. McConnell, let me ask you about a similar situation. We are being asked now to consider what we are going to do to avoid future Enrons and some people have said, well, strengthen the law, which basically means strengthen your agency so it can apply the law and enforce it with the Department of Justice.

But there are others who say government is never going to keep up with the growth of business and the complexity of business for a lot of the reasons we have talked about. Maybe we ought to look to that other safeguard, the courts. As long as we have an opportunity for securities litigation, if these companies know that they could face civil penalties for their wrongdoing, that is going to be a greater disincentive than whether or not from year to year SEC has an appropriate workforce. What is your reaction to that?

Mr. MCCONNELL. The regulatory scheme that we employ does rely upon enforcement as a very strong tool to ensure compliance with our other oversight responsibilities. So we have that working hand-in-hand now and it needs to continue and be strengthened, even, as we go forward.

I certainly have watched this as it has developed and I happen to believe that—maybe this betrays my background, too—that the courts play an important role in this, too, as an effort to try to stop the excesses of those who abuse the law.

Senator DURBIN. Can I ask one very parochial question of you, Mr. Aldonas, and I think that perhaps Senator Voinovich might be interested in the answer, too. Exactly how many exclusions to the Section 201 remedy relative to steel that the President announced are now pending before this administration?

Mr. ALDONAS. Over 1,000.

Senator DURBIN. And how many have been granted?

Mr. ALDONAS. That, I have been away for 3 weeks and I have not actually been able to follow that, so I cannot give you an answer, but I would be happy to get back to you on that, Mr. Chairman.

Senator DURBIN. Of course, many of us thought the President was moving in the right direction with his Section 201 and his response on steel, but the exclusions make us nervous, because if we are going to continue to exclude by the hundreds all sorts of steel products to come into the United States, the net positive impact on the American steel industry and its workers is not going to be there.

Mr. ALDONAS. Understood, and what I want to assure you is the basic rule that is being applied is whether or not the specific exclusion request would undercut the remedy and the protection that we

are trying to offer, the breathing space that we are trying to offer the industry, and so generally what we are looking at under those circumstances is whether the product is actually made in the United States in any commercially available quantities. If it is not, and generally, the industry will agree with us that it is not, then we will go ahead and grant the exclusion request. Where we see that it is being made, our view is that it is going to be undercutting the remedy under those circumstances.

Senator DURBIN. Thank you very much. I am going to step away, and as further indication of bipartisanship trust between parties, I am going to turn over the gavel to my friend, Senator Voinovich, and I will be returning shortly.

Senator VOINOVICH [presiding]. Thanks very much. Is it true that there are currently 250 unfilled positions at the SEC?

Mr. MCCONNELL. Right now, we have done a better job of hiring up and we have lost significantly fewer people just in the last several months. So I will have to give you an update of that figure now, but it is less than that right now. But still, we have authority to fill positions that we are not able to fill, there is no doubt about that.

Senator VOINOVICH. How long does it take to hire a new employee at the SEC?

Mr. MCCONNELL. It depends. Attorneys, we can hire very quickly. We have delegated authority to do that and we do not have to go through all the normal—

Senator VOINOVICH. Can you waive the Title V provisions and bring people on?

Mr. MCCONNELL. We can waive those.

Senator VOINOVICH. Under what provision are you able to do that?

Mr. MCCONNELL. We were delegated that by OPM because we have a unique class of attorneys for which—that we need and are available in the marketplace and so they delegated the authority to us for that.

Senator VOINOVICH. That is from the Office of Personnel Management?

Mr. MCCONNELL. That is correct.

Senator VOINOVICH. Is this a new flexibility offered by Kay James's at the Office of Personnel Management?

Mr. MCCONNELL. No, that has been in existence for quite some time, for about 15 years, as far as I can recall. Now, accountants and other staff are much more difficult. We have to use traditional hiring mechanisms for those and they can take quite a bit of time.

With respect to something you mentioned earlier, we use the 3.5 GPA program, as well, and that is very quick. Getting young people right out of college, we can do that. If they have got the GPA, we can hire them quickly. But typically, it takes months. It takes months to hire accountants and economists, examiners.

Senator VOINOVICH. I would like you, if you would, to see if you can give me a couple of examples and get it back to me.

Mr. MCCONNELL. Certainly.

Senator VOINOVICH. Take a couple of people that are, I would say, the average person you employ and give me some idea of how long it takes and why does it take as long as it does.

Mr. McCONNELL. Absolutely.

Senator VOINOVICH. OK. Mr. Aldonas, how long does it take to hire a new ITA employee?

Mr. ALDONAS. Well, it varies——

Senator VOINOVICH. Does the agency utilize the rule of three where the best qualified are rated and ranked taking veterans performance into consideration?

Mr. ALDONAS. Generally, yes, and the way we approach recruiting varies a little bit by the different constituent parts of ITA. In some respects, the Import Administration serves as a basic intake mechanism because working on the dumping and countervailing duty cases gives people a fairly good grounding in what the international trade rules are and things of that nature. So what we try and do is keep the pipeline full with potential applicants so that we can try and ease the process as much as possible, but it still takes time.

When we have been going through this process to fill in behind the fiscal year 2001 request, for example, it has taken us until, I think, just at the tail end of last year, maybe even early this year, before we really got the numbers up to where I thought they should be. So we are at the staffing levels we need to be under the fiscal year 2001 request, but it really took that sort of 18-month period to get fully up to speed.

Senator VOINOVICH. And how many more employees will you bring on with the new budget?

Mr. ALDONAS. With the new budget, we will be looking at 33 full-time equivalents in market access and compliance and 40 in Import Administration, again, because Import Administration provides something of an intake mechanism. Oftentimes, young folks will join the Department, will come in through Import Administration and they will spend about 2 years there getting a grounding and then they will move into the other areas of trade development, the Foreign Commercial Service, or market access compliance.

Mr. YAGER. Senator Voinovich, if I could add——

Senator VOINOVICH. Yes?

Mr. YAGER. The USTR has had, I think, a more difficult time from our data collection with the hiring than ITA. It appears that they place a premium, as I said in my statement, on personnel with particular experiences in litigation or economists with significant experience rather than hiring at the entry level. So, for example, when they were trying to increase their staffing for the 2001 year, it took them nearly a year to get the staff on board that they were trying to get, and I think that was significantly more time than they had anticipated.

One thing I will mention also about USTR which is unique is they have a very significant program of detailees. They apparently at most times have about 30 to 40 detailees from other agencies in order to get the kind of expertise——

Mr. ALDONAS. That is part of our retention problem. [Laughter.]

Mr. YAGER. Well, they do, as a matter of fact. They take detailees from some of the other agencies and sometimes they do stay at USTR.

Senator VOINOVICH. Can you explain the concept of detailing employees to other Federal agencies?

Mr. YAGER. A detailee would be a person, an employee of another Federal agency who is working full-time at the U.S. Trade Representative's Office for 1 to 2 years, and oftentimes they are asked to do that because of specialized expertise they may have, for example, in food safety issues or in other—

Senator VOINOVICH. Are they in the budget of USTR, then, or—

Mr. YAGER. No. They would be on the originating agency's budget at that time.

Senator VOINOVICH. So they are still on the agency that is detailing them over to the U.S. Trade Representative?

Mr. YAGER. That is right.

Senator VOINOVICH. So it is difficult to capture the true operating cost of an agency with a lot of detailees.

Mr. YAGER. Right, but it has been very effective because USTR is a small agency and sometimes they need the staff for a limited amount of time. In other cases, it may be that they determine through the course of the detail that they do need someone on staff with that particular expertise. So in some ways, this is an innovative approach for an agency to get the expertise that they need and also have some flexibility with the use of those slots that they do have, the limited number of slots at USTR, which is only about 200.

Senator VOINOVICH. I am particularly interested in the impediments of hiring mid-level career employees from the private sector. As you know, one of the items in my legislation provides more vacation time to mid-career employees who are hired from the private sector. I know it sounds like a minor item, but I think it is a nice incentive. Do you agree?

Mr. YAGER. I can imagine that would be quite an irritant, particularly if you were coming in at mid-level, for example, to USTR, which is really quite a difficult agency in terms of the number of hours worked and the travel schedule and things like that. So you come in at a mid-level and you are asked immediately to take on significant responsibilities and working long hours while at the same time you are told that you get 4 hours of leave per pay period. I do not know that would be a major factor, but certainly that would be an irritant in trying to understand just how they value their employees.

And so I think the kind of changes that you have talked about, such as making leave more liberal, I think would certainly send the right signal to those kind of applicants that they recognize the value that they provide to the agency and they also recognize the kind of sacrifices that they are making when they take a job at USTR or in the Import Administration.

Senator VOINOVICH. We are working with David Walker on this legislation and I would like you to go back and talk to him a little bit about maybe just zeroing in on those bills that we have introduced to see if there is anything else that, from your experience, you think we might add that might make it more easy for the agencies, the three that deal with trade. I am sure that if they would be helpful there, they probably would be helpful for the SEC and in many other places.

Mr. YAGER. I will do that, Mr. Voinovich.

Senator VOINOVICH. Does anyone want to make any other comments before we go to the next panel?

[No response.]

Senator VOINOVICH. Thank you very much for coming here, and again, I would like you to go back to your respective shops and talk to Evans and see if there is a possibility that he is in the administration and maybe get the word to Mitch Daniels. In fact, I am going to try to mention it to Mitch, that somehow in the next budget they clarify where these dollars are going so that Congress can understand this is money that is going in to deal with the human capital crisis.

Mr. Blansitt, I would like to hear from you in about 3 months about how Mr. McConnell is doing on filling the hole.

Mr. BLANSITT. Actually we are responsible for Mr. Aldonas's programs.

Senator VOINOVICH. Oh, I am sorry—

Mr. ALDONAS. But we would be happy to have him look at Mr. McConnell for the next 3 months. [Laughter.]

Senator VOINOVICH. Well, you can do that, too. [Laughter.]

Mr. BLANSITT. But we will definitely get back to you in about 3 months.

Senator VOINOVICH. Thanks very much.

Our next two panelists, Lynn Turner is Professor of Accounting at the Center for Quality Financial Reporting at Colorado State University and former chief accountant at the Securities and Exchange Commission, and Ms. Troy Cribb is Trade Counsel at Steptoe and Johnson and former Assistant Secretary for International Trade, U.S. Department of Commerce.

You have heard the testimony and I would be interested in knowing, how do we keep some of the good people in the agencies, since both of you have left. [Laughter.]

If you would stand up, I would like to swear you in. Do you swear to give the testimony as the whole truth and nothing but the truth, so help you, God?

Ms. CRIBB. I do.

Mr. TURNER. I do.

Senator VOINOVICH. Let the record show that they answered in the affirmative.

Ms. Cribb, we will start with your testimony this morning.

TESTIMONY OF TROY CRIBB,¹ TRADE COUNSEL, STEPTOE AND JOHNSON, L.L.P.

Ms. CRIBB. Thank you, Senator Voinovich. It really is a pleasure for me to be here this morning to appear before your Subcommittee on a topic that I feel very strongly about. I have been following the fiscal and human capital needs of the Commerce Department since my days I spent up here as staff to the Senate Commerce Committee, and, of course, then while I was at the Department serving first in Trade Development and then as Assistant Secretary for the Import Administration, and now in the private sector practicing international trade law.

¹The prepared statement of Ms. Cribb appears in the Appendix on page 87.

I think much of what is in my statement mirrors what Under Secretary Aldonas was saying. I think it is important for the Subcommittee to hear that message from someone like me, who is now in the private sector, because I do not have to say these things. Of course, Grant does not really have to, either, but I feel very strongly, even though it is a Republican administration that has taken over now and I was very sad to have to walk out the door when I had to leave the Commerce Department, I cannot think of anyone I would rather have in there than Grant Aldonas. He is really doing just a fantastic job.

One of the pleasures about working at the Commerce Department was that the mission of ITA is truly bipartisan. Now that I am on the other side, I do want to do my part to help make sure that remains the case.

I do want to second what the Under Secretary was saying about the extraordinary staff at ITA. It is a very talented, hard working group of people and I think that the business community has largely recognized that and has lent good support to the Department.

As you know, the array of trade issues these days is extraordinarily complex and growing day by day. Often, trade issues get into very complicated issues involving, for example, health or safety standards or transportation or telecommunications, and I think ITA really deserves credit for evolving over the years to develop the expertise to handle these new issues as they come along.

I also want to second Under Secretary Aldonas's comments about the really critical role that ITA plays in supporting USTR, from the negotiating stage to implementation to dispute settlement. ITA is really fundamental to what USTR does, and as you know, USTR is deliberately a small agency within the Executive Office of the President and it has to rely on other agencies to help fulfill its mission. Certainly, ITA every day is working hand-in-hand with USTR on a number of fronts. Of course, once the ink is dry on an agreement, it is ITA's primary responsibility to enforce those agreements.

Furthermore, I think that one role obviously very important for ITA is trying to help resolve these often difficult market access issues before they get into a lengthy and costly dispute settlement proceedings. As you know, these WTO cases can go on for a long, long time and that is also true under some of the other dispute settlement proceedings under other agreements. Furthermore, we have to be careful about overloading the WTO with a large number of disputes. So, certainly, a large part of what ITA does is to try to get in early, identify the problem, and work with the U.S. businesses and the foreign governments to see if we can reach a resolution of these before kicking off official disputes.

Furthermore, as I think Congress has fully recognized, ITA does a really terrific job of reaching out to smaller and medium-sized businesses and help them understand export opportunities. I ran into so many businesses during my years at Commerce who would not be in the business of exporting were it not for the help that they got from ITA, and so there really are a large number of success stories there and those are crucial to help maintain and further the support of the American people for new trade agreements.

With respect to the Import Administration, where I served, I think I carry an important message today because my firm represents both respondents and petitioners, and for both sides it is very important to have adequate staff and a very talented staff there to process the cases and then make sure that there is a fair outcome. I would be happy when we get to the question section to try to elaborate on some of the comments people have already made about trying to attract and maintain good staff.

Just a couple of other things I would throw out as suggestions, having served in the Department. I think that the Department benefits by having people rotate throughout the offices. Of course, you want to maintain industry expertise and country expertise, but I think especially with the younger staff that it benefits both the Department and the staff if they have exposure to different offices and different issues.

I also think that Congress could work with ITA on its recruiting effort to make sure that it is an ITA-wide recruiting effort. I think too often it has fallen to the different components to do their own recruiting.

And finally, any support that you could give to the Department for helping upgrade its technology would be greatly appreciated. Often, the offices work on different computer systems. With respect to the Import Administration, they need to move to the point where parties can do electronic filings, as a lot of the courts are doing now. I realize that is a costly issue, as well, but certainly one to which I would like to lend my support.

Thank you very much and I would be happy to answer any questions.

Senator VOINOVICH. Thank you. Mr. Turner.

**TESTIMONY OF LYNN TURNER,¹ PROFESSOR OF ACCOUNTING,
CENTER FOR QUALITY FINANCIAL REPORTING, COLORADO
STATE UNIVERSITY**

Mr. TURNER. Thank you, Senator Voinovich, for the opportunity to be here and address some of these serious issues regarding the human capital crisis.

I was listening to your questions to the first panel and it brought back some memories, not all fond. In fact, the particular question about how long it takes to hire someone brought back some real memories, and so I commend you and Chairman Durbin for holding these hearings on a very important issue. The human capital part of the government is very important today. A very important asset to the government walks out of the office every night.

Let me state that the SEC staff are some of the hardest working, most dedicated employees I have ever had the privilege to work with, including those that I worked with in private practice. However, as Enron and the growing trend in restated financial statements has demonstrated, one of the critical issues facing American investors is the lack of adequate resources for the SEC. As you heard earlier, resource shortages at the SEC have been highlighted by the recent study of the GAO. This problem has occurred at a time when U.S. capital markets have experienced explosive growth,

¹The prepared statement of Mr. Turner appears in the Appendix on page 89.

as highlighted in my testimony which I ask be included in the record.

In fact, the recent history of the SEC tells the story of an agency captured and held hostage by the chains of its budgetary constraints, budgetary constraints that take on more of a flavor of a back-door attempt to stop regulation and oversight by ceasing to fund the regulator in what I would consider to be an adequate fashion. But let me take you inside the agency and discuss the implication for investors of some of the restraints placed on the SEC, and as you noted, Senator, that is literally one out of every two adult Americans today.

Investors do need to be sure that the SEC is on the beat after the litany of financial fraud cases that have cost them approximately \$200 billion in recent years. Time and time again, I saw practical limitations placed on the staff's ability to conduct timely, effective investigations as a result of the staffing constraints. These limitations were the direct result of an insufficient number of staff to investigate the current financial fraud caseload, some 200 to 250 cases at the SEC.

Cases were understaffed and the staff faced insurmountable odds against some of the finest defense attorneys in the country. The defense was often able to outgun the SEC due to sufficiently more resources, including staff and experts. Adding 25 to 50 accountants to the accounting staff at the SEC Division of Enforcement is long overdue. It will help ensure investors and those who break the law receive timely justice.

The staffing needs of the Division of Corporation Finance has also been shortchanged. Total filings with the SEC in 2000 were over 98,000. That comes out to about 1,200 filings per accountant. At the same time, below-market wages have almost single-handedly increased the turnover levels of the staff well beyond those of other governmental agencies. That has left the Commission with the task of hiring and training less experienced, albeit dedicated, staff.

In order for the SEC to effectively review the filings it receives, there needs to be a 50 to 100 percent increase in the number of accounting staff in the Division of Corporation Finance. The staff need to be fairly compensated at market rates for the work they are performing rather than receiving wages well below what they can earn elsewhere.

Based on my experience as a CFO, an audit partner, and the chief accountant, I believe increasing the staffing levels will provide significant benefits to the markets and investors and these benefits will greatly outweigh the costs. We need to remember that the costs to investors and creditors in the case of Enron have been estimated as high as \$93 billion. The cost of adding these additional staff is but a drop in the bucket to that number.

Let me switch to my experience as chief accountant. In that office where I had the lead, we functioned much in the same role and capacity as the national office of the Big Five accounting firms in all respects but one. We had less than half of the staff. Those offices typically had 70, 75 people in them. We were working in the neighborhood of 20 to 25 staff much of the time. Amazingly, in light of Enron and a rise in the financial fraud restatements, the

original SEC budget estimate for 2000 stated an actual decrease in the staffing of that office.

But the SEC, and I think you have pointed this out, needs more than just people to allow it to do its job properly. It needs tools, such as updated information, personnel management systems that allow improved management of the agency, more effective utilization of personnel, greater information technology know-how, and a quicker deliver of the product to the investing public in companies they invest in. These needs must also include improved training.

In light of the various resource needs the SEC has to carry out its duties, its original budget estimate for 2003 falls considerably short of the target. The proposed budget represents a 6.6 percent increase over the appropriated funding for fiscal year 2002 and would actually reduce total budgeted positions from 2,716 to 2,670 positions. In light of the losses investors have suffered due to abuses and fraud in our capital markets, it is hard and perhaps impossible to reconcile the budget request with good, responsible government.

The House of Representatives marked up a bill last week that provides for little real reform. However, that legislation does, perhaps realizing its intended effect, greatly increase the budget of the SEC to \$776 million. I agree with the members of the House and support this increase and hope the Senate will, too. At this time of crisis in our capital markets, American investors and the employees and families of the SEC deserve no less.

Thank you, and I would be more than happy to answer any questions you have, as well.

Senator VOINOVICH. Thank you very much.

Ms. Cribb, how serious do you think the nations that we have trade agreements with take our Department of Commerce's efforts to enforce the trade laws? How much respect do we have from our partners around the world?

I am a free trader. As Governor of Ohio, we had wonderful experiences with the Foreign Commercial Service officers. They really helped our businesses and I made trade one of my four goals in terms of economic development for the State of Ohio.

But the impression that I received was that there was not a lot of respect for what we are doing. In fact, I believe that we need to have the right people with the right qualifications working in our trade agencies. We need to hire employees who will wake up early in the morning and go to bed late at night and stay energized about their jobs. This will help spread the word out across the world that we are serious about this, and if we do this, we might see a different approach.

To be candid, if I were out there, and knew what was going on, I would run against us every day I could, down the field as far as I could go, and get away with as much as I could because I would figure that the flag would not be thrown until I got pretty close to the goal line. That is my attitude from what I have picked up as I have traveled the world for 8 years on these trade missions. I would like your reaction.

Ms. CRIBB. I actually think that there is a great deal of respect around the world for both the Commerce Department and USTR. In fact, a lot of governments will send delegations from their gov-

ernment to come visit the Department and have the Department help teach them how to set up their own trade departments.

So I think you are right in that as a matter of negotiating posture with us, of course, a lot of other countries are going to try to push the limits of what they can do. But at the same time, I think that they largely look to our regulatory agencies as models for what they can do in their own countries.

Certainly the dumping laws, provide a perfect example. Of course, a lot of our trading partners have complaints about not only the way we administer the law, but the very existence of the law. Meanwhile, they are busy setting up their own departments at home and making active use of the laws, as was referenced before.

Senator VOINOVICH. In your opinion the Chinese, Taiwanese, South Koreans, Brazilians, and our European friends, respect the way we have established our trade agencies and that they come over here to learn from our lessons, but how serious do they take our efforts to enforce the trade laws?

Ms. CRIBB. I think this goes back to the comments made from the first panel that it is absolutely vital that we make sure that we have the staff to do compliance in addition to negotiations. As Senator Durbin was saying, you cannot just be racing ahead, constantly negotiating, without looking back and enforcing.

I think that, certainly over the last few years, that the Congress has given more money to ITA to help beef up staff and do those activities. The Compliance Center was set up several years ago to be the focal point within ITA for initiating these compliance activities.

I think that it is going to be a constant struggle and that there will be more resource needs within ITA to make sure that the staff levels are what they need to be.

Senator VOINOVICH. Excuse me for interrupting you, but one of the things we called for in our legislation, and I would like to send you a copy of it, maybe you could look at it—have you seen it yet at all?

Ms. CRIBB. I have not.

Senator VOINOVICH. I would like you to look at it, just from your experience.

Ms. CRIBB. Yes.

Senator VOINOVICH. When you were at the Department, do you really think that human capital was given the attention that it really deserved and needed?

Ms. CRIBB. I think so, and as I say, it is hard for any administration, and even in the years of budget surpluses when we finally turned the corner on that, it was still a very difficult budget environment, and it is even more so now when so much of everyone's attention is focused on security issues. It is hard to get attention for international trade.

But certainly I think that in the years I was there, that the administration always tried to make international trade an important part of both our U.S. economic agenda and our foreign agenda, and as I said, it has been a very bipartisan effort on that score.

Senator VOINOVICH. Did you have somebody in the Department whose soul responsibility was to focus on human capital? One of the things we are requiring in this legislation is a designated per-

son dealing with human capital that gets up early and works on it constantly and looks at whether or not the workforce is where it should be and shapes it and is on top of it. Do you think it was given enough attention when you were there?

Ms. CRIBB. One of the things I think Under Secretary Aldonas has done that has provided a continuity is to pick up on those efforts that we had started. As I mentioned in my remarks, I do think that there is more that can be done ITA-wide to ensure that there is a better recruiting effort, and that may be one thing that the Congress should work with ITA on, to closely examine.

As I said, a lot of times with recruiting, it just falls to the various offices to go out themselves and try to find people, whereas I think that there could be a much more effective, coordinated effort to go out and attract recruits—especially young people coming out of law and graduate schools. ITA has a lot to offer that the private sector can never offer. As Grant said, it is a perception of wearing the white hat and it is a great feeling. I mean, there is really nothing like going to work and knowing that your job is to be out there looking out for the interests of the U.S. people. That is a feeling that a law firm cannot offer, no matter how much they pay.

I think that the travel opportunities are exciting for young people. I think young people are very interested in all the international issues. So I think that even though it is tough not always being able to offer competitive salaries, that these are certainly things ITA can go out and sell itself on.

Senator VOINOVICH. Thank you. Mr. Turner, what is it going to take for us to get your brightest and best accounting students to come to work for the Securities and Exchange Commission? Once they get there, how do we keep them?

Mr. TURNER. Without a doubt, I think during my entire time at the SEC, the No. 1 issue as I watched people walk out the door was the pay parity issue. The compensation, you have got to keep in mind that the staff, they are, on average, I think, dedicating about 25 percent of their hours each year as contributed hours, so they are not getting paid but they are putting in the hours and yet maybe they are getting 70 percent of pay. So you have this where they are working 25 percent more but getting 30 percent less in terms of compensation.

Senator VOINOVICH. You are saying that your people are salaried people—

Mr. TURNER. Right.

Senator VOINOVICH [continuing]. And they are putting in 25 percent—you are talking about overtime?

Mr. TURNER. Overtime.

Senator VOINOVICH. So you are going over 40, 25 percent, and then they are not compensated for that, and then if they look at the pay they are getting for the 40 hours, it is about 30 percent less than what they would get in the private sector, is that—do I get it?

Mr. TURNER. That is—you have got it. Instead of here, you are going this way. When people have to put food on the table, you can only do that for so long.

The people do not expect to be compensated at private sector wages. They are not even asking for that. They are just asking to

be treated fairly, and they know that when, sooner or later, they will have kids going to college and have to pay for college education or schooling needs or something, they really do love the public service and do a great job at it. That is why they put in the 25 percent donated hours. But at some point in time, the bills do mount up and come home and the rooster comes home, so to speak, and they can just not afford to do it any longer.

As you heard earlier, whereas in the past you could maybe keep an accountant for 2, 3, or 4 years—I was at the Commission from 1989 to 1991 and it was not unusual to see the staff stay 3 or 4 years—this last go-around, 18 months is what they were spending. So it just does not keep them there.

So pay is one thing, and when you have that turnover, then you have problems with inexperienced people, as well. It takes additional supervision. You do not have the supervision because they are not there, either. You talked about the SES turnover, so you do not have that. That impacts the markets and the people trying to come in because it makes it more difficult, since they are dealing with less experienced people, just to communicate and talk about what is going on and get over their filing issues. So it creates probably more struggles in the system, as well, both for people inside the Commission and for people outside the Commission.

And I do think if we had had enough staff to review filings on a timely basis on Enron, we would have seen it. Those financial statements were restated for 1997, 1998, 1999, 2000, and now it looks like 2001. It used to be the staff did try to get through filings of every company at least once every 3 years. They did not do that on Enron, and, in fact, in the fall of 1999, I remember a meeting in the office of Chairman Levitt at the time where we all got together. We did not even have the staff at that point in time to review all the public offerings at the time. We would just run out of staff, I mean, literally could not do it. We are all struggling—

Senator VOINOVICH. Is that because you did not have the budget to hire them?

Mr. TURNER. Yes.

Senator VOINOVICH. While you were at the SEC, you did not have the budget to hire more employees, and even if you did, the levels of compensation were not as competitive as they should be, is this correct?

Mr. TURNER. Right, and you still saw then the 250 open slots, so it was you did not have the money, you could not get them, and so you did not have the slots, you did not have—

Senator VOINOVICH. And you also suffered, did you not, from the fact that other financial regulatory agencies were able to change their pay schedules. So some of the SEC employees float from one Federal agency to another because they wanted equally challenging work, but they wanted more money as well?

Mr. TURNER. Yes. I actually loved working with my counterparts down at the Federal Reserve but I hated to go down to meetings with them, because if I took my staff with them, they might decide to stay. [Laughter.]

They could get these 30, 40 percent increases down there, and out of our office, we did have people that made those type of jumps and you cannot blame them for that, certainly, so—

Senator VOINOVICH. Is the new SEC pay schedule, from your observation, competitive now with other financial regulatory agencies?

Mr. TURNER. I have not seen where they are coming out with their new pay schedules. I have seen what the discussions have been and how they are redoing it, so I honestly do not know if they are coming out. They did need to jump up quite a bit, and the people are good, talented people.

I remember one fellow in my office who left in the summer of 2000 and had been with the Commission 10 or 12 years. He was very good, excellent. He had been in industry, been in with a Big Five firm, done very well every place he had been, really wanted to stay. I was able to pay him around \$85,000, plus we could do some things with bonuses, retention bonuses, and we did have to actively use that. If we could not have been actively using retention bonuses, we would have lost a lot more people, although there were some restrictions. But I could pay him \$85,000 plus maybe a \$15,000 bonus, max.

He left to go join one of the Big Five firms as a partner, that is the type of caliber people we had in that office. He went out for half-a-million dollars a year. So these people can jump. Now, in his particular case, if we could have just bumped his pay, I would say another—if we could have gotten him up in the \$115,000 range, there is no question in my mind he would have stayed. I mean, everyone knows they can jump for that type of compensation, but he loved the work, but he had two daughters starting college and he just could not afford to pay it. I know if I had had that—the guy almost came in and pleaded, but you did not have it in the budget and you did not have the flexibility to do that.

Senator VOINOVICH. I have seen that during my years in government, also, people that come in that do not want to leave, but they have to, and you do not blame them for leaving because they have got family responsibilities they have to take care of, particularly those that have got children that are college age.

Let us go back to Colorado. What is it going to take to get some of your bright people to come, in terms of the procedure? Have starting salaries got to be up, or tell me what you think.

Mr. TURNER. Starting salaries have got to be up. I think you have got to give the people the tools that they need to do their jobs right, technology, information systems. When I walked out of private enterprise as a CFO and walked into the Commission, it was like going into the dark ages with respect to technology.

Senator VOINOVICH. Now, do your students know that?

Mr. TURNER. Yes. I think—in fact, it is interesting. A couple of weeks ago, we had a discussion. Some of the kids were talking about where they might go in terms of employment. I was trying to encourage them to think about public service and some government service for at least some period of time. I do think they have a perception that if they go into the government, they are not going to get the ability to work with some of the things like the new technologies that they might otherwise get in one of the accounting firms. They will not get that level of training.

They certainly do not see the type of recruiting that emphasizes that. In fact, when I first got into—

Senator VOINOVICH. Yes, how about the recruiting? I have heard stories that Federal Government recruiting is not as good as it should be, that agency websites leave a lot to be desired. How do you feel about that?

Mr. TURNER. I would agree with that. I think that if you were to benchmark the recruiting done, that I did when I was one of the recruiting partners at one of the Big Five accounting firms versus what I did as a CFO versus what was done at the government agencies, they are just on different playing fields. The government is going to lose out every time. We did not have the type of recruiting brochures. We did not have the type of outreach and contact. People do not create the image in the students' mind that you see being created by private enterprise. It is a non-competitive recruiting effort.

So if you have a non-competitive recruiting effort in terms of really saying what you can do, and I have got to tell you, the jobs at the SEC are absolutely fabulous. There is a very compelling, great story to tell to students that should make it very attractive to them. If you tell that story in a competitive fashion and then get to where salaries are competitive for those new accountants we hired like into the compliance and inspection program at the SEC, I think they will be able to get and attract people.

But you have got to do those two things and then you have got to let them know that when they come into the Commission, they are going to have the level of training that they should have to continue their education and the technology tools—

Senator VOINOVICH. That is the other thing. I have added a comprehensive training provision to my human capital legislation, because when I came in, I asked the 12 departments how much they spent on training and they could not tell me. When you were at the SEC, how much emphasis was placed on training and upgrading the skills of individuals, because, again, you are pointing out, that is important. If I am a new employee, I want to know if I will work on exciting projects and what type of training opportunities are available to help me grow professionally. While you were at the SEC, how much attention was given to training the employees?

Mr. TURNER. Training, almost—initially, it was an afterthought, and I will tell you why. They were so short of staff and people were already working 25 percent overtime—

Senator VOINOVICH. Right.

Mr. TURNER [continuing]. That when you went and said, let us have a training session, in people's mind, it was, like, OK, now you have put me up to about 30, 40 percent overtime. I would love to do it. The problem is, that created a bad environment for training that made it difficult to get it done, so the training was not there. The coordinated training effort absolutely was not there, no question about it.

People did want training. We did go out periodically to the Big Five accounting firms and they were very helpful. They would bring in people. So you had the ability to do it. You had the ability to get the resources. We just had no one to coordinate it, and quite frankly, then again, there was not time allocated to go do it because everyone was already buried.

Senator VOINOVICH. I have co-sponsored legislation that increases the student loan repayment amount from \$40,000 to \$80,000. If you work for the Federal Government and you pay off the loan, I guess you have to add it to your income, and if you work for somebody else in the private sector, you do not have to do that. Do you think increasing the student loan repayment amount will help recruit and retain qualified employees?

Mr. TURNER. Yes, I actually do think that would make a difference. I actually think that is a very fine program and I think people realistically could work through any implementation. I do not see the implementation issues being that big on that. So I think that would actually be a fine program, and certainly for the students in my classes that have just spent 4 or 5 years and they are tired of being poor, the opportunity for them to walk out and think, I am going to have that school loan, at least some piece of that forgiven, I think that would be a big ticket item to them, so I would commend you for moving in that direction.

Senator VOINOVICH. So it is higher starting wages that are more comparable. They do not have to as well as in the private sector, but somewhere in the ballpark.

Mr. TURNER. Yes.

Senator VOINOVICH. Potential employees must have an understanding of the type of technology, equipment and training available at the Federal agency they are applying to. We don't want them to feel like they are, as you said, going into the dark ages. An opportunity to upgrade their skills with training, help get their loans paid off. That would make a big difference, you think?

Mr. TURNER. Yes. I think there is one other thing I picked up on, if I heard you right. You talked about each of the agencies really having a dedicated human capital strategic plan, a human capital resource officer—

Senator VOINOVICH. Right.

Mr. TURNER [continuing]. Where that is their focus, that is their job and they are trying to stay on the front edge, not be so far behind where private enterprise and all is. I would commend you for that, too. We do not manage that asset in the government nearly as well as what I think is done in the private enterprise area. The resources are not devoted to it. People do think about it in budget, give me X-amount of budget, but they are not thinking about, how do I turn those dollars into real good management of my people so I get what I am paying for, because you have got good people there. That needs to be part of any agency's plan, and an important part and then well managed.

I think we had a lot of opportunity and challenges in that area at the SEC, but I think we had a lot of improvements that we could have been making and I just do not think we fit within the notion of what you were looking for. I just do not think we were there.

Senator VOINOVICH. My legislation will require that. Furthermore, it is important for agencies to add their human capital plans in the Government Performance and Results Act process. This is a main focus in my legislation. Unfortunately, agencies are not tying their human capital plans into the goals of their agency. Would you agree that this is a key management concept that needs to be addressed?

Mr. TURNER. Yes.

Senator VOINOVICH. So we need to emphasize that more.

Mr. TURNER. I definitely agree with you.

Senator VOINOVICH. Ms. Cribb, how about your experience in terms of people coming into the agency? What is needed to really make them competitive?

Ms. CRIBB. Again, more competitive salaries always would help. I would also say that training is an area where I think ITA could improve a good bit. The resources are stretched so thin that it is hard to have money left over for the training opportunities, and I think a lot of the staff are interested in expanding their skills, especially in language skills, which would be helpful to their performance in ITA.

We did run into a lot of the problems you were describing about also finding the time for training. It is a long work day as it is and it is hard to get people to stick around sometimes for after-hour training.

But I also would add, I think that while across the whole GS spectrum it would help to have higher salaries, I think that at some of the highest levels, you have a group of people who have made a decision to stay in the government as a career. They have already made that decision. It is really at more of the mid-level where you tend to lose people, who get frustrated that—

Senator VOINOVICH. But you do not—

Ms. CRIBB [continuing]. There are not as many people, and so I think the compensation—

Senator VOINOVICH. But the compression problem, that is another thing. At the Senior Executive level, 70, 75 percent of the people make the same amount of money is what we are hearing. Again, it is anecdotal. If I am here and I have got an opportunity to retire, I am kind of locked, and I get more of an increase in my annuity every year than I do if I stay with the agency.

Ms. CRIBB. Right.

Senator VOINOVICH. So you finally sit down and figure the numbers out and say goodbye. Do you think that is something that needs to be looked at?

Ms. CRIBB. Sure. I also think that as you move up the GS scale, that often, getting the highest scale is dependent on managing a team of people. I am not quite sure if that is a Commerce-specific rule or if it is more OPM-wide. I think it is governmentwide.

Within ITA, often, you want to reward someone for their expertise, which is not always tied directly to how many people they are managing. So I think something that the Department could look at, too, is how to get higher grades for a lot of those people who are bumping up against situations in which there are only so many jobs within ITA that are going to be supervising a number of people, but there is plenty of need for the expertise. We need to make sure we reward the expertise.

Senator VOINOVICH. So, salary levels are a problem. It is like in the teaching profession. If you teach in a classroom, you get X and the only way you can get it is to become assistant principal and then become principal.

Ms. CRIBB. Right.

Senator VOINOVICH. Even though you may be a marvelous teacher, you move out of the classroom.

Ms. CRIBB. Right.

Senator VOINOVICH. So you are saying you have certain expertise in the agency, but there is still a problem there. If you want more money, then you have got to go into a supervisory—

Ms. CRIBB. Exactly.

Senator VOINOVICH [continuing]. So that should be looked at, too, from a comparability point of view.

Ms. CRIBB. Exactly.

Senator VOINOVICH. I really appreciate your both being here today. This is a subject that I am very interested in and I really appreciate Senator Durbin's continuing to work on it. I know it is going to take a long time to get this across. I feel that my biggest asset is my years of experience as an executive. I know that I have to constantly educate my colleagues on the importance of sound management practices. I really want to break through the bureaucratic barriers that have been impeding change for so many years.

Mr. TURNER. Stick with it and you will get there, Senator.

Senator VOINOVICH. Thanks very much for being here.

Ms. CRIBB. Thank you.

Mr. TURNER. Thank you.

Senator VOINOVICH. The Subcommittee is adjourned.

[Whereupon, at 12:07 p.m., the Subcommittee was adjourned.]

A P P E N D I X

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight of Government
Management, Restructuring and the District of Columbia,
Committee on Governmental Affairs, U.S. Senate

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HUMAN CAPITAL

Major Human Capital Challenges at SEC and Key Trade Agencies

Statement of

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GAO-02-662T

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to appear here today to discuss the human capital challenges facing the agencies that play key roles in monitoring publicly traded companies and enforcing our nation's trade laws. As you are aware, GAO has been a leading promoter of a more strategic approach to federal human capital issues. We are particularly gratified to come before this subcommittee, as you have been committed advocates of our efforts, sponsoring much of our work in this area. The leadership provided by this subcommittee and the Senate Committee on Governmental Affairs has been especially important in focusing attention on the federal government's human capital challenges.

Over the past 2 years, our work in the major management challenges and program risks across the government has identified human capital as a primary factor affecting current and future agency performance. In fact, in January 2001, GAO designated strategic human capital management as a governmentwide high-risk area.¹ As our 2001 *High-Risk Series* and *Performance and Accountability Series* reports make clear, serious human capital shortfalls are eroding or threatening to erode the ability of many agencies to effectively perform their missions.² We found that many agencies lack a consistent strategic approach to marshaling, managing, and maintaining the human capital needed to maximize performance and ensure accountability. Today we will discuss the specific challenges faced by the Securities and Exchange Commission (SEC), whose mission is to protect investors and the integrity of securities markets, which includes overseeing public companies. We will also discuss the Department of Commerce, the Office of the U.S. Trade Representative (USTR), and the U.S. Department of Agriculture--the key agencies that monitor and enforce our nation's trade agreements.

Although these agencies have diverse responsibilities, our statement today will address the specific human capital challenges these agencies face. Specifically, this statement provides information on (1) workload and staffing challenges, (2) the effects of workload and staffing imbalances on the agencies' ability to fulfill their missions, and (3) other factors that affect the fulfillment of these agencies' respective missions. Our observations about the challenges faced by SEC and the key trade agencies are based on three reports issued between 2000 and 2002.³ In addition, we updated our previous work through a series of meetings with appropriate agency officials. This statement was completed in accordance with generally accepted government auditing standards.

In summary, our work at these agencies has resulted in reports that address the human capital challenges faced by SEC and the key trade agencies. In our 2002 report on SEC, we found that SEC faces a workload that is growing at a rate much faster than staffing in an environment where

¹ See U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-01-263 (Washington, D.C.: Jan. 2001).

² U.S. General Accounting Office, *Performance and Accountability Series—Major Management Challenges and Program Risks: A Governmentwide Perspective*, GAO-01-241 (Washington, D.C.: Jan. 2001). In addition, see the accompanying 21 reports (numbered GAO-01-242 through GAO-01-262) on specific agencies.

³ See U.S. General Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, GAO-02-302 (Washington D.C.: Mar. 5, 2002); *International Trade: Strategy Needed to Better Monitor and Enforce Trade Agreements*, GAO/NSIAD-00-76 (Washington, D.C.: Mar. 14, 2000); and *Securities and Exchange Commission: Human Capital Challenges Require Management Attention*, GAO-01-947 (Washington D.C.: Sept. 17, 2001).

markets have become more complex, global, and technology-driven. We found that workload and staffing imbalances have affected most aspects of SEC's regulatory and supervisory activities, from its inhouse technological capabilities to its ability to take enforcement actions against market participants. SEC also faces challenges beyond its resource limitations. For example in our 2001 and 2002 reports on SEC, we discussed the high staff turnover, which hampers its effectiveness and efficiency, and a strategic planning process that has not included a strategic reevaluation of programs and activities in light of current and emerging challenges.

We also found that the key agencies that monitor U.S. trade agreements faced human capital challenges. As we reported in March 2000, since the early 1980s, the United States has entered into several hundred trade agreements, which has caused dramatic increases in the trade monitoring and enforcement workloads at USTR, Commerce, and Agriculture. This workload has continued to grow over the past 2 years as a result of such factors as the launch of major multilateral, regional, and bilateral trade negotiations. In our 2000 report, we found that these agencies' efforts to monitor and enforce trade agreements were hampered because they lacked sufficient staff with appropriate expertise, did not receive adequate support from other agencies, and had difficulty obtaining comprehensive input from the private sector. We found that since our report was issued, staffing for trade compliance efforts has increased at all three agencies, but we believe it is too early to predict the impact of these increases. Moreover, the agencies face other human capital challenges, including problems with recruitment and high turnover rates.

Human Capital Issues at SEC Threaten Its Ability to Fulfill Its Mission

Over the last decade, securities markets have experienced unprecedented growth and change. Moreover, technology has fundamentally changed the way markets operate and how investors access markets. These changes have made the markets more complex. In addition, the markets have become more international, and legislative changes have resulted in a regulatory framework that requires increased coordination among financial regulators and requires that SEC regulate a greater range of products and participants. Moreover, the recent sudden collapse of Enron and other corporate failures have stimulated an intense debate on the need for broad-based reform in such areas as financial reporting and accounting standards, oversight of the accounting profession, and corporate governance, all of which could have significant repercussions on SEC's role and oversight challenges. At the same time, SEC has been faced with an ever-increasing workload and ongoing human capital challenges, most notably high staff turnover and numerous vacancies.

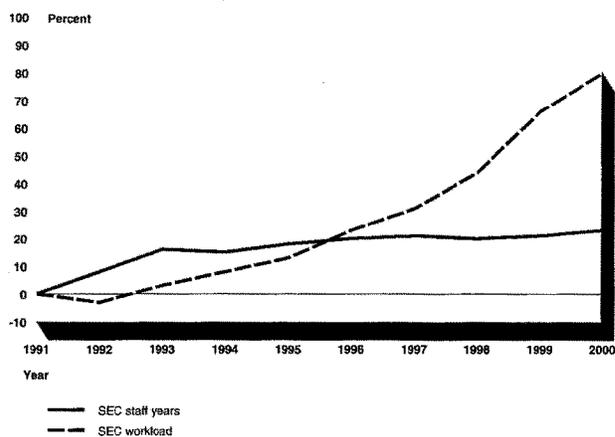
SEC Faces Significant Workload and Staff Challenges

As stated in our March 2002 report, we found that SEC's ability to fulfill its mission has become increasingly strained due in part to imbalances between workload and staff resources.⁴ As illustrated in figure 1, the larger, more active, and more complex markets just discussed have

⁴ Staff resources are measured in terms of full-time equivalent staff years.

resulted in an increased aggregate workload (e.g., filings, complaints, inquiries, investigations, examinations, and inspections) for SEC. As the dotted line indicates, SEC's workload has continued to grow at a rapid rate throughout the decade while staff resources, represented by the solid line, have grown little. As a result, SEC has been challenged to keep up with its increasing workload since about 1996.⁵

Figure 1: Percent Change in SEC Staff Years and Workload, 1991-2000



Source: GAO analysis of SEC data.

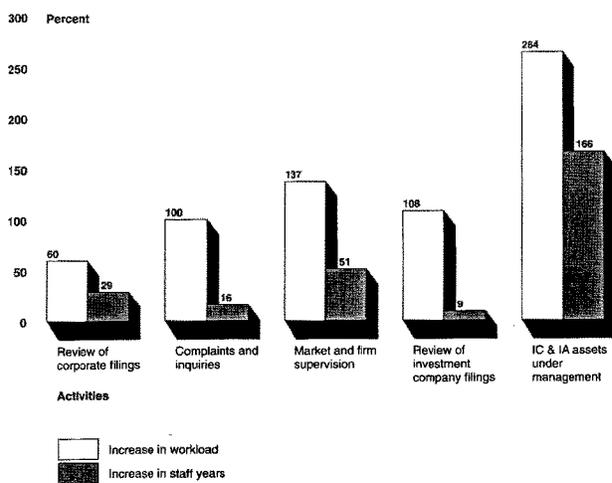
When we reviewed this workload on an activity basis, we found that over the last decade staffing within the various areas of SEC's regulatory oversight grew between 9 and 166 percent, while workload in those same areas grew from 60 to 264 percent. As figure 2 illustrates, these disparities exist across all key SEC activities, as the increase in SEC's workload has substantially outpaced the increases in SEC's staff. For example,

- the number of corporate filings increased almost 60 percent, while related review staff increased 29 percent;
- the number of complaints and inquiries received increased by 100 percent, while the enforcement staff dedicated to investigate complaints and other matters increased by only 16 percent;

⁵ All years are fiscal years unless otherwise noted.

- the number of market and firm supervision actions increased 137 percent, but the number of staff responsible for these activities increased 51 percent;⁶
- investment company filings increased 108 percent while staff increased 9 percent; and
- total assets under management by investment companies (IC) and investment advisers (IA) increased by about 264 percent, while the number of IC and IA examination staff increased by 166 percent.

Figure 2: Percent Change in Workload and Staff Years for Selected SEC Activities, 1991-2000



Source: GAO analysis of SEC data.

SEC's Ability to Fulfill Its Mission Has Become Increasingly Strained

In our work at SEC, we found that its ability to fulfill its mission has become increasingly strained due in part to imbalances between SEC's workload (such as filing, complaints, inquiries, investigations, examinations, and inspections) and staff resources (full-time equivalent [FTE] staff years). Although industry officials complimented SEC's regulation of the industry given its staff size and budget, both SEC and industry officials identified several challenges that SEC faces. First, resource constraints have contributed to substantial delays in the turnaround time for many SEC regulatory and oversight activities such as approvals for rule filings and exemptive

⁶ Market and firm supervision actions include: self-regulatory organization and SEC rule proposals; interpretive guidance and exemptive applications; analyses of proposed enforcement actions, disclosure documents, and risk assessment reports; automated trading system analyses and automation reviews of self-regulatory organization systems; policy papers; Congressional, governmental, industry, and public correspondence; and other reports and analyses of SEC's Division of Market Regulation.

applications.⁷ According to industry officials, such delays have resulted in forgone revenue and have hampered market innovation. Second, resource constraints have contributed to bottlenecks in the examination and inspection area as SEC's workload has grown. As a result, certain examinations and inspections take longer to complete. Third, limited resources have forced SEC to be selective in its enforcement activities and have lengthened the time required to complete certain enforcement investigations.⁸ Fourth, SEC staff have reviewed certain filings less frequently and completely as workloads increased. Fifth, today's technology-driven markets have created ongoing budgetary and staff challenges. Finally, SEC and industry officials said that SEC has been increasingly challenged in addressing emerging issues, such as the ongoing internationalization of securities markets and technology-driven innovations like alternative trading systems⁹ and exchange-traded funds. Although we address the implications of all of these challenges in our 2002 report, today we will focus our discussion on two critical aspects of SEC's operations—its reviews of corporate filings and enforcement activities.

Certain Financial Statement and Other Filings
Are Subject to Less Frequent Review by SEC Staff

Like other aspects of SEC's workload, the number of corporate filings has grown at an unprecedented rate. For example, from 1991 to 2000, the number of corporate filings increased 60 percent. During this same period, the percent of all corporate filings that received some type of review by SEC decreased from about 21 percent to 8 percent.¹⁰ We found that SEC's 2001 goal was to complete a full financial review of each issuer's annual filings in 1 of every 3 years—a review goal of about 30 to 35 percent of annual filings per year. According to SEC, this level of review was expected to “ensure that material issues are disclosed clearly and completely and that possible fraudulent activities are addressed promptly.” However, in 2001, SEC completed full or full financial reviews of only 16 percent of the annual reports filed or about half of its annual goal.

In November 2001, the Division of Corporation Finance announced that staffing levels were expected to remain flat while filings were expected to continue to increase in number and complexity. In this post-Enron environment, SEC plans to reconsider how it will select filings for review and how it will review the filings selected. Rather than conducting full reviews of fewer firms, SEC officials said SEC may limit its review to a specific disclosure issue and

⁷ A company files an exemptive application when it seeks an SEC decision to exempt a new activity from existing rules and laws.

⁸ The SEC chairman has recently announced an initiative called real-time enforcement, which is intended to protect investors by (1) obtaining emergency relief in federal court to stop illegal conduct expeditiously; (2) filing enforcement actions more quickly, thereby compelling disclosure of questionable conduct so that the public can make informed investment decisions; (3) deterring future misconduct through imposing swift and stiff sanctions on those who commit egregious frauds, repeatedly abuse investor trust, or attempt to impede the SEC's investigatory processes. According to the SEC, insufficient resources may inhibit the effectiveness of this initiative, which depends upon prompt action by enforcement staff.

⁹ An alternative trading system is an entity that performs the functions commonly performed by a stock exchange.

¹⁰ SEC's review of corporate filings may involve a full review, a full financial review, or monitoring for specific disclosure items. A full review involves an in-depth examination of the accounting, financial, and legal aspects of an issuer's filing. A full financial review involves an in-depth accounting analysis of an issuer's financial statements and management's discussion and analysis or business plan disclosure.

review more filings for that issue. For example, SEC may choose to focus on off-balance sheet activities and work with the companies to improve disclosure. However, SEC officials said that full reviews will not be completely abandoned, but the revised approach should help SEC better deploy limited staff resources and enable it to have a greater review presence across all types of corporate filings in the future. Further, in December 2001, in response to the disclosure and accounting problems of Enron, SEC began to review the annual filings of the 500 largest U.S. companies.

Workload Growth and Limited Staffing Raise Concerns about Enforcement

In the 2002 report, we also reported that delays in closing cases and a growing backlog of smaller investigations presented ongoing challenges for SEC. Over the past decade, SEC's Division of Enforcement staff devoted to investigations increased 16 percent to about 482 staff years, while the number of cases opened increased 65 percent to 558. Although increased staff has allowed more work to be initiated, delays in completion of individual cases persist. Moreover, the number of cases pending at the end of the year increased 77 percent over this same time period. SEC officials said the increase in the number of cases pending was due in part to high staff turnover, which has resulted in old cases not being closed or ongoing cases being delayed until other staff can take over. For example, SEC officials reported that in 2000 alone, over 58 experienced staff left the division.

As this subcommittee recognizes, enforcement activities are important for carrying out SEC's mandate to protect investors and deter fraud and abuse. Because SEC has limited resources and cannot prosecute every case, SEC officials said they must prioritize the cases they will pursue. According to SEC officials, SEC generally prioritizes the cases in terms of (1) the message delivered to the industry and public about the reach of SEC's enforcement efforts, (2) the amount of investor harm done, (3) the deterrent value of the action, and (4) SEC's visibility in certain areas such as insider trading and financial fraud. Except for the length of time taken to complete an investigation, most industry officials said that SEC was effective in this area. Although SEC data show that the average length of time to complete an investigation has decreased, we did not perform a detailed review of the individual investigations to determine whether this was an improvement or whether SEC on average pursued less time-consuming matters for investigation.

SEC Faces Other Human Capital Challenges

In addition to the staff and workload imbalances, other factors also contribute to the challenges SEC currently faces. SEC officials said that although additional resources could help SEC do more, additional resources alone would not help SEC address its high turnover, which continues to be a challenge for the agency. As we discussed in our 2001 report on SEC's human capital practices, about one-third of SEC's staff left the agency from 1998 to 2000.¹¹ By 2001, this

¹¹ GAO-01-947.

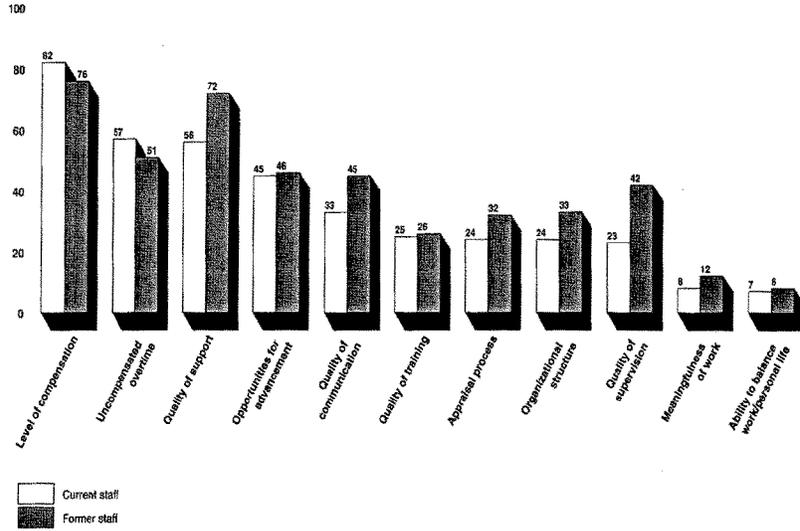
number had increased to 40 percent. SEC's turnover rate for attorneys, accountants, and examiners averaged 15 percent in 2000, more than twice the rate for comparable positions governmentwide. Although the rate had decreased to 9 percent in 2001, turnover at SEC was still higher than the rate governmentwide. Further, because of its high turnover and inability to hire new staff quickly, about 250 positions remained unfilled in September 2001, which represents about 8.5 percent of SEC's authorized positions. Likewise, industry officials agreed that many of the challenges SEC faces today are exacerbated by its high turnover rate, which results in more inexperienced staff and slower, often less efficient, regulatory processes.

SEC and industry officials alike recognize that SEC will always have a certain amount of turnover because staff can significantly increase their salaries in the private sector, and some staff plan to stay at SEC for only a limited period of time. Many officials said pay parity with other financial regulators could enable SEC to attract and retain staff for a few additional years. SEC estimates that a new employee generally takes about 2 years to become fully productive; in some divisions, junior staff were staying 2 years on average. We found that from 1992 to 1999, the average tenure of an examiner decreased from 2.9 to 1.9 years and the average tenure for attorneys leaving SEC had decreased from 3.4 years to 2.5 years. Moreover in 2000, 76 percent of SEC examiners had been with the agency less than 3 years.

We explored the reasons for SEC's high turnover among its professional ranks and actions taken to address this problem in our 2001 human capital report.¹² To do this, we surveyed current and former SEC attorneys, accountants, and examiners to determine why they had left or would consider leaving SEC. Overwhelmingly, compensation was cited as the primary reason for leaving SEC. However, respondents also identified other nonpay factors that had affected or would affect their decisions to leave, such as the lack of opportunities for advancement, the amount of uncompensated overtime, and the quality of administrative support. As illustrated in figure 3, these factors also had a generally or very negative effect on morale. This graphic also illustrates that 20 percent or more of current staff identified other aspects of work at SEC that could negatively affect staff morale, including the quality of communication, training, and supervision; the appraisal process; and the organizational structure. Among other things, in our 2001 report we recommended that the chairman SEC identify ways to involve human capital leaders in decision making and establish a practice that requires management to continually monitor and refine SEC's human capital approaches to ensure their ongoing effectiveness.

¹² GAO-01-947.

Figure 3: Percentage of Staff Indicating Certain Aspects of Their Job Had a Generally or Very Negative Effect on Morale



Source: GAO survey of current and former SEC attorneys, accountants, and examiners.

Although SEC has taken numerous actions to address its high turnover including use of special pay rates and retention bonuses, its turnover rate remains higher than the governmentwide rate. The compensation challenges that SEC faces are indicative of the pay issues that some other agencies face as well, and underscore the need to consider governmentwide pay reform that needs to make a more direct link between pay and individual knowledge, skills, abilities, and performance.

Aside from special pay rates for certain professional staff, SEC employees are paid according to general government pay rates. However, on January 16, 2002, legislation was enacted that exempted SEC from federal pay restrictions and provided it with the authority necessary to bring salaries in line with those of other federal financial regulators, but to date SEC has not received any additional appropriations to fund higher salaries. SEC estimates that an additional \$76 million is needed to provide pay parity for the agency in 2003. For 2003, SEC also is seeking from its congressional appropriators an additional 100 staff positions. It requested 30 accountants, lawyers, and other professionals in the Division of Corporation Finance to enhance its capability to review periodic disclosure filings of public companies. It requested 35 accountants and lawyers in the Division of Enforcement to deal with an increasing workload of financial fraud and reporting enforcement cases. It also requested 35 accountants, lawyers, and other professionals in other divisions including the Office of the Chief Accountant—to deal with

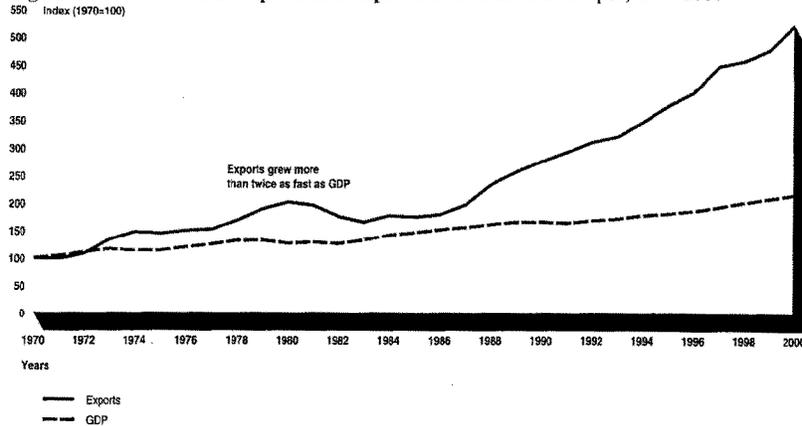
evolving needs and policy development. Without these requested increases for pay parity and additional staff, SEC says that it will continue to be restrained from retaining and attracting experienced staff and from fully addressing the new regulatory challenges and growth of workload that it faces.

Although SEC's workload and staffing imbalances have challenged SEC's ability to protect investors and maintain the integrity of securities markets, SEC has generally managed the gap between workload and staff by determining what basic, statutorily mandated duties it could accomplish with existing resource levels. This approach, while practical, has forced SEC's activities to be largely reactive rather than proactive. For instance, SEC has not put mechanisms in place to identify what it must do to address emerging and evolving issues. Although SEC has a strategic plan and has periodically adjusted staffing or program priorities to fulfill basic obligations, SEC has not engaged in a much needed, systematic reevaluation of its programs and activities in light of current and emerging challenges. Given the regulatory pressures facing SEC and its ongoing human capital challenges, it is clear that SEC could benefit from some additional funding. However, a comprehensive, agencywide planning effort, including planning for use of technology to leverage available resources, could help SEC better determine the optimum human capital and funding needed to fulfill its mission. On March 20, 2002, SEC announced that it had undertaken a special study of the agency's operations and resources intended, in part, to implement a recommendation in our report.

Commerce and Other Agencies that Oversee Trade Agreements Face Human Capital Challenges

Trade's influence on the U.S. economy has increased dramatically over the past decade, with exports growing more than twice as fast as U.S. output (figure 4). Most of the growing volume of U.S. exports is governed by the terms of trade agreements. U.S. government efforts to monitor and enforce these agreements involve at least 17 federal agencies, with three key agencies, USTR and the Departments of Commerce and Agriculture, having significant roles.

Figure 4: Growth of U.S. Exports as Compared to Overall U.S. Output, 1970-2000



Source: GAO calculation based on IMF data.

In March 2000, we reported that the creation of a vast array of U.S. trade agreements since the early 1980s had caused dramatic increases in the trade monitoring and enforcement workloads at USTR, Commerce, and Agriculture. Further, we found that these agencies' ability to monitor and enforce trade agreements was limited due to a lack of sufficient staff with appropriate expertise, inadequate support from other agencies, and difficulty obtaining comprehensive input from the private sector. Since our report was issued, staffing for trade compliance activities has increased at all three agencies, although the impact of these increases is uncertain. Moreover, the agencies face other human capital challenges, such as problems with recruitment and high turnover rates.

Trade Agencies Face Workload and Staffing Challenges

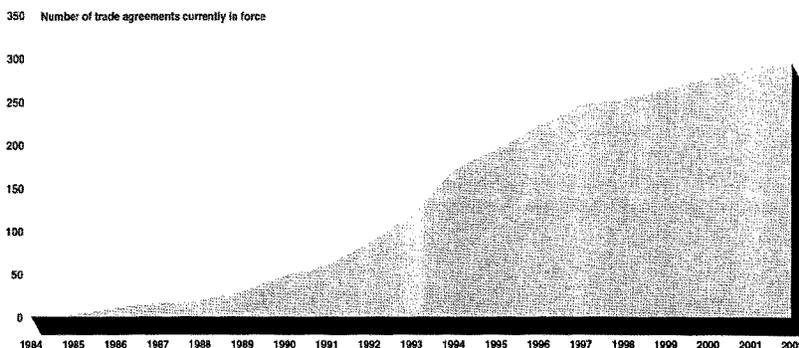
USTR's, Commerce's, and Agriculture's trade monitoring and enforcement workload has increased substantially in the last few years. While the number of staff performing these functions at the three agencies has also increased, their workload continues to grow in volume and complexity. Therefore, human capital challenges remain. Some important reasons for the growing workload include the rising number of U.S. trade agreements, the increasing number of countries that are party to these agreements, and the growing number of active trade disputes involving the United States.

Agencies' Workload Is Increasing in Volume and Complexity

In recent years, the number of trade agreements has grown substantially. Since the early 1980s, the United States has entered into more than 400 trade-related agreements. USTR negotiated

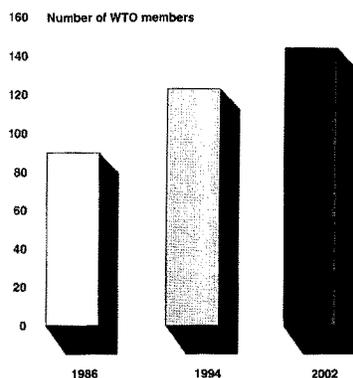
about 300 of these, over 70 percent of which entered into force after 1992. According to USTR, the majority of these agreements have increased U.S. exporters' access to foreign markets. Figure 5 depicts the growth in the number of trade agreements that USTR negotiated since 1984.

Figure 5: Number of USTR-Negotiated Trade Agreements in Force, 1984-2002



Source: USTR, 2001 Trade Policy Agenda and 2001 Annual Report.

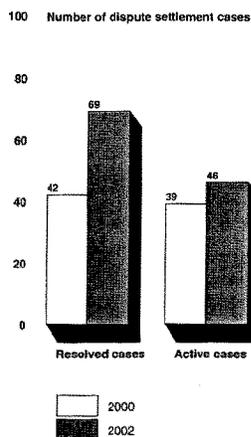
At the same time, the number of nations that participate in key trade agreements has grown, further expanding the federal monitoring and enforcement workload. For example, when the Uruguay Round of multilateral trade negotiations was launched in 1986, 90 countries were members of the General Agreement on Tariffs and Trade, the organizational structure that preceded the World Trade Organization (WTO). By the time that the WTO agreements were signed in 1994, the number of WTO members had expanded to 123. An additional 21 countries have joined the WTO since then, including China. China's WTO membership, in particular, will increase the agencies' monitoring and enforcement workload given that the terms of its accession are extremely complex, totaling about 1000 pages. Figure 6 depicts the growth in WTO membership since 1986.

Figure 6: World Trade Organization Membership, 1986-2002

Sources: Data for 1986 and 1994 from GAO/NSIAD-00-76. Data for 2002 from WTO.

Further, while these far-reaching agreements have substantially increased U.S. trade agreement rights, they have also increased U.S. trade agreement obligations to other nations. As a result, the agencies' dispute settlement caseload has continued to grow. This situation has affected USTR's workload in particular because the agency is responsible for advocating and defending U.S. trade agreement rights and obligations within North American Free Trade Agreement (NAFTA) and WTO. The number of active cases involving the United States has increased from 39 in 2000 to 46 in 2002 even as the number of resolved cases has grown. Moreover, a growing focus of U.S. dispute settlement efforts is responding to cases brought against the United States by other nations. More than half of these cases have focused on U.S. use of trade remedy laws, particularly U.S. actions taken against steel imports. USTR relies on support from Commerce for these cases. According to Commerce officials, WTO dispute settlement cases are especially time consuming because of the tight deadlines and numerous filings required. Figure 7 depicts the status of WTO dispute settlement cases involving the United States in 2000 and 2002.

Figure 7: WTO Dispute Settlement Cases Involving the United States, 2000 and 2002



Source: USTR data.

U.S. Trade Agencies Have Recently Increased Staffing in Key Areas, but Impact of Additions Is Uncertain

Human resources are the single most important asset of the agencies responsible for monitoring and enforcing the growing volume of trade agreements. This work requires country, industry, and functional expertise, and a mixture of economic, technical, and legal analysis. In March 2000, we reported that the three key trade agencies' human capital capabilities had not kept pace with their increased monitoring and enforcement workload. Specifically, staff levels at the three key agencies were flat or declining.

Since our March 2000 report, USTR, the Foreign Agricultural Service (FAS), and two of the three divisions in Commerce's International Trade Administration have received significant increases in funding for staff to monitor and enforce trade agreements. However, due to the recent nature of the increases, we believe it is too early to determine fully whether these additions have been effective in resolving the human capital issues that we cited in our report.

These increases involved the following groups:

- In 2001, USTR received funding to add 25 new positions, which increased the agency's total FTE staff level to 203. All 25 positions have been filled. Thirteen of the new positions were in the area of trade enforcement, 11 were in negotiations, and one was administrative.

- In 2001, Commerce's ITA received increased funding for staff, but not all of ITA's divisions with monitoring and enforcement responsibilities have actually added resources.
 - ITA's Market Access and Compliance (MAC) Division—one of ITA's two main divisions with export-related trade agreement monitoring responsibilities—was funded for an additional 35 positions. As of the end of 2001, MAC had filled 31 of these authorized positions. MAC's new positions filled in 2001 included nine staff to work specifically on China issues and four to work on general issues involving compliance with trade agreement provisions.
 - ITA's Trade Development (TD) Division, which has responsibility for monitoring export-related trade agreements in sectors such as automobiles, aerospace, and telecommunications, was funded for one additional position in 2001. However, the division's actual staff levels declined from 380 to 363 that year. Staff levels at Commerce's Office of Automotive Affairs have remained flat at 16 full-time employees for the past 4 years.
 - ITA's Import Administration Division hired 27 additional staff in 2001. This division administers U.S. trade laws on antidumping and countervailing duties and monitors enforcement of sector-specific agreements governing U.S. imports. Most of the new positions were for enforcing subsidies agreements and monitoring China's and Japan's compliance with trade agreements.
- The FAS, which handles most of Agriculture's trade policy and promotion responsibilities, was funded for a total of 18 new staff years in 2001 and 2002. This increase in staff was for activities related to monitoring countries' technical trade barriers and foreign regulatory measures regarding imports of products with a biotechnology component.

With increased staff levels in 2001, officials at the three agencies generally believe they now have adequate capacity to monitor and enforce trade agreements. However, we believe it is too early to tell if the new staff will enable the agencies to fulfill their mission of monitoring and enforcing trade agreements. One reason is that most of the new staff have been on board for a year or less, so the impact of these new additions is uncertain. Another reason it may be difficult to judge the effectiveness of the staff increases is the continuing growth in the agencies' workload, which could potentially cause a shift in resources intended for trade compliance activities. According to USTR's 2003 budget justification, never in history have so many countries participated in global trade negotiations.¹³

¹³ The WTO Ministerial Declaration that launched new multilateral trade negotiations in 2002 sets an ambitious timetable, with the negotiations scheduled for completion by 2005. At the same time, USTR is pursuing another major negotiating initiative, the Free Trade Area of the Americas (FTAA), which would establish the largest free trade zone in the world. In addition to these multilateral negotiations, the United States intends to complete bilateral free trade agreements with Chile and Singapore this year. Further, the United States is exploring a free trade agreement with five countries of Central America.

To handle the expected increase in the negotiations workload, USTR is requesting authority for six new negotiator positions. The MAC unit in ITA, which will support USTR in all the negotiations, is requesting 33 new FTEs in its 2003 budget, 21 of whom will provide support for WTO and FTA negotiations. Without additional resources for negotiations, agency officials told us they may have to shift resources away from trade compliance to meet the increased workload in conducting negotiations.

Past Workload Imbalances Hindered Trade Agencies' Ability to Fulfill Their Missions

Past staffing and workload imbalances hindered the three trade agencies' abilities to fulfill their trade monitoring and enforcement missions. As we reported in March 2000, agency officials stated that gaps in staff expertise had hindered their efforts to analyze and respond to compliance problems. In addition, officials at all three agencies said that steady declines in staff resources had limited the level of support they provide to each other. Finally, we also cited challenges at the three agencies in coordinating their efforts with the private sector.

While trade agreements in the past focused primarily on tariffs, they now address a broader range of trade issues, such as product standards and food safety measures, making the task of monitoring and enforcing trade agreements more challenging. Given these developments, agencies need staff with the ability to perform a mixture of economic, technical, and legal analysis. However, most of the agencies we examined in our 2000 report did not have the capability to do all types of analysis themselves, and they required input from other offices and agencies.

As we reported in March 2000, insufficient staff resources limited the agencies' ability to provide each other the needed input and support. USTR, in particular, requires support from other agencies, as it was created to coordinate federal trade efforts; its staff was not intended to have expertise on every area covered by trade agreements. USTR officials as well as those at Commerce and Agriculture often stated that they had difficulty obtaining needed analytical support from offices within their own agency or from other agencies.¹⁴ USTR and Agriculture officials also reported that insufficient staff at other agencies limited the extent to which these agencies had supported their monitoring and enforcement efforts. Since our March 2000 report, however, USTR officials noted that the level of support they receive from other agencies, particularly Commerce, has improved as a result of increased staff levels.

In our 2000 report, we also found that the three agencies identified challenges in coordinating with the private sector. We found that the agencies were not always able to obtain comprehensive private sector input and unified positions on pending trade issues. As a result, we recommended that USTR assess whether existing mechanisms for obtaining private sector input are adequate. USTR did undertake a self-assessment on one aspect of this issue in 2000 that

¹⁴ Although USTR is the lead trade agency and was intended to coordinate federal trade efforts, the multiple agencies responsible for monitoring and helping USTR enforce trade agreements still independently estimate their staffing and budget needs, and USTR has no input into their staffing or budget requests. However, officials are making efforts at the operational level within the agencies to coordinate on staffing needs. For example, Commerce and State co-chair an Interagency Compliance Coordination Committee that is focused on determining whether the trade-related agencies have adequate staff with the right skills working on trade agreement compliance issues at U.S. posts overseas and at headquarters in Washington, D.C.

resulted in a January 19, 2001, report that recommended some improvements. The current administration is now considering these and other recommendations for improvement. At the request of the Senate Finance Committee's ranking minority member, we are currently studying whether the statutorily mandated private sector advisory committee system that USTR chairs adequately supports U.S. trade policy.

Recruiting and Retention Issues Present Other Challenges

There are several other human capital challenges facing the agencies that monitor and enforce trade agreements. In particular, the need for specialized knowledge and demand for individuals with experience in trade compliance and litigation creates challenges in recruiting and retaining staff.

While staff levels for monitoring and enforcing trade agreements have increased at the three key agencies, officials noted that the hiring process has often been slow. For example, at USTR it took most of 2001 to hire the 25 new staff that the agency had been authorized at the beginning of the year. Factors that contributed to the hiring delays included difficulties attracting individuals with the requisite skills and experience. In addition, the agency needed to hire specialists for many of the positions, including economists, attorneys with litigation experience, and individuals with industry and regional expertise. Because of its small size, USTR does not have a formal recruitment program. The agency reports attracting numerous applicants for each position. However, finding individuals with specialized experience can be difficult. FAS officials also told us that in some cases it took up to a year to hire staff because of difficulty finding applicants with the needed technical skills. Commerce's ITA has a formal recruitment program and did not experience difficulty attracting applicants. In addition, in 2001 they began using OPM's Outstanding Scholarship Program as a recruitment tool. However, ITA officials noted that since September 11, there have been significant delays in obtaining security clearances for staff hired to fill trade compliance positions overseas, which in turn has delayed bringing the staff on board.

Turnover at the three trade agencies has remained high, particularly at USTR and Commerce. For example, while comparisons must be made with caution, USTR's attrition rate was almost 17 percent in 2001, more than triple the government wide rate of 5.4 percent that year. Attrition has also been relatively high at Commerce's Import Administration Division, reaching 11 percent in 2001, or more than double the government wide rate.

Attrition at both USTR and Commerce's Import Administration Division historically has been high. Reasons include the intensity of work and the long hours required to handle caseloads. In addition, as with the SEC, staff often leave government as they receive lucrative offers from the private sector due to their highly technical areas of expertise, such as experience with trade litigation. USTR has devoted additional resources to training and performance bonuses in an effort to improve retention. Because persons leaving USTR for jobs in the private sector often receive offers that are \$50,000 to \$100,000 higher than their government salary, USTR has not pursued retention bonuses as a strategy for stemming attrition. Commerce's ITA has also taken a number of steps to increase retention, including expanding their award and training programs and

conducting surveys on employee satisfaction. The agency is working to have career ladders for non-supervisory personnel extend more routinely to the GS-14 level. For example, Import Administration Division officials worked with ITA management to retain current staff through flexibility in using promotions, such as upgrading certain specialized positions based on increased duties and responsibilities. According to ITA's deputy undersecretary, the two biggest human capital challenges facing ITA are turnover rates and succession planning. He noted that almost 60 percent of ITA's senior executive service will be eligible to retire by 2007.

Concluding Remarks

We will end as we began, serious human capital shortfalls are eroding the capacity of many agencies, and threatening the ability of others, to economically, efficiently, and effectively perform their missions. Many of the challenges that we discussed today are not unique to SEC or the key trade agencies but reflect governmentwide issues this subcommittee has been grappling with for years. The federal government's human capital weaknesses did not emerge overnight and will not be quickly or easily addressed. Committed, sustained inspired leadership and persistent attention on the behalf of all interested parties will be essential if lasting changes are to be made and the challenges we face successfully addressed. Although we are seeing positive changes and developments overall, including some positive steps at the agencies we discussed here today, there continues to be much work to be done.

As the Comptroller General recently testified before this subcommittee, the proposed Federal Human Capital Act of 2001 (S. 1603) represents an important next step to helping agencies address their human capital management challenges.¹⁵ In that testimony, we also discussed our model of strategic human capital management, released last month as an exposure draft to assist in transforming the human capital cultures of federal agencies. These important new developments have important implications for the agencies discussed today.¹⁶

Thank you again for your continuing attention to human capital reform. The leadership shown by this subcommittee, by holding this and related hearings and in its oversight generally, has both helped to create and increase the needed momentum for change and highlight the need for, and direction of, possible solutions. We would be pleased to respond to any questions you or other Members of the subcommittee may have.

Contacts and Acknowledgments

For further information regarding this testimony, please contact Orice M. Williams, Financial Markets and Community Investment, at (202) 512-5837 about SEC; and Kim Frankena or Elisabeth Sirois, International Affairs and Trade, at (202) 512-4128 about the key trade agencies. Individuals making key contributions to this testimony include Shirley Brothwell, Jill M. Johnson, Barbara Roesmann, and David Tarosky.

¹⁵ U.S. General Accounting Office, *Managing for Results: Building on the Momentum for Strategic Human Capital Reform*, GAO-02-528T (Washington, D.C.: Mar. 18, 2002).

¹⁶ U.S. General Accounting Office, *A Model of Strategic Human Capital Management, Exposure Draft*, GAO-02-373SP (Washington, D.C.: Mar. 2002).

Testimony of
Under Secretary of Commerce for International Trade
Grant D. Aldonas
"Vital Assets: Human Capital in the International Trade Administration"
U.S. Senate Committee on Governmental Affairs
Subcommittee on Oversight of Government Management, Restructuring
and the District of Columbia
April 23, 2001

Thank you, Mr. Chairman, Senator Voinovich, and Members of the Committee, for inviting me to testify today. I welcome the opportunity to address a critically important part of your Subcommittee's mandate: the human capital management challenges confronting the Federal Government. I have had the good fortune of working with the professionals in the International Trade Administration (ITA) throughout my career, while in government and in private life. They are an incredibly dedicated group of people.

Serving as the Under Secretary for International Trade at the Commerce Department has simply reinforced my view that, in public service, our most important assets are our people. The employees of ITA fill in the front lines in the battle to open overseas markets, promote economic growth at home, and sustain jobs in our export sector that are about 15 percent higher-paying than the national average. The work of our troops in ITA also helps deliver a wider range of higher-quality, lower-priced goods to American consumers. In fact, probably the most important effect of international trade is in lowering the cost of living for working families across America. For example, through their work on trade agreements, such as the Uruguay Round, ITA staff helped deliver what amounted to a tax cut for the average American family of between \$1300 to \$2000 every year.

President Bush's Trade Agenda

President Bush has set out an aggressive trade agenda. It has three parts. First, the President intends to open markets for American goods and services through the ongoing negotiations of the new round of World Trade Organization (WTO) talks launched in Doha this past year, together with completing the Free Trade Area of the Americas (FTAA) and bilateral agreements with select trading partners. Success in the WTO talks alone could amount to an *additional* \$2500 in annual savings for the typical American family of four.

Second, President Bush has made clear that we must secure in the implementation of trade agreements what we won at the bargaining table. That requires a two-part effort -- (1) consistent pressure for compliance by our trading partners and (2) reinforcement of our export promotion efforts in markets we have opened through negotiations.

Third, President Bush insists that we enforce the rules of trade in a way that ensures international competition is fair. The President's recent action on steel and lumber reflects that commitment. As Secretary of Commerce Don Evans has said many times, "there is nothing more disheartening to the American worker and entrepreneur than the sense that the playing field is not level." We do not intend to let that happen.

The President, however, lacks one very important tool to serve American workers, farmers, and small-businesses. That tool is the grant of negotiating authority embodied in the Trade Promotion Authority (TPA) which is awaiting Senate action. It is difficult to overstate the importance of the Senate's passage of TPA in securing the benefits of trade to the American public. What TPA represents is a joint commitment by Congress and the President to expand the economic horizons for all Americans. To seize the opportunities before us in the form of multilateral trade negotiations, the President must have the authority that every one of the past five presidents had.

I recognize that many question the need for TPA. Some have said that TPA is only needed at the end of negotiations, not at the beginning. That reflects a fundamental misunderstanding of what TPA represents. TPA represents more than a set of negotiating objectives and the procedural rules that will govern congressional consideration of an implementing bill.

Indeed, what TPA represents is a compact between Congress and the President on the agenda for U.S. trade policy. That consensus is critical to success at the negotiating table. I know from more than a decade in private practice that it is difficult to negotiate on behalf of your client unless his or her objectives are clear. Based on my prior service as a diplomat and a trade negotiator, I can say that the same holds true in international trade talks. Unless we state our objectives clearly, it is hard to know with any certainty what the final deal has to achieve. It also makes it hard to squeeze the best offer out of the other side because they are uncertain that the deal will stick.

It is time to move on TPA. It is time to restore American leadership on trade. It is time we got off the sidelines and back into the game. To do that, the Senate must pass Trade Promotion Authority. Delay hinders the ability of the President to deliver for the hard-working men and women across the country who want the opportunity to succeed and build the best possible future for their families. Ultimately, it is not only the President who needs TPA, it is the workers, farmers, and business people across America who need TPA.

Securing the Benefits of an Open Trading System

As I noted at the outset, the work of ITA does not stop with the conclusion of trade negotiations. In fact, that is when the real work begins. Both the President and Secretary Evans have made the point that, unless we can demonstrate that our trading partners are living up to their end of the bargain, it will be hard to ask the American people to support an aggressive, trade-liberalizing agenda. Both the President and Secretary Evans firmly believe that promises made must be promises kept.

In recent testimony before the Senate Finance Committee, I made clear the Administration's willingness to accept the responsibility of keeping the bargain with the American people on trade. Good government, as both you, Mr. Chairman, and the Ranking Member understand best of all, depends on accountability. Unless government is accountable,

the welfare of our citizens suffers. We do not intend to let that happen.

When it comes to accountability, there is only one way to judge us and that is by our actions. What that means in a trade context is judging whether this Administration is willing to make the tough decisions in defense of American economic interests that American workers, farmers and business-owners have a right to expect. The Committee, in its oversight responsibility, needs to judge whether the Administration is carrying the interests of the American people to the negotiation table and then ensuring that we secure the benefits of an open trading system once the deals are done.

We are committed to that goal. A good example is how we intend to follow up on the agreement we concluded with China on its accession to the WTO. That agreement is a tribute to the hard work of many, both in Congress and the Executive Branch, over a period of 15 years. From the perspective of American exporters, China's accession to the WTO represents the most significant market-opening initiative since the North American Free Trade Agreement (NAFTA) and the Uruguay Round. But, the agreement will only be as good as its implementation and our willingness to promote the interests of American exporters aggressively in the Chinese market.

Mr. Chairman, our actions on the implementation of China's WTO accession offer an example of our approach, which is (1) to highlight the importance of China's implementation of its WTO obligations as the key issue in our bilateral trade relations and (2) to ensure that we are finding and resolving problems at the earliest stage possible in order to avoid the need for protracted disputes within the WTO dispute settlement process whenever possible. On the first point, Secretary Evans is in China at this moment, leading a business development mission to Beijing and Shanghai to help American companies take advantage of the opportunities that China's membership in the WTO will bring. He also is meeting his Chinese counterparts as part of the Joint Commission on Commerce and Trade, which he chairs for the U.S. side, to drive home the message about the importance of timely and transparent implementation of each of China's commitments under the WTO.

Three weeks prior to Secretary Evans' trip, I was in China myself leading a delegation of senior professional staff from the House and Senate who were a part of the Congressional passage of Permanent Normal Trade Relations (PNTR) and are experts on trade matters. The goal of that trip was to prepare the way for Secretary Evans and to underscore for the Chinese the oversight role that Congress will continue to play throughout the WTO implementation process. The subtext -- and an equally important point to have made -- was that there is no daylight between the Administration and the Congress when it comes to China's implementation of its WTO obligations.

I believe it was useful for Chinese officials to understand the importance that both the executive and legislative branches of our government place on implementation. The Ministry of Foreign Trade and Economic Cooperation -- our counterpart agency -- appears to have the best of intentions for tackling a very tough job. We need to do what we can to help them -- especially in

terms of our work with other central government agencies as well as with provincial authorities. Our meetings in China were extremely productive in getting this process started, and I plan to travel to China roughly every six months until the majority of China's WTO obligations fall due, and I hope to take a delegation of Members of Congress or staff with me as frequently as possible.

As to the second prong of our compliance strategy, the Administration's enforcement efforts start with outreach by our Foreign Commercial Service officers on the ground in China – working with their counterparts from the Departments of State and Agriculture and U.S. Customs – and our officials in ITA's Market Access and Compliance unit. Their job is ensure that they maintain close contact with American firms doing business in China and with Chinese officials in order to intervene as quickly as possible when a problem arises. Many trade disputes start as a misunderstanding that can be resolved at the local level without it becoming a point of principle on one side or another. Our early warning system is designed to facilitate that approach.

In addition, the Department of Commerce has developed a China compliance working group that meets weekly to coordinate action on China's implementation of its WTO commitments. This group serves as a clearinghouse for all information received by the various agencies with roles in the process, from Commerce and the Office of the United States Trade Representative to the Departments of Agriculture, State, and Treasury. The goal at this stage is to make judgments as to whether and when we need to raise the issues directly at a political level with our Chinese counterparts to get appropriate action.

Beyond those standing functions, Secretary Evans has committed to send one senior Commerce official to China every month for the foreseeable future to check up on our implementation and trade promotion efforts. I will be leading that effort with help from the Assistant and Deputy Assistant Secretaries at the Department. But, the commitment of those senior resources to the fight further reflects the priority we place on China's implementation of its commitments.

Compliance, of course, is not just the threat of retaliation for the failure to implement trade agreements. In many instances, compliance has as much to do with encouraging a greater understanding of the WTO rules and their purpose. Toward that end, the Commerce Department, together with help from a variety of other agencies, has conducted a series of WTO compliance seminars in China that are designed to disseminate as much information as possible regarding the practical implications of the WTO agreements to Chinese officials both in the central government and in the provinces. The seminars to date have focused on those areas, such as intellectual property and standards, in which we have had particular problems in the China market in the past. My recent trip helped me assess what more we could be doing and where we need to focus our training efforts in the future.

The Commerce Department's efforts on WTO compliance, both in terms of monitoring and raising issues with the Chinese and in terms of training, have been greatly facilitated by the Congress' authorization and appropriation of funds for a number of new positions attached to the

compliance function. Recognizing the importance of ensuring China's compliance with its WTO obligations, a significant expansion of resources was proposed as part of its overall approach to China's WTO accession and the Congressional action on PNTR. Those resources, which have now been fully implemented with minor exceptions, have proved instrumental in this Administration's compliance efforts, as has the continuing support from Congress.

Outreach on Compliance

While our effort on China is a solid example of our commitment to compliance, that commitment extends well beyond that single case. For example, following my visit to China, I traveled to Taiwan to discuss WTO implementation and compliance issues there as well. Taiwan remains a particular problem with respect to intellectual property protection, and the trip offered the opportunity to bring the message home to our Taiwanese counterparts that we need to see significant progress on that and other fronts before we will be satisfied with the effort on implementation of Taiwan's commitments.

Following my trip to Taiwan, I visited Japan. There, we pressed our Japanese counterparts on a variety of market-opening issues. Those talks forged the way for a new market-promotion effort between Secretary Evans and Minister Hiranuma, the head of the Ministry of Economy, Industry and Trade (METI), and a joint effort to expand tourism and travel, signed just this past week between Secretary Evans and Minister of Land, Infrastructure and Transportation (MLIT) Ogi. But, in addition, we began the process of coordinating our compliance efforts on China. It is important from both Japan's and our perspective that we are consistent in a friendly but firm message to our Chinese counterparts regarding our expectations on implementation.

From Tokyo, I traveled to join Assistant Secretary for Import Administration (IA) Faryar Shirzad for the fourth high-level meeting on steel at the Organization for Economic Cooperation and Development (OECD). There, we continued an effort that I know is important to both the Chair and Ranking Member -- working to eliminate the vestiges of a 50-year legacy of foreign government intervention in the steel market. I view those talks as a fundamental part of the Administration's compliance efforts. The actions of other governments for years violated the spirit, and often the letter, of international trade rules by heavily subsidizing their steel industries, providing protected home markets, and by turning a blind eye to the anti-competitive actions of the industry in its home market. My point is that, from the perspective of the Administration, the notion of compliance reaches beyond ensuring the implementation of the letter of trade agreements -- it goes to the fundamental fairness that must prevail in the international marketplace if we are to ask the American public to support a trade-liberalizing trade agenda.

My partner in our compliance outreach efforts, and the leader of our troops in Market Access and Compliance (MAC), is Assistant Secretary Bill Lash. Bill, the Secretary and I discussed the Assistant Secretary's role in the compliance effort before Bill took the job. I can honestly say that at least Bill was forewarned. Assistant Secretary Lash has been on the road almost non-stop since he arrived, visiting virtually all of our major trading partners, and many of our smaller trading partners, preaching the gospel of trade compliance. Bill is on a mission to have MAC reach out to each of the 50 states to meet with American exporters to identify their trade expansion and compliance priorities. Senior officials from MAC have already visited your state, Mr. Chairman, that of the Ranking Member, and other members of the Committee, including Senator Carnahan.

The point of all of those efforts is to improve our outreach to American business. Secretary Evans has focused on outreach because it is instrumental to our problem-solving approach to compliance. That means that our outreach efforts have gone well beyond the travel of senior officials. Instead, we have made it a core part of our entire approach, using the resources we have in Washington and the resources we have throughout the United States and abroad via the tremendously talented individuals in the U.S. and Foreign Commercial Service.

In other words, we have cast a wide "net" in terms of our compliance efforts. Rather than simply waiting for problems to come to us, we conduct extensive public outreach programs to ensure that American business understands the benefits of trade agreements and the resources available through the Commerce Department and other governmental agencies to enforce them. We have a Compliance Liaison Program with trade associations and local business export councils to facilitate communication and prompt action on compliance issues. We also conduct routine surveys of our private sector Compliance Liaisons to learn about trade barriers and compliance problems their industries are facing. We continue to work with our Industry Sector Advisory Committee and Industry Function Advisory Committee members in this regard as well.

MAC tracks cases in a consolidated database of compliance and market access cases. This centrally administered database is the product of extensive consultations with users. It is operational at our posts in China and Brussels, and we will continue to roll it out to other posts throughout the year. MAC continuously seeks out information on specific compliance work that has not yet been reported.

I would be remiss if I didn't mention one other critical facet of our outreach efforts. As one of his first actions in office, Secretary Evans expanded our compliance liaison outreach to include the Congress. He asked all Members of Congress to identify a staff person to work with our Compliance Center to refer constituent market access or compliance problems. If your staffs are not already working with us on this effort, I hope they will. In addition, in MAC, we have dedicated a full-time staff person traveling state-to-state meeting with American workers and businesses and we are deploying members of our NAFTA office to the border states, in part to provide a means to follow up on issues raised in our discussions with individual Senate and House offices. Our EU rapid deployment team also is being sent to the states with the greatest number of exporters to the EU.

ITA's Human Capital -- The People Who Get the Job Done

As I indicated earlier, Congress has recognized the importance of compliance and has fully funded increases for us over the last couple of years. I applaud your leadership and foresight and hope to have your continued support for the President's FY 2003 budget request, which is essential to ensure a level-playing field for U.S. businesses and workers. Congress provided funding for 62 new full-time equivalent (FTE) positions in FY 2001 and 27 additional FTEs in FY 2002 as part of the FY 2001 Trade Compliance Initiative. We are using these positions in MAC and IA to:

- (1) monitor U.S. trade laws and international agreements;
- (2) monitor the accessions of China and Taiwan and the expected accessions of Russia, Saudi Arabia and the Central Asian Republics to the WTO;

- (3) address the increase of cases coming from Asia and the EU; and
 (4) prepare for a growing number of compliance cases

These positions are based abroad, as well as here at home. To address the growing number of market access cases we have in the EU, we have hired a compliance expert to serve on-the-ground in Brussels, and we have created the EU rapid deployment team. We are placing an IA officer in Geneva to work on compliance with World Trade Organization commitments on subsidies and trade remedies. In Asia, we have created several positions to be placed in China, Japan and Korea.

Our MAC unit saw 64 cases valued at \$2.9 million in FY 2000 and 106 cases valued at \$16.79 million in FY 2001. To date in FY 2002, MAC worked on 90 cases valued at over \$7.6 billion. This caseload represents an increase of an average of 67 percent per year. In 1995, IA conducted 159 antidumping and countervailing duty cases. From 1999 through 2000, IA conducted on average 280 cases per year, representing an increase of more than 75 percent. In addition, IA has worked with USTR to participate in 20 cases in the WTO, holding other countries to their commitments in the WTO and defending our right to utilize unfair trade remedies. We expect to continue to see caseload increases as we ramp up our compliance outreach efforts.

I believe that, with the recent increases in staffing, ITA currently has the resources to monitor and enforce trade agreements effectively. That said, I very much appreciate the Committee's interest in regularly reassessing the resources needed to meet new challenges in the enforcement arena, including new agreements which will in turn require additional monitoring and enforcement. If our outreach efforts continue to be successful, more people will learn about our work, and we will receive more compliance cases.

To address these growing needs, for FY 2003, the President's budget contains a request for an additional \$5 million and 33 FTEs for MAC, and more than \$6 million and 40 new FTEs for IA. What that means in practical terms is that MAC will be able to add enough trade specialists to support the recently launched WTO talks and the continuing FTAA negotiations and other bilateral talks as they enter the most critical phase. Over the next three years, negotiations will focus on the important details of trade analysis and building consensus on the most contentious issues. Once the agreements are complete, our staff will shift their focus to intensive monitoring and continued outreach with the public to ensure that our trading partners are upholding their obligations under these new agreements.

ACTUAL FTE POSITIONS

	FY '92	FY '93	FY '94	FY '95	FY '96	FY '97	FY '98	FY '99	FY '00	FY '01	FY '02 est.	FY '03 req.
MAC	224	204	192	177	161	171	169	175	158	197	216	249
IA	276	286	322	303	287	293	265	305	299	273	358	396
TOTAL	500	490	514	480	448	464	434	480	457	470	574	645

At the direction of the National Security Council, the Departments of State and Commerce co-chair an interagency committee on trade agreement compliance and monitoring. The committee also includes representatives from USTR, Treasury and Agriculture and serves to reduce duplication of efforts as well as coordinate overall U.S. policy. We also have created a similar working group to focus on the significant issue of textile compliance.

IA also monitors several agreements relating to imports of steel, including 10 suspension agreements, and an Executive Agreement with Russia that sets quota restrictions on 15 categories of steel products. In addition, as part of the President's steel initiative, IA is in the process of implementing an import monitoring program that will guard against surges of imports from countries excluded from the recently imposed Section 201 relief. IA will review data on imports from excluded countries on a quarterly basis. If the Administration determines that the increased imports threaten to undermine the goals of the relief, then those imports will no longer be excluded.

Simply increasing staff, however, is not enough. We are very focused on ensuring our folks are properly trained in foreign languages, economics and international relations, and we have requested \$1.2 million in FY 2003 for training them to have all the necessary tools. We are proud of the compliance training course that we have developed with the State Department's Foreign Service Institute, which has helped specialists from ITA as well as other agencies.

We will not rest on those efforts to date. One of the benefits of the management expertise that the President and Secretary Evans bring to the government as a whole and the Commerce Department in particular is a commitment to constant improvement. That principle is at the core of the President's Management Agenda and is, as a consequence, at the top of the Department's management agenda as well. What that means in practical terms is reflected in the new initiative Secretary Evans launched this past year in the inter-agency Trade Promotion Coordinating Committee (TPCC), which he chairs. That initiative is intended to establish benchmarks against which we could assess our performance in the trade promotion arena. One of the items we will be looking at this coming year as a part of that ongoing benchmarking exercise is the training needs of all ITA employees. We will determine how best to ensure that our training helps us accomplish the goals Congress has set out for us in our authorizing legislation. Compliance is on top of that list.

Conclusion

In conclusion, I want to stress that we stand ready to tackle the enforcement and compliance challenges ahead. If the Senate acts quickly to pass Trade Promotion Authority, we will begin with our efforts at the negotiating table, where we must insist that market access concessions are reciprocal and that the agreements offer enforcement tools that will assist our efforts in securing the benefits of an open trading system. Once agreements are in place, we will ensure that parties comply with agreements, and, in the event that parties fail to honor their agreements, we are fully prepared to enforce our rights through bilateral and regional dispute settlement procedures, the multilateral trading system, and U.S. trade remedy laws. In order to realize the benefits of the global free market system, we must keep the bargain on trade.

Thank you for giving me this opportunity to testify on a topic that is always relevant – but especially timely in the lead-up to the Senate's consideration of TPA. I appreciate your support for our efforts and welcome your questions.



TESTIMONY OF

**JAMES M. McCONNELL, EXECUTIVE DIRECTOR
U.S. SECURITIES AND EXCHANGE COMMISSION**

**CONCERNING CRITICAL RESOURCE AND STAFFING ISSUES
FACING THE SEC**

**BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF
GOVERNMENT MANAGEMENT, RESTRUCTURING AND THE
DISTRICT OF COLUMBIA**

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

APRIL 23, 2002

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

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**BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT
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OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS**

UNITED STATES SENATE

April 23, 2002

Chairman Durbin, Senator Voinovich, Members of the Subcommittee:

Thank you for the opportunity to testify before you today on behalf of the Securities and Exchange Commission to discuss critical resource and staffing issues that the Commission faces in its oversight of our increasingly complex financial markets.

Introduction

The events of September 11th, the bankruptcy of Enron and the more recent indictment of Arthur Andersen have all tested the strength, security and spirit of our economy, our capital markets and indeed our Country. In light of these events, and as the complexity and utilization of our financial markets continues to grow unabated, the Commission must have the resources it needs to fulfill its multiple missions and to maintain the public's full confidence in our capital markets.

The SEC regulates industries and markets that have grown enormously in both size and complexity. The Commission currently oversees an estimated 8,000 brokerage firms employing nearly 700,000 brokers; 7,500 investment advisers with approximately \$20 trillion in assets under management; 34,000 investment company portfolios; and over 17,000 reporting companies. The Commission also has oversight responsibilities for nine registered securities exchanges, the National Association of Securities Dealers, the National Futures Association, 13 registered clearing agencies, and the Municipal Securities Rulemaking Board.

The Commission today faces some of the most complex and difficult issues it has ever considered. No segment of American business has been more transformed by the rapid pace of technological innovation in recent years than the securities industry. New technologies, new participants, and new financial products are reshaping our markets. Our markets also are becoming increasingly global - a trend that most expect to accelerate in the coming years. Moreover, our national securities markets are taking steps to shed their long-held membership status and are moving to become publicly held entities. In addition, online trading and new technologies have empowered individual investors in ways that were previously unimaginable.

We are a nation of investors. In 1980, only 5.7 percent of Americans owned mutual funds. Today, some 93 million shareholders, representing 52 percent of U.S. households, hold mutual funds. Our nation's investors have an unprecedented stake in our markets. Whether through college savings plans or retirement accounts, our collective stake in U.S. markets continues to grow, and we are increasingly dependent on the success and integrity of those markets. In short, it is now more important than ever that the SEC remain vigilant in policing and maintaining the integrity and transparency of our securities markets.

Unfortunately, at the very time the challenges facing the Commission have grown, the Commission has been subject to extremely high attrition, principally because our employees earn substantially less than their counterparts in the private sector and even those who work for the other financial service regulatory agencies. Perhaps the single largest barrier to the Commission's effective recruitment and retention efforts was eliminated with the recent enactment of "pay parity." This critical legislation does not mean – nor should it – that SEC employees will be paid at the level of the private sector. It does, however, redress the obvious disparity that previously existed between SEC employees and employees of the federal bank regulatory agencies. Pay parity, when fully funded on a permanent basis, will help the Commission attract highly qualified staff who might otherwise decline employment with the SEC; it will also undoubtedly help the Commission retain its highly qualified staff. The legislation had the added benefit of establishing a stable, long-term funding source for the Commission, even after the meaningful fee relief provided under the legislation. In fiscal 2003, for example, the Commission will collect approximately \$1.3 billion in securities-related fees. Even after fully funding pay parity and the additional positions we have requested for fiscal 2003, the Commission will still collect over \$750 million more than our budget.

The Subcommittee has raised the issue of whether or not, in light of the collapse of Enron, our government has adequate staff to monitor publicly traded companies. I commend the Subcommittee for tackling such a critical issue. In fact, the Commission itself is engaged in a comprehensive review of the SEC's resource needs and operations. When Chairman Pitt came to the SEC last fall, he expressed his intention to perform an in-depth review of the Commission's operations, effectiveness, and resource needs in time for the fiscal 2003 budget process. The extraordinary events of the past eight months, including the destruction of our Northeast Regional Office, which was located in the World Trade Center complex, made any contemplative review of our resource needs impossible until recently. Though the extraordinary demands on the Commission's resources continue unabated, last month Chairman Pitt announced the commencement of a four-month internal special study to examine our resource allocations and needs to allow the results of the study to be part of the fiscal 2004 budget process, which starts in August with our submission to the Office of Management and Budget. This special study is also a direct result of the findings of the General Accounting Office as set forth in its two recent reports on certain aspects of the SEC's operations. We hope the special study will provide comprehensive and useful answers to the very questions that bring me before you today.

In my testimony today, I will address the steps the Commission has taken on the Subcommittee's stated topic of concern, which include our efforts to achieve, and now fund, pay parity; our immediate request for 100 additional personnel; our implementation of the special

study to address resource-related issues; and the Commission's response to two recent reports issued by the General Accounting Office.

Pay Parity

With the recent enactment of the Investor and Capital Markets Fee Relief Act, which authorizes the SEC to create a compensation system comparable to the systems of other federal financial regulators, the Commission finally is in a position to address the compensation issues at the heart of our serious recruitment and retention problems -- provided the SEC receives the ongoing funding to do so.

The SEC intends to make responsible increases in staff salaries and benefits and to ensure the appropriate use of merit and performance-based principles. We have described our plan to implement pay parity in our Pay Parity Implementation Plan and Report that we submitted on March 6, 2002 to the Congress (including the Senate Committee on Governmental Affairs) and the Office of Personnel Management.

In developing our compensation system, we strove to strike a delicate balance among competing interests that include the goals of the Administration, the concerns of Congress, and equity issues within the agency. Recognizing our responsibility to appropriately manage performance as we improve staff compensation, our system includes strong merit/pay-for-performance principles, as opposed to large, across-the-board pay increases that may be inappropriate for the federal service. Moreover, our \$76 million cost estimate represents a conservative approach to obtain comparability with the other federal financial regulators. We believe this will allow us the opportunity to ascertain over time how well our system is working before we become locked into a structure that might not meet our goals. In addition, to begin the program we plan to maintain the same benefits as are currently available to all Federal employees. It will take some time and additional funds to implement a more expansive benefit system.

Our proposed pay scale has 20 levels, each with up to 31 steps. Most staff will be placed within levels 1 through 17 (that include two additional supervisory levels), as opposed to the current 15 general schedule grades. Levels 18 through 20 are the executive levels with broad pay ranges, instead of the current 6 SES steps. The step structure is designed to make extra steps available to attorneys, accountants, and securities compliance examiners with securities industry experience. Our goal is to apply this new structure so that we can have a broader range of salaries available to aid in hiring new employees and to provide incentives to staff to perform at a high level.

In order to implement the new compensation system this fiscal year, the Commission has requested and obtained authority to use \$25 million from its no-year funds. We are actively seeking funding to assure that the new compensation system can continue in fiscal 2003. Failure to continue funding pay parity beyond fiscal 2002 would only exacerbate the problems that the legislation passed by Congress last December was intended to cure. By temporarily raising salaries and expectations of finally achieving lasting pay parity relief, we believe we will face even greater employee losses and suffer irreparable harm to morale if pay parity is not funded in

fiscal 2003, and thereafter. The threat of either terminating our pay parity program in fiscal 2003 or terminating approximately 700 employees — the number we estimate would have to be cut from the agency to continue pay parity — would cripple many of the projects we have underway, which are important for the protection of investors and Americans whose retirement accounts are invested in the securities of public companies.

We hope to make pay level increases in the pay period beginning May 19th in a manner consistent with the Pay Parity Implementation Plan and Report. We have had both preliminary discussions and a detailed pay system briefing with the National Treasury Employees Union and are advised that negotiations will commence next week. We are making, and will continue to make, every effort to complete negotiations by May 19th so that all employees will enjoy the benefits of pay parity at the same time. Each day of delay past May 19th will mean that our staff will not receive increased pay for which we have funding since we cannot make pay levels retroactive. After so many years of working for pay parity, the Chairman does not want to let a single day pass in which pay parity funds are available, but are not used, to increase the pay of the hard-working employees of the Commission.

Pay parity has been and remains Chairman Pitt's highest budget priority. This is a crucial time in the development and strategic future direction of our capital markets. The SEC cannot afford to continue suffering the staffing crisis it has endured for the past decade at such an important juncture. Pay parity, once fully funded, will provide the benefits we truly need to meet the increasing regulatory challenges we face.

Immediate Additional Staffing Needs

Because of recent events, and because of the sheer size and complexity of our markets, we need to act fast to maintain full confidence in our capital markets. We believe we cannot do that without additional personnel. Accordingly, when Chairman Pitt testified on the SEC's budget before the Senate last month, he requested that our fiscal 2003 staffing level be increased by 100 positions to meet our immediate resource needs. Since that hearing, the Administration has submitted its supplemental budget request to Congress and included in it \$20 million to fund these positions in fiscal 2002 and fiscal 2003. We are very grateful for the Administration's support. They have been extremely receptive to our request and willing to work with us to meet our resource needs. These 100 positions would allow us to add:

- 35 accountants and lawyers in the Division of Enforcement to deal with the increasing workload from financial fraud and reporting cases. To give you a sense of scale of this increasing workload, consider that over the first three months of this year, the Division of Enforcement has opened 64 cases investigating financial fraud and reporting, compared to approximately half that number of cases opened over the same time period last year.
- 30 professional staff, including accountants and lawyers, in the Division of Corporation Finance to expand, improve and expedite our review of periodic filings. Our Division of Corporation Finance has undertaken to monitor the annual reports submitted by all Fortune 500 companies that file periodic reports with the Commission in 2002. This new

initiative, which we announced in December, significantly expands the Division's review of financial and non-financial disclosures made by public companies.

- 35 accountants, lawyers, and other professionals in the other divisions – including the Office of the Chief Accountant – to deal with new programmatic needs and policy.

These 100 positions are the absolute minimum staffing levels we believe we require to deal with our *immediate* post-Enron needs.

Special Study

In March, we began a special four-month study to assess our resource needs in preparation for our upcoming fiscal 2004 budget submission. The study has three principal objectives: 1) to identify means to improve agency quality, efficiency, timeliness, and productivity with the existing resources available; 2) to determine whether the SEC requires additional resources (including personnel, technology, and training) to successfully fulfill its statutory responsibilities in light of the external environment in which it operates, and, if so, how much is needed, either immediately or long-term; and 3) to examine how the agency can operate strategically, by developing and implementing methods to rapidly identify trends and changes in the external environment so that it can respond and act effectively and on a timely basis, consistent with the goals of the President's Management Reform Agenda and the Government Performance and Results Act.

The special study is intended, in part, to implement the GAO's conclusion that strategic planning could help the SEC better identify and manage its resource needs. The special study is being conducted by mid- and senior-level staff from divisions and offices throughout the agency with working experience in more than one of the major divisions or offices. An outside consulting firm with expertise in both private and government legal settings is assisting this team. The study is examining and documenting the current operations of the agency, focusing on workload, resource allocation, methods for assignment and management of work, and existing means of measuring performance, productivity and quality of effort. Commission staff leading the study have already apprised the GAO and the OMB of this effort and solicited their views, and intend to continue to do so throughout the study.

We anticipate completing the study by the end of July. While we cannot predict what the results of our in-depth evaluation will be, we are asking ourselves tough questions and remaining mindful of the competing and important priorities our government faces.

The special study team welcomes comments from the public. Comments should be directed to SpecialStudy@sec.gov or to Special Study Team, Office of the Executive Director, U.S. Securities and Exchange Commission, 450 Fifth St., N.W., Washington, D.C. 20549.

Responses to the GAO Report on Human Capital

In addition to implementing the special study, the SEC has also taken numerous steps in direct response to last year's report of the General Accounting Office entitled Securities and

Exchange Commission: Human Capital Challenges Require Management Attention (GAO-01-947). This GAO report confirmed that “inadequate compensation is the primary reason that employees leave the agency.” While recognizing the appropriateness of the SEC’s efforts to ameliorate its staffing crisis by seeking pay parity with the banking regulators, the GAO made several additional recommendations to improve the SEC’s human capital management practices. We have taken and will continue to take steps to implement these welcome recommendations, and I will now briefly address those relevant to today’s hearing.

Formal Employee Surveys

The GAO recommended that the SEC use formal approaches, such as periodically surveying employees, to evaluate job satisfaction and morale, identify employee concerns, and analyze the effectiveness of the agency’s use of flexibilities and work-life programs. Commission staff previously indicated to the GAO that we would review the results of the GAO survey and the 2001 Office of Personnel Management survey, and would further survey employees “as needed.” While finding this to be a “useful first step,” the GAO recommended that a systematic process for an independent survey be established, so that fact-based measures may be used to determine the success of initiatives, gauge morale, and identify concerns on an ongoing basis.

The Commission understands the importance of surveys as a tool to measure the morale and learn about the concerns of its employees. The SEC intends to continue to take the steps necessary to examine the level of employee morale and job satisfaction, and our special study does this explicitly. As part of this effort, the Commission is developing and will implement a more formalized survey system.

Involve Human Capital Leaders in Decision-Making

The GAO also recommended that the SEC identify ways to involve human capital leaders in decision-making and establish a practice that requires management to monitor and refine the SEC’s human capital approaches to ensure their ongoing effectiveness in addressing employees’ needs, including working with the National Treasury Employees Union to address expeditiously areas of dissatisfaction identified in the GAO report. These areas include opportunities for advancement and the quality of administrative support services.

Although the level of consultation between the SEC’s senior management and human capital leaders has historically been very high, the Commission is working very hard toward formalizing the process. Specifically with regard to working with the NTEU on the areas of concern noted in the GAO’s report, Commission representatives are presently conducting negotiations with the NTEU on a collective bargaining agreement that should help address these concerns.

Responses to the GAO Report on SEC Operations

In addition to the foregoing, the SEC has taken many steps in response to the recent report of the General Accounting Office entitled SEC Operations: Increased Workload Creates

Challenges (GAO-02-302). This GAO report reviews how the securities markets have changed and evaluates whether the SEC's resource levels have affected its ability to regulate and oversee the markets.

We agree with most of the conclusions that the GAO draws in the report. In particular, we agree that securities markets have experienced unprecedented growth and change in the last decade, that the markets have become more complex and international, and that legislative changes have spurred new products and created new regulatory responsibilities. We also agree with the report's conclusion that the SEC's ability to fulfill its mission has become increasingly strained. As noted in the report, SEC resource levels have not grown commensurate with its workload, and the SEC faces continuing challenges from its high staff turnover rate and difficulty in hiring qualified staff.

Findings in the GAO report go to the core of the Chairman's view that government is a service business, consistent with the Commission's overriding investor protection mission. Being a service business does not mean saying "yes" to any and all parties. It does mean that the Commission and its staff, as public servants, have an obligation to reach decisions and provide answers as quickly and as efficiently as possible so that government does not end up inadvertently impeding a vibrant and growing economy. The promptness with which the Commission responds to its many constituencies is one of several objectives of the special study.

While recognizing the SEC's efforts to address its resource challenges, the report recommends that the SEC develop short-term and long-term strategies to address these challenges. As discussed below, we are taking steps to implement these recommendations.

Short-Term Strategies

The GAO recommends that, in the short-term, the SEC take definitive steps to continue to address its turnover problem and fill its vacant positions. The GAO indicates that these actions should include exploring use of the SEC's no-year funds to expand recruiting and retention efforts to ensure that all available resources are maximized to attract and retain staff. The GAO also recommends that the SEC explore innovative ways to attract senior level staff and bring in additional information technology expertise to better position itself to oversee evolving securities markets.

The Commission understands the importance of addressing our staffing needs. As discussed above, we hope to be in a position to implement pay parity for all employees by May 19th. The Commission has also worked diligently over the last several years to take advantage of recruiting and retention tools available to it under Title 5.¹ The Commission will continue to use these tools and explore innovative ways to attract and retain staff, even after the implementation of pay parity. Ultimately, however, the solution to our recruiting and retention difficulties depends in large part on the ability to compensate our employees adequately, a solution that could be largely achieved with the full and ongoing funding of pay parity.

¹ Please see Appendix A for a summary of these efforts.

Long-Term Strategies

The GAO also recommends that, in the long-term, the SEC broaden its strategic planning process to systematically determine regulatory priorities and resource levels to fulfill its mission. Once this is completed, the GAO recommends that the SEC link the strategic plan to staffing allocation and workforce determinations and expand its existing recruiting efforts to include any additional disciplines identified as necessary to effectively regulate evolving securities markets. Our special study is a critical first step in accomplishing this, and we look forward to employing the results of the study to better fulfill our important mission.

Conclusion

The SEC currently oversees increasingly complex and international industries and markets with modest staff and limited resources, operating in conjunction with the states and self-regulatory organizations. While this cooperative structure enables the Commission to leverage its resources to fulfill its missions, leverage can only go so far. The SEC needs full funding for pay parity in fiscal 2003 and more personnel immediately. In addition, we are continuing to evaluate our staffing and other resource needs through our agency-wide resource assessment which will conclude at the end of July.

We are confident that with these additional resources, the SEC will have the capacity and personnel to ensure that our markets remain the envy of the world and are as fair and transparent to all investors as we can possibly make them. Thank you for the opportunity to testify today. I am pleased to respond to any questions the Subcommittee may have.

APPENDIX A**Summary of the SEC's Actions Taken Under Title 5**

The recruiting and retention problems the Commission faces are not new, nor are the Commission's attempts to remedy them. Indeed, the Commission has worked diligently over the last several years to take advantage of the existing flexibilities available under its current pay schedule that exists under Title 5. In particular, the SEC has gained special rate pay authority on two different occasions; used recruitment bonuses, retention allowances, and superior qualifications appointments; and undertaken various quality of life efforts. In addition, in 1998, the Commission received the authority under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), to increase the salary levels that it can pay its economists. While some of these efforts have provided temporary relief for the Commission, none has resolved the Commission's need for permanent, systemic pay relief. The Commission's experience with these various tools is as follows:

Special Pay. In 1992, the SEC obtained the authority from the OPM to pay staff attorneys and accountants with at least two years of securities industry experience special pay rates at approximately ten percent above base pay. Over the short term, this grant of authority did reduce the Commission's recruitment and retention problem, although our turnover rates still remained above the government-wide averages. However, its effectiveness was eroded quickly with the implementation of annual government-wide locality pay increases. In 1994, locality pay became available and the special pay differential began to disappear because employees receiving the special rates cannot, by OPM regulation, receive locality pay raises each year.

The SEC's fiscal 2001 budget also included funds to reinstate a special pay differential for securities industry attorneys and accountants, and added the differential for experienced securities compliance examiners. New special pay rates were approved by OPM in March 2001. While we believe these rates contributed to reduced staff turnover in fiscal 2001, they were less than the differential between the SEC and the other federal financial regulators and again are subject to the locality pay erosion.

Recruitment Bonuses. Since 1992, we have provided over 245 recruitment bonuses averaging 10 percent of base pay. Over 180 (74 percent) of these bonuses have been provided within the last one and one half years, as our difficulty in attracting key staff has increased dramatically. Recruitment bonuses, by their nature, are one-time payments that do not address the serious structural problems with the Commission's salary scale.

Superior Qualifications Appointments. In fiscal 2000 and 2001, most of our attorney, accountant, and compliance examiner hires were appointed at higher than Step 1 of their grade as the only way we could attract these high quality candidates to the SEC. However, such appointments mean that these individuals will now run more quickly into in-grade pay ceilings that are significantly lower than those at the banking agencies.

Retention Allowances. Since 1993, over 120 employees have received retention allowances. Currently, 53 employees receive allowances that range from 3 to 25 percent of their base pay. In

fiscal 1999, three employees receiving retention allowances left the SEC; in fiscal 2000, ten employees receiving retention allowances left the agency; and in fiscal 2001 seven employees receiving retention allowances left the agency. Like recruitment bonuses, these payments are merely stopgap measures that do not address the structural, long-term problems with the Commission's uncompetitive pay scale.

Economist Special Pay. Although SLUSA granted the Commission authority to pay higher salaries to certain economists than those permitted under Title 5, this authority was capped at levels significantly lower than those at which the banking agencies pay their economists. Even with this limitation, however, higher pay has slowed economist attrition at the SEC. Since 2000, when the new pay scale went into effect, the SEC has had a net gain of eight economists. The economist pay provisions of SLUSA were repealed by the pay parity legislation.

Transportation Benefits. In 1993, the SEC began providing transportation subsidies of \$21 per month to eligible staff in an effort to encourage them to use public transportation. The SEC increased the subsidy to \$42 per month in 1999, and further raised it to \$65 per month in 2000. Approximately two-thirds of the staff currently receive the transportation benefit. We believe this benefit has not had an appreciable affect on the length of time that employees choose to stay with the Commission, as it translates into a very small benefit for the average mid-level professional.

Compressed Work Schedules. The SEC has allowed staff to request alternate work schedules for many years. During the past five years, pilot compressed work schedules following the "5-4-9" model have been implemented in certain SEC offices. In February 2001, a "5-4-9" pilot program was introduced for the entire agency. The SEC currently is negotiating a contract with its employee union that will, among other things, address alternative work schedules.

Fitness Center. The SEC's Headquarters fitness center opened in 1992. Approximately 475 employees currently are members of the Headquarters fitness center and 100 employees belong to the center at our Operations Center, paying only a small monthly fee. The fitness center also sponsors wellness programs for all employees. However, to our knowledge, two of the banking agencies, and possibly more, provide a comparable fitness facility and programs at less cost to most users.

Emergency Child Care. In 1999, the SEC made arrangements with a contractor to provide emergency child care for employees in several locations.

Critical Pay. Current law allows certain "critical personnel" to be paid at rates up to that paid to the Vice President. Government-wide, this authority is colloquially referred to as the "Nobel Laureate" provision because an employee essentially needs to be of Nobel Laureate caliber to be approved for critical pay by OPM. No more than a handful of employees currently receive this level of pay across the entire government, and none of them works for the Commission. As such, and after various discussions with OPM regarding this authority, this is not a tool that the SEC has attempted to employ.

Pay Banding. The Commission has not implemented pay banding. Implementing such a system would provide more flexibility to reward outstanding performers, but only up to the pay levels at the top of the band. Many of our staff already are being paid close to the ceiling of what we would be able to give them under a pay banding system. Therefore, this would be at best a partial solution that fails to address the main problem, leaving our top performers well short of the pay of their counterparts at the banking agencies.

STATEMENT BY

**EDWARD L. BLANSITT
DEPUTY INSPECTOR GENERAL
U.S. DEPARTMENT OF COMMERCE**

**BEFORE THE
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,
RESTRUCTURING AND THE DISTRICT OF COLUMBIA
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE**

APRIL 23, 2002

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to discuss the Department of Commerce Office of Inspector General's work and plans in connection with the Department's efforts to increase international compliance with trade agreements and expand foreign market access for American exporters.

As part of a comprehensive planning process performed during the summer of 2001, the Office of Inspector General sought to identify those areas and activities of the Department of Commerce that we believe are most in need of our attention. Our staff conducted research on the Department's operating units and its primary missions, reviewing a wide range of materials including budget requests, executive branch policy directives, legislative documents, annual performance plans and reports, and relevant congressional testimony. Finally, we held discussions with key Commerce officials, congressional staff, and other stakeholders to gain additional insight into potential topics for subsequent review by our office.

Through this process, as reported in our September 2001 *Semiannual Report to the Congress*, we identified the need to increase international compliance with trade agreements and expand market access for American exporters as one of the top 10 management challenges facing the Department of Commerce. We made this determination based on the fact that trade compliance was, among other factors, a critical component of the nation's overall trade agenda, a priority of the Secretary, and a concern of the Congress and others.

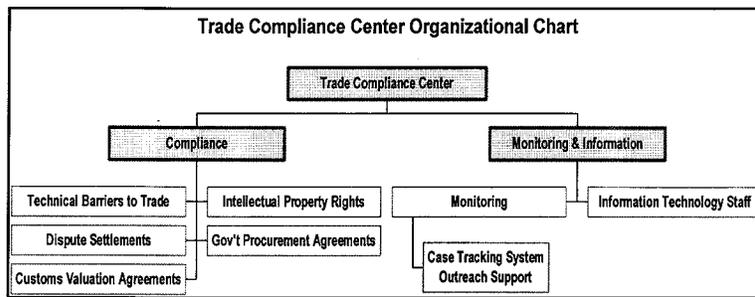
In our efforts to address this major management challenge, we plan to undertake a series of reviews aimed at evaluating the overall effectiveness of the Department's activities to enforce trade agreements and laws designed to prevent unfair trade and to help U.S. exporters overcome trade barriers, as well as the Department's cooperation and coordination with other U.S. agencies working on these issues. We also plan to review specific management and operational aspects of the International Trade Administration's (ITA) trade compliance initiative, including plans for new overseas compliance officers and additional country desk officers. Furthermore, we also intend to evaluate the ITA Office of Import Administration's efforts to enforce U.S. antidumping and countervailing duty laws.

In March 2002, we issued our initial report dealing with ITA's trade compliance efforts. Within ITA, market access and compliance is handled by three units: Market Access and Compliance (MAC), Trade Development, and the U.S. and Foreign Commercial Service (US&FCS). The Commerce Department reorganized its international economic policy and market access staff in July 1996 to give greater focus to market access and trade compliance issues. It created the MAC unit within the International Trade Administration and housed a new Trade Compliance Center in that unit. Our review focused on the activities of ITA's Trade Compliance

Center (TCC) in an effort to determine whether its management of the trade agreement compliance process was efficient, effective, and responsive to client needs. Let me briefly discuss the TCC and some of the observations contained in our report.

The TCC is now the Department’s focal point for trade compliance. It provides information about trade agreements and helps U.S. businesses understand their rights and gain market opportunities. The TCC’s Compliance staff is divided into five areas of expertise that are based on technical areas in World Trade Organization (WTO) agreements, including technical barriers to trade, intellectual property rights, dispute settlements, government procurement, and customs valuation (See Figure 1).

Figure 1



In addition to an on-line database of trade agreements, the TCC offers web-based products such as a complaint hotline, trade agreement “how-to” guides for businesses, and compliance or agreement-related news and updates. The compliance and the monitoring staffs also oversee foreign compliance with trade agreements, and conduct outreach to the exporting community to explain the Department’s compliance services. Finally, the TCC tracks and helps to resolve

company trade complaints that come to its attention. In doing so, the TCC coordinates with staff of other federal agencies, as needed. Of equal importance is the TCC's coordination with other ITA staff.

At the time we did our review of the TCC, we found that prior to fiscal year 2001 its budget and staffing had remained relatively level since its creation, except for an increase in fiscal year 1998, and a temporary funding drop in fiscal year 2000 (See Table 1).

Table 1: TCC Resources

	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Budget Allocation	\$1.15 M	\$2.07 M	\$2.05 M	\$1.50 M	\$1.91 M
FTE Allocation	17	25	25	24	30
Actual FTEs	17	18	19	18	24

In fiscal year 2001, ITA received a \$12.8 million increase to fund a compliance initiative for MAC and Import Administration. Of this amount, MAC received a \$5.3 million increase. The compliance initiative placed special emphasis on building expertise within Import Administration and in MAC in order to increase attention to compliance and market access issues related to China, Japan, and Korea.

We conducted our review of the TCC just as it was expanding. At that time, we found that there was considerable confusion among ITA's units about the mission and responsibilities of the TCC. Thus, we evaluated how to better coordinate the compliance activities of the various ITA

units so as to avoid duplication and ensure full reporting. We also examined whether ITA's compliance efforts were successful at promoting adherence to trade agreements and addressing market access problems.

Our report noted that trade agreement compliance work needs to be better coordinated within ITA and that collaboration between ITA's operating units should be improved. Each ITA unit has unique areas of expertise that are important to the positive resolution of trade compliance cases. However, we found that many staff members did not understand the role of the TCC and thus were not effectively using its assistance in working trade compliance problems. Moreover, we reported that organizational rivalries between the various ITA units further hindered better collaboration, as did the lack of written guidance about the need for and importance of working together to ensure that U.S. exporters receive complete, timely, and accurate responses to compliance complaints. In addition, we pointed out that the TCC lacked the authority necessary to require cooperation from the units.

We recommended a number of actions that ITA management should take to address these problems, including the development of guidance that clearly delineates the role of the TCC and defines the types of complaints and issues that the overseas and domestic staff from the other ITA units should bring to the TCC's attention.

After we completed our fieldwork, the TCC developed and distributed a trade compliance manual to all ITA staff. The manual does a good job of explaining how the compliance program works and outlining the roles of the various ITA components. At the same time, it should be

strengthened to provide more definitive criteria or guidance that staff can apply to incoming complaints to guide them as to when to coordinate with the TCC.

Our review also identified the need for a central database of trade compliance work. The TCC is responsible for tracking ITA-wide compliance-related activities and reporting this work monthly to the Secretary. The TCC relies on the individual units to provide it with information about their activities, but the various units often fail to report all of their compliance work. We determined that there was no single database for tracking ITA-wide compliance activity, as the units used several databases to record their own work. Therefore, we recommended that ITA establish a central database that tracks all compliance work performed by the TCC, the U. S. and Foreign Commercial Service's overseas posts and domestic U.S. Export Assistance Centers, MAC's country desks and the TD industry experts, as well as the other parts of the Department.

ITA has advised us that it moved to a consolidated database of compliance and market access cases in February 2002 and that the monthly compliance reports to the Secretary receive clearance from all four of its operating units. We are encouraged by ITA's efforts. However, because the consolidated database is primarily used by MAC units (the country desks and the TCC), it is still unclear how market access and compliance work performed by US&FCS and Trade Development will be included in the database. Accordingly, we have asked ITA to look at further consolidation of its database.

Our report also examined performance measures proposed by ITA for assessing the effectiveness of its trade compliance activities and noted that although some adjustments were still needed, the TCC complaint process has improved since the TCC began handling such matters in 1997. The

staff's knowledge and experience have grown, and the results achieved by the compliance teams have enhanced ITA's efforts to increase access to foreign markets and compliance with trade agreements

As I mentioned earlier, because of the importance of trade compliance and market access to the success of U.S. exporters, we intend for our recently completed report to be the first in a series of reviews to be conducted in this area. Our future reviews will focus on different aspects of ITA's strategy for helping companies reduce trade barriers, gain greater market access, reap the benefits of trade agreements, and lessen the impact of unfair trade due to foreign dumping and subsidies.



This concludes my prepared statement. Mr. Chairman, I would be happy to answer any questions you or other members of the Committee may have.

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Step toe & Johnson LLPBefore the Subcommittee on Oversight of Government Management,
Restructuring and the District of ColumbiaHearing on Vital Assets: Human Capital
In Federal Economic Regulatory Agencies

April 23, 2002

Mr. Chairman and Senator Voinovich, thank you for giving me the opportunity to testify before the Subcommittee this morning on the human capital needs of the International Trade Administration (ITA) at the Department of Commerce. The fiscal and personnel needs of ITA have been matters of interest to me for many years – first in my oversight capacity as a staff member to the Senate Committee on Commerce, Science, and Transportation; then in my roles within ITA as a Deputy Assistant Secretary in Trade Development and Assistant Secretary for Import Administration; and now as an attorney in the private sector practicing international trade law.

While at the Department, I also served on the ITA Performance Review Board, which reviews the annual appraisals of the ITA Senior Executive Service, and on the Undersecretary's task force on diversity.

First, let me say that it was a privilege to have served in the International Trade Administration. ITA is filled with many talented, dedicated public servants. As you know, we have moved into an age in which being an international trade specialist means much more than being able to read a tariff schedule. Trade issues increasingly require the ITA staff to delve into a daunting array of complex issues, including regulatory systems, intellectual property, trade in services, and information technology. ITA deserves a great deal of credit for constantly evolving to develop expertise as the parameters of international trade issues rapidly expand.

I greatly appreciate your efforts today to focus attention on the role that ITA plays in promoting the economic well-being of U.S. businesses and workers. ITA is the one agency which is immersed in every facet of the Federal government's role in international trade policy: from negotiations, to enforcement, to export promotion.

The staff of the Office of the United States Trade Representative (USTR), like ITA's staff, is extraordinarily talented. Since the inception of USTR, the Congress and each Administration have seen fit to have USTR remain a relatively small staff, under the Executive Office of the President, whose role is to be an "honest broker" among agencies in formulating U.S. trade policy. Thus, USTR must draw upon the expertise of other agencies in order to carry

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out its mission. ITA, therefore, plays an enormous role, working hand-in-hand with USTR on negotiations, enforcement, and dispute settlement.

No matter what the subject matter du jour, ITA staff are at the negotiating table with USTR. And, once the ink is dry on an agreement, the primary responsibility for monitoring and enforcement falls to ITA. In its enforcement role, ITA works closely with U.S. businesses to pinpoint specific instances in which our trading partners are not living up to their commitments, and to identify cases for the United States to pursue under the dispute settlement procedures of our various trade agreements.

I think one of the most important roles ITA can play, though, is to help U.S. businesses resolve market access issues before going to costly and lengthy official dispute settlement proceedings. In this regard, it is crucial that Trade Development, Market Access and Compliance and the Commercial Service work closely together.

Also, it is very important to remember that, while acrimonious dispute proceedings get the bulk of ink in the press, a great deal of what ITA does is to facilitate business contacts between U.S. and foreign parties. The efforts of ITA to help small and medium sized businesses understand and realize the opportunities afforded by international trade are especially admirable and should be expanded.

With respect to the Import Administration (IA), it is important for both petitioners and respondents alike that the agency has the staff and financial resources to process the cases in a manner that is fair to both sides. Also, IA needs adequate resources to monitor antidumping actions by foreign governments and to assist U.S. companies affected by those actions.

Again, I have great admiration for the staff at ITA and the herculean job they are doing in assisting U.S. businesses and workers in a rapidly-changing world. Based on my experience, I would offer a few suggestions, all of which I think would be supported by the ITA staff:

- While it is important for ITA to maintain both industry-specific and country-specific expertise, the agency would benefit from a somewhat greater rotation of staff around the different offices – especially with the more junior staff. This would allow staff to develop a well-rounded expertise in international trade law.
- Congress could provide more support to an ITA-wide recruiting effort – especially to attract young people coming out of law and graduate schools who are eager to work on international issues.
- ITA definitely needs an “information-age” makeover, to allow the various components of ITA to operate on the same information technologies, and to allow for electronic filing of submissions with IA.

Again, thank you for the opportunity to share my thoughts with you. I will be happy to answer any questions you may have.

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THE GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON OVERSIGHT OF
GOVERNMENT MANAGEMENT,
RESTRUCTURING AND THE DISTRICT OF
COLUMBIA

UNITED STATES SENATE

**"The Economic Implications of the Human
Capital Crisis."**

Tuesday, April 23, 10:00am

342 Dirksen Senate Office Building

Written Statement

Lynn Turner

Thank you Chairman Durbin and Ranking Member Voinovich for the opportunity to address the implications of the human capital crisis faced by the United States Securities and Exchange Commission (SEC). This crisis is very real today and I commend you for your leadership in calling this hearing. As the regulator of the U.S. capital markets that have attracted over half of the total capital available around the globe, it is vitally important that the investors have faith and confidence in the work of the SEC.

As I believe you are aware, I served as the Chief Accountant of the SEC from July of 1998 through August of 2001. I also served on the staff of the SEC from June of 1989 through July of 1991. Currently I am a professor of accounting and Director of The Center For Quality Financial Reporting at Colorado State University.

From June of 1996 to June of 1998, I was Vice President and Chief Financial Officer (CFO) of Symbios, Inc., an international manufacturer of semiconductors and storage solution products. In that capacity I was actively involved in human resource issues including budgeting for company-wide human resource needs and recruiting and hiring all staff in the finance and accounting department. Prior to joining Symbios, I served as a partner at one of the then "Big Six" international accounting firms, Coopers & Lybrand (C&L). While at C&L, I served as an auditor and partner who reviewed SEC filings. I was also active in our personnel recruiting efforts.

Dedicated Public Servants

Let me begin by first noting that the SEC staff are some of the hardest working, most dedicated employees I have ever worked with. They take a back seat to no one, including thousands I have worked with in the private sector. Those that worked with me in the Office of The Chief Accountant were highly professional and technically competent, often worked ten to twelve hour days, as well as gave up part of their weekends, and never once complained.

In fact, time and time again, the private sector has reached out and hired the staff of the SEC. Many of these former staffers serve in such prestigious positions today as senior partners in many of the premier law firms in this country, as the heads of the National Offices of the Big Five accounting firms, and as senior financial executives in public companies. The success stories both while the staff have been at the Commission and in private industry speaks highly for the quality of individuals the SEC has been able to retain. In light of the high cost of living in Washington D.C. and in cities where some of the regional offices are located, such as New York, San Francisco and Los Angeles it also speaks volumes about the willingness of these people to make sacrifices while they provide an invaluable service to the American public.

Inadequate Resources Creates Crisis In Confidence

However, as Enron has clearly demonstrated, one of the critical issues facing American investors is a lack of adequate resources for the SEC. The budgetary handcuffs that have been placed on it in the past have prevented it from accomplishing its mission as the

advocate for the investors. Investors that today comprise one out of every two adult Americans. Investors that in recent months, have grown uncertain and unsure about investing in the U.S. capital markets that are the economic crown jewel of this nations economy.

Resource shortages at the SEC have been highlighted by the recent study of the SEC conducted by the General Accounting Office and entitled "Increased Workload Creates Challenges." These shortages include insufficient funding for adequate staffing, pay scales significantly below both pay scales for private industry and other governmental agencies, and a lack of tools necessary for the staff to do their jobs effectively such as up-to-date technology. For example, some key highlights that have been pointed out include¹:

- The volume of shares traded in 2000 was over 30 times higher than in 1980. In 1947, the average daily turnover on the New York Stock Exchange was less than 1 million shares; in 1971 it was over 15 million shares; last year it hit 1.24 billion shares.
- At the end of calendar year 2001, the total market value of U.S. stocks was almost \$13 trillion, representing an increase of 345 percent from the \$3 trillion level in 1990.² At the height of the markets, almost one-third of the total wealth in America was invested in the stock markets.
- The number of initial public offerings (IPO's) in 2000 was over 50 times the number of IPO's in 1980.
- The number of investors has increased from 6 million in the 1948; to almost 32 million in 1972; to approximately 85 million today. There has been a 61 percent increase in just the ten years from 1988 to 1998.
- Electronic Communication Networks (ECNs) now account for approximately 35 percent of the daily share volume in Nasdaq securities. Although unknown just a few years ago, by 2001 there were 200 online trading firms operating in the U.S., with approximately 19.3 million online brokerage accounts generating approximately 900,000 trades per day.³
- The number of corporate filings has increased by 59 percent from 61,925 in 1991 to 98,745 in 2000.

¹ See United States General Accounting Office Report to Congressional Requesters, *SEC OPERATIONS – Increased Workload Creates Challenges*, GAO-02-302, March 2002; U.S. Securities and Exchange Commission, *Agency Resources and Industry Growth*, April 2002.

² Securities & Exchange Commission, *Governmental Performance and Results Act (GPRA), 2003 Annual Performance Plan and 2001 Annual Performance Report*, March 2002, page 4.

³ Ibid, page 5.

- Today there are over 1,300 foreign companies from over 59 countries accessing our markets. Many of those companies come from countries where the regulator is at best weak, at worst practically nonexistent.
- Over one-third of the SEC's staff left the agency from 1998 to 2000. Approximately 250 positions of the SEC's 3,285 positions remained unfilled in September 2001. By far and away, the most common reason I heard from staff as to why they were leaving was the inability to continue doing what they really liked to work at, as they were unable to afford it and meet their commitments to their families.
- While the value of public offerings increased from \$587 billion in 1991 to \$2.535 trillion in 2001, an increase of 431 percent, the SEC review staff increased during the same time period from 238 to 259, an increase of less than 9 percent. No wonder the staff was unable to review filings on a timely basis by companies such as Enron.
- While the assets of the New York Member firms increased from \$604 billion in 1991 to \$2.718 trillion in 2001, an increase of 450 percent, the SEC oversight staff increased from 180 to 281, an increase of 56 percent.
- While the assets under management of investment advisors increased from \$5.4 trillion in 1991 to \$20 trillion in 2001, an increase of 370 percent, the number of inspection staff increased from 140 to 376, an increase of 268 percent.

I could go on and on, but I think these facts present a stark enough story. The story of an independent agency, vitally important to Americans, our capital markets and our economy. An agency also captured and held hostage by the chains of its budgetary constraints.⁴

But let me take you inside the agency and discuss the implications for investors of some of the constraints placed on the SEC.

Timely Enforcement Activities Impeded

First let me start with enforcement activities. Investors need to be ensured after events like Enron, Global Crossing, Waste Management and the litany of financial fraud cases that have cost them approximately \$200 billion, that the SEC watch dog is on the beat. The current chairman of the SEC, Chairman Pitt has called for real time enforcement. I commend him for this initiative. But given current funding levels, I know "real" substantive enforcement is a figment of one's imagination.

⁴ See the U.S. Securities & Exchange Commission, *Authorization for Appropriation Fiscal Years 2002 – 2003*, which requested \$587 million in funding, including \$70 million for pay parity. The appropriation request highlights the challenges and budgetary crisis facing the SEC. However, as the U.S. Securities and Exchange Commission, *In Brief – Budget Estimate Fiscal 2003* notes, the total budget authority enacted for fiscal year 2002 was only \$438 million, or only 75 percent of what was requested.

While I served at the Commission, I worked closely with the Division of Enforcement and its staff. In the SEC's Washington D.C. headquarters, there were approximately 25 positions for enforcement accountants. It was not unusual to see somewhere between 5 to 10 of these positions open. Perhaps there are another 40 enforcement accountants around the country in regional offices. At the same time, the Commission had 200 to 250 open cases at various stages of investigation and prosecution.

I have served as an expert witness on financial fraud cases, including as a partner at C&L. Often we would have 3 to 4 accountants working on a single case. Complex cases such as Enron may require considerably more. Simple multiplication tells one very clearly that the odds are good to excellent the SEC will not be able to successfully investigate many of the financial fraud cases in front of it. In fact, it was not unusual at all, that a case would become stale and grow old and staff assigned to the case would pursue other job opportunities. Often the outcome was that the cases would be closed and never be completed because of this lack of resources.

Another detrimental outcome from a lack of resources were trade-offs the staff had to consider from time to time. When confronted with a difficult case, we would sometimes have to decide whether to take a settlement we really did not like, or face the prospect of spending a disproportionate share of resources litigating it. Often litigating a case to achieve justice for investors might mean other worthy cases would have to be dropped. It was a trade-off that happened all too often for the law enforcement agency charged with overseeing the integrity of the markets. And the defense bar knew all too well that they could and would likely win the war of attrition.

I would encourage the subcommittee to consider requesting the SEC or GAO to analyze financial fraud enforcement cases opened during the 1990's, and determine the actual disposition of the cases including those that were successfully settled or litigated, and those that were just closed and withered away for lack of resources. In the end, I believe that such a study would prove out the need for a significant increase in the number of personnel assigned to financial fraud cases. To adequately prosecute these cases, an increase in the number of accountants upwards towards 50 to seventy-five accountants may be necessary.

I will also point out for you that timely enforcement activities have been precluded by the inability to obtain timely decisions from the administrative law judges. For example, a decision on a case that was tried before a judge in the summer of 1998 was just handed down at the end of 2001.⁵ It is unfortunate for both the defense and SEC to have this process proceed at such a snail's pace. Consideration should be given to whether the SEC has sufficient funding for the administrative law judge offices.

Protecting Investors By Timely Filing Reviews

⁵ See *In the Matter of Jeffrey M. Steinberg and John Geron*, Administrative proceeding File 3-9628, initial decision rendered December 20, 2001 regarding 1993 misstated financial statements.

As I mentioned earlier, total filings with the SEC in 2000 were 98,745. In 2000, approximately 14,280 issuers filed annual reports with the Commission. These issuers will also typically file three quarterly reports with the Commission. That adds up to about 57,120 filings a year. And of course, that is before all of the initial and secondary public offerings, merger and tender offering filings the Division of Corporation Finance receives. There were 451 initial public offerings alone on the Nasdaq, NYSE and AMEX in 2001. Often these filings may include complex legal documents and agreements that can be over a foot thick! To read and understand them sufficiently to be able to effectively communicate with the company, can often take days or weeks. And just as in the case of Enron, these filings require one to gain an understanding of complex transactions involving derivatives, special purpose entities, off balance sheet financing and aggressive accounting practices

One needs to compare the number of filings to the 80 to 90 accountants on staff in the Division during my tenure Chief Accountant. That comes up to about 1,162 filings per accountant. As you can see, the math tells a compelling story. In order for the SEC to effectively review these filings, be able to correspond on a timely and effectively manner with the company, thereby facilitating their access to the capital markets, I believe there needs to be a significant increase of perhaps a 50 to 100 percent increase in the number of accounting staff in the Division of Corporation Finance.

I recall in about October of 1999, as the markets were going gangbusters, former Chairman Levitt calling a number of us into his office. The level of IPO's at the time was such that there was no longer sufficient staff in the Division of Corporation Finance to keep up with reviews of these filings. No staff were available to review other filings such as annual reports, quarterly reports, filings for mergers or tender offers or secondary offerings in the markets. While the Division and SEC had always prided itself on ensuring a review of all companies entering the markets for the first time, it no longer had the staff to do so. However, to ensure investor protection, we pulled staff from other Divisions or Offices to attempt to review all of the IPO's. It was like robbing Peter to Paul in that other tasks were put on hold for a period of time. Having come from private industry I remember thinking more than once that this was one heck of a way to run on business on a shoestring budget. As important a product as our capital markets are, the lack of funding for the agency represented nothing short of myopic vision.

Another personnel issue I saw first hand at the Commission was a dramatic change in the level of experience of the accounting staff. Between 1989-91 when I was first on the SEC staff and my more recent tenure of 1998-2001, the experience of the staff had taken a noticeable decline. This was no doubt due to the high turnover in staff, and the difficulties of attracting new staff with below market wages. While the new staff continued to be highly motivated and dedicated public servants, they just did not have the breadth of experience or knowledge I had noted ten years earlier.

This lack of experience has a number of negative implications. It necessarily results in the need for increased supervision which just isn't available in an already overtaxed system, the likelihood of significant filing deficiencies being innocently missed, higher

training costs, and frustration on the part of companies as they try to explain more complex business transactions to the inexperienced staff.

Based on my experience as a CFO, an audit partner with SEC experience and the Chief Accountant, I believe increasing the staffing levels will provide the following benefits to the markets and investors:

- Quicker access to capital for business.
- Reduced cost to market participants as both time and the associated costs are reduced.
- Likelihood of SEC reviews identifying improper accounting practices increases thereby providing increased protection for investors who in turn will have greater confidence in the capital markets. The increased confidence will allow the U.S. capital markets to continue to maintain or increase their leadership and market position.
- Ability to identify emerging issues affecting filings and companies and reacting to them on a proactive versus reactive basis. Today, the staff is faced with the impossible task of just keeping up with the day-to-day filings, let alone trying to get ahead of the issues.

I believe these benefits will greatly outweigh the costs. Remember the costs to investors and creditors of Enron have been estimated to be as high as \$93 billion dollars. Comparatively speaking, the cost of additional SEC reviewers is but a drop in the bucket.

Increase Funding For Proactive Oversight of Standards

Let me switch to my experience as the Chief Accountant of the Commission. The Office of the Chief Accountant serves as the advisor to the Chairman and Commission on matters involving financial reporting and disclosures, both in the United States and internationally. This involves developing and making recommendations on financial reporting and disclosure issues, interacting with representatives of foreign governments and securities regulators, consulting on enforcement cases, and drafting rules, regulations and interpretive releases. The staff also responds on a daily basis to inquiries from both companies and the staff within the SEC regarding the proper accounting or disclosures for transactions. Finally, the staff of the office oversees the private standard setting process. This in and of itself can be quite a task and involves oversight of the Financial Accounting Standards Board (FASB), its Financial Accounting Standards Advisory Council (FASAC), the FASB Emerging Issues Task Force (EITF) and other FASB task forces that are often active, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants and the many task forces it has, the AICPA Auditing Standards Board (ASB) and its task forces, the AICPA SEC Practice Section (SECPS), the International Accounting Standards Board (IASB), its Standards Advisory Council (SAC) and Standards Interpretation Committee (SIC), Chairing

Working Party One of the International Organization of Securities Commissions (IOSCO), etc. The staff also has periodic and frequent liaison meetings to coordinate their efforts with other regulators such as the Federal Reserve or state boards of accountancy, or business community organizations such as the Financial Executives International.

In reality, the Office of the Chief Accountant functions much like the national office of one of the Big Five accounting firms, with one major exception. These offices in the private sector, which serve the 2-3,000 public companies as well as private companies they audit, may have upwards of 70 plus partners and staff. The Office of the Chief Accountant, which has to respond to the needs of 14-15,000 public companies, was budgeted for 28 staff in 2001. Amazingly, in light of Enron and a rise in financial fraud and restatements, the budget estimate for 2003 stated a decrease in staffing to 26. Instead a necessary increase of 50 to 100 percent would still leave the Office well below comparable staffing of its private industry counterparts.

I do not believe such an increase is out of line given my experience as the Chief Accountant and time in private practice. A tremendous workload coupled with a shortage in necessary personnel often made it difficult to, among other things, oversee projects on a timely basis, identify and address emerging issues in a timely fashion, review and update rules and regulations that had become outdated or superseded, and respond as quickly as we desired to inquiries from the public. In some cases, priorities dictated that important and useful projects be delayed or dropped. For example certain rules or interpretations of the SEC needed to be updated for changes made to generally accepted accounting principles by the FASB, but staff simply were not available to undertake the task. Another example of this is the auditor independence rules that we undertook to modernize in 2000. Despite dramatic changes in dual wage earner families, increasingly mobile employees, and the internationalization of business and the accounting firms, these rules had not been updated since 1982, in part due to staffing constraints.

But a lack of staffing is not the only obstacle I faced as the Chief Accountant. Being able to attract and retain the staff was a real, serious and recurring issue. For example, staff in the Chief Accountant's office have left to join accounting firms, as partners who earn hundreds of thousands of dollars compared to the \$80-90,000 they earned as an Associate Chief Accountant.

To help alleviate this issue, the office began a very successful fellowship program whereby senior managers in the Big Five accounting firms spend a two year assignment with the office. Typically at the end of the fellowship, the managers return to their respective firms as partners. In recent years, we increased the number of fellowship positions to as high as seven out of the total office personnel of 28. However, we were concerned about the "revolving door" effect and recently took steps to reduce this. Nonetheless, we constantly were fighting to attract talent who could make much more in private industry. For example, corporate controllers who have the level of experience we needed and could easily make \$120-150,000 in private practice would have to take a

significant pay cut of upwards of \$20-50,000 to join my staff. Needless to say, that takes one heck of a sales job to close on that recruiting effort.

The Staff Need the Necessary Tools

But the SEC needs more than just people to allow it to do its job properly. Once it is able to attract and retain the necessary personnel, the staff must have the necessary tools to do their job right.

For example, when I left Symbios in 1998 to join the SEC, it was like walking back into the dark ages as far as technology goes. Technologies available to me at that time at the SEC had been replaced several years earlier at Symbios. SEC technology support help was insufficient and lacked timeliness. The level of technology expertise resident within the Commission was very basic and unsophisticated. Tools we needed such as current research and retrieval systems were not available. When I needed the staff to undertake research projects and search our own SEC database, we found it necessary to use outside search engines. And technology that would permit automation of such tasks as electronic screening of filings for potential issues and unusual trends in financial performance was not available and not in the budget. While Edgar is a tremendous tool for the public, search and retrieval capabilities on it for both the staff and public require significant enhancements.

During my three years at the Commission, it made progress in updating its systems and hardware. I was able to hire a very good computer specialist that I shared with a number of offices. However, much remained to be done at the time I left.

The Commission should be provided sufficient funding to update its technology. Chairman Pitt has initially requested an appropriation of approximately \$4 million dollars. I myself have done major system improvements in the private sector and I can tell you this will fall way short of the necessary funds. I would hope the SEC will undertake to develop quickly a five-year strategic Information Systems plan that addresses the level of necessary resources including among other things:

- Upgrading the Edgar Database including the use of a standard “tagging” language, and an improved search engine for use by the staff and public.
- Hiring a Chief Information Officer and increasing the technology knowledge within the agency.
- Use of systems to increase the consistency and quality of filing reviews.
- Necessary hardware and software system upgrades on a timely basis.
- Online training.
- An improved research and retrieval database for the accounting staff.

- Ensuring the agency's financial accounting and reporting systems are capable of generating accurate financial information for external reporting on a timely periodic basis under generally accepted accounting principles. The agency is currently working towards its initial audited financial statements. This is not a simple task for an organization of this size. Without appropriate financial information systems, internal controls and the necessary competencies within the staff, this can be an insurmountable task.

Another tool that needs to be provided to the staff is timely training. Training on a regular basis on timely topics can and will enhance the quality of the work performed by the staff. Unfortunately, with shortages in staffing, training too often has been put on the back burner. I cannot fault the staff and agency for this however, as they often had to chose between even longer workdays or weekends in the office, and a training class. Too often the training lost out.

I would urge the SEC to consider, as part of its current strategic planning process, to build into its budgeting process the financial resources necessary to ensure adequate time for the staff to participate in both internal and external training, the development or purchasing of quality training materials, and personnel on staff who have the responsibility for, and authority over training programs. The resulting benefits from increasing knowledge among the staff will no doubt enhance the quality of the review process, increase the focus and quality of enforcement actions, and assist the staff in better understanding current developments in business and the financial markets.

Improving Personnel Policies

I also believe the SEC has opportunities to improve its overall personnel policies and procedures. It lacks a strategic succession plan. Its evaluation process needs to be significantly improved and applied consistently across the agency, on a timely basis. The evaluation process needs to become more merit based and tied more closely to compensation awards or increases. Chairman Pitt has stated that additional funding for salaries would be used to provide increases on a merit basis. I wholeheartedly concur with that decision, assuming pay parity is fully funded.

It also needs to consider ways to streamline its hiring process. Too often it took too long to go through the hiring process and finalize the paperwork necessary to make offers of employment. In the private sector an executive can respond more quickly when a high quality prospective employee is available. The SEC needs to consider if there are ways in which it can more effectively and efficiently recruit new hires.

Budget Estimate For Fiscal 2003

In light of the various resource needs the SEC has to carry out its duties, its budget estimate for 2003 falls considerable short.⁶ This budget estimate provides for a budget

⁶ U.S. Securities and Exchange Commission, *In Brief - Budget Estimate Fiscal 2003*.

request of \$467 million or \$120 million less than requested in May of 2001. It does not include funding for pay parity, which until funded, represents nothing less than a broken promise on the part of Congress to the staff of the SEC and their families. Aside from funding for a Disaster Recovery Supplemental, it represents a 6.6 percent increase over the appropriated funding for fiscal year 2002. This funding level provides for no increase in full time equivalents between 2002 and 2003 for such programs as Full Disclosure (462), Prevention and Suppression of Fraud (987), Regulation of Securities Markets (449), and Investment Management Regulation (561). In fact, for these programs, the brief notes the total positions for these programs would actually be reduced from 2,716 budgeted positions to 2,670 positions. In light of the losses investors have suffered due to abuses and fraud in our capital markets, it is hard and perhaps impossible to reconcile the budget request with good, responsible government. Certainly it is a budget estimate that falls short of being fair to the employees of the Commission and to American investors who deserve an SEC watchdog who is active on the beat protecting their interests.

Closing

In closing let me note that one of our country's great statesmen, Benjamin Franklin once said all mankind is divided into three classes: those who are immovable; those who are movable; and those who move. I hope and urge the Senate will move to provide the necessary funding for the Securities and Exchange Commission and its dedicated employees. At this time of crisis in our markets, they and the American investor deserve no less.

**Statement of Colleen M. Kelley
National President
National Treasury Employees Union
To the
Subcommittee on Oversight of Government Management
U.S. Senate
April 23, 2002**

Chairman Durbin, Ranking Member Voinovich and members of the Subcommittee on Oversight of Government Management, I am pleased to present this statement on behalf of the National Treasury Employees Union (NTEU) on the human capital situation at the Securities and Exchange Commission (SEC).

Mr. Chairman, what this committee may call human capital, I call the two thousand bargaining unit employees at the Securities and Exchange Commission which NTEU proudly represents. NTEU is the sole association that the employees of the SEC have selected to speak for them and it is a charge and a commission that I take very seriously. The accountants, examiners, attorneys, administrative staff and other bargaining unit employees of the SEC are not faceless civil servants but real people with real lives who are some of the best and most dedicated employees in the federal sector. NTEU has long understood the importance of the work they perform and with the recent Enron scandal, now the rest of the American public have learned this as well.

Three years ago, I was invited to meet with a number of employees at the SEC. They explained to me a situation at SEC that was nothing less than a

human capital disaster. Employee morale was at a pathetic level. The staff was literally fleeing the agency. With a third of the staff leaving within a three year period, SEC management was incapable of filling positions as fast as employees left. Furthermore, employees were being given impossible workloads to make up for vacant staff positions and the steady increase in filings, complaints, inquires, investigations, examinations and other duties. From 1991 to 2000, SEC workload increased about 80% while the staff increased around 20%, according to the General Accounting Office.

All of these factors were exacerbated by the employees' belief that management was taking no effective action to remedy this crisis. SEC was the only financial regulatory agency that was limited to the general service pay schedule. SEC employees would work side by side with employees of the NTEU represented FDIC who would be earning compensation 30% higher than they were. They lagged even further behind the private sector. While SEC management had requested authority from Congress to offer its employees pay parity with the other financial regulatory agencies, over a ten year period they were unable to convince Congress to take any action on this proposal. Management had also not availed itself of even more modest, partial remedies. Special pay rates had lapsed, transit allowances were not being offered and communication with employees was nil. Additionally, as detailed in a 2001 GAO study requested by Senator Robert Bennett, a member of the Government Affairs Committee, while compensation was a primary factor in employee turnover, non-

compensation flexibilities were also highly desired by employees but implemented such as flexiplace, alternative work schedules and improved administrative and support services.

Seeing no action by SEC management, SEC employees took it into their own hands to save this agency and to defend its important work. The employees of the SEC decided to form a union and asked that NTEU represent them. I cannot say the process of forming the union was an irenic one for employees and management. Government funds were used to hire a notorious anti-union consulting firm with no previous history in federal sector labor relations but a long history of helping hotels and other private sector employers fight attempts by their employees to unionize. Nevertheless, the employees of SEC voted 968 - 373 for representation by NTEU.

These newly organized employees wasted no time in moving forward to fix this broken agency. One of the most significant factors causing the crisis in human capital at SEC was the lack of pay parity with the other financial regulatory agencies. From the first day of this Congress, NTEU put the full weight of our union behind pay parity legislation. It was a difficult legislative struggle, but we never faltered. I want to particularly thank you, Chairman Durbin, for at numerous times you and your staff worked closely with NTEU for passage of this bill. I also want to thank Senators Akaka and Carper and their staffs for the time they spent collaborating with NTEU to win passage of this bill.

Thanks to you in less than a year, NTEU was able to win this important legislative change.

In speaking with NTEU members at SEC, I found better morale among the staff starting last year. Employees told me the certification of the union gave them renewed hope that employees would be treated with dignity and respect and that they now had a voice on the job. The legislative progress we were making with the pay parity legislation, which employees told me was their number one issue, also lead to optimism and faith in the future. Because I knew from our members that pay parity was the critical element in recruiting and retaining quality employees, at the point where I had sufficient assurances from key Congressional leaders that we would have this legislation, I suggested to SEC management that we begin informal discussions on the implementation of pay parity. My offer was not accepted.

Mr. Chairman, delay in coming to a fair and just agreement on pay between SEC management and bargaining unit employees is the critical priority in resolving the recruitment and retention problems at SEC. I have spoken directly with Chairman Pitt on this several times. We agreed to form a separate bargaining team on implementation of pay parity and then agreed to reduce the size of our bargaining teams so that a speedier resolution can be reached. I have appointed to the employee team our union's National Executive Vice-President, our lead negotiator with the FDIC and the President of NTEU's SEC

chapter. They have full authority to conclude these negotiations. It appears that the SEC team does not have that authority. The SEC team includes no executives or SES level individuals.

I am also disturbed that Chairman Pitt has stated his intention to move ahead to increase the pay and compensation of supervisors before coming to an agreement with his other employees. Agreement and implementation of pay parity for bargaining unit employees should be the priority for this agency. To ensure a fast and fair agreement, NTEU proposed to the bargaining team appointed by Chairman Pitt that we agree to a date certain to end bargaining with any unresolved issues to be submitted to mediation/arbitration for final resolution. SEC has refused. This has simply inflamed the situation for no productive reason. In fact, the recruitment and retention problem SEC management has allowed to develop has almost been exclusively among the non-supervisory employees.

Mr. Chairman, the American public and investor deserve better from the SEC. This is an agency that touches the retirement and economic security of millions of citizens. They will not have that without a SEC that provides fair compensation to its employees along with dignity and respect in the workplace. We in NTEU have worked to be a useful partner in achieving that goal. We ask that this committee help keep the focus on that goal.

Finally, let me mention the issue of the SEC appropriation for this fiscal year. We were very disappointed that the President provided no funding for pay parity or additional staff in his FY03 budget proposal. I appreciate the fact that Chairman Pitt has been willing to differ with the Administration and ask for \$76 million for partial implementation of pay parity along with \$15 million for much needed new staff. However, Congress was very clear in the legislation it passed last year for pay parity with the other financial regulatory agencies. Recent events have also made it clear that business as usual is not an option at the SEC. I would ask that the Senate follow the guidance in the resolution passed by the Senate Budget Committee and provide an additional \$220 million to the SEC over the President's woefully inadequate request. This will allow for full implementation of pay parity and an expansion of staff to serve the needs of the investor and the public.

Thank you Chairman Durbin for this opportunity to present NTEU's views.

May 10, 2002

**Response to Questions for the Record
For Senator Richard J. Durbin**

**Vital Assets: Human Capital in Federal Economic Regulatory Agencies
James M. McConnell, Executive Director
Securities and Exchange Commission**

Question: Can you provide the subcommittee with the most recent turnover rates for attorneys, examiners, and accountants as well as the turnover rate for supervisory personnel?

Answer: Between October 1, 2001 and May 1, 2002, the Commission had the following turnover rates:

Category	Turnover rate
Attorneys	2.26%
Accountants	1.57%
Examiners	4.24%
Supervisors	2.68%

The Commission attributes these low turnover rates not only to current economic conditions and the events of September 11th, but also to the Commission's successful efforts to obtain pay parity.

Question: Could you give us some insight into why the Chairman hasn't asked for enough funding to implement Congressional intent in parity legislation?

Answer: I believe that the Commission has requested funds sufficient to meet Congressional intent with respect to pay parity. The Commission's estimated cost for pay parity in fiscal 2003 is \$76 million. This estimate is \$8 million more than the \$69 million cost estimate developed independently by the Congressional Budget Office when it scored the pay parity legislation on April 3, 2001. At this funding level, the Commission and its outside expert pay consultant believe that we can implement a pay parity system that maintains comparability with the federal banking agencies while remaining mindful of the need to use the public's resources wisely.

While the Commission's approach on pay parity may be viewed as conservative by some, we believe that if we are to serve as a model for other agencies we must work to obtain an appropriate mix between salaries and benefits that enables us to keep turnover low over the longer term. Towards this end, the Commission is in the process of determining what additional benefits and benefits enhancements it should provide employees. These benefits enhancements take substantially longer to implement and may not be completed for some time. As we move ahead with this portion of our pay parity plan, I assure you

that we will work with this subcommittee and Congress in order to keep you fully apprised of the Commission's need for any further resources.

Question: I'm not sure if my interpretation is correct: if you're not a member of NTEU, you will receive pay increases on May 19th, but if you're a member of the bargaining unit, you get nothing. Is that correct?

Answer: After so many years of working for pay parity, the Chairman does not want to let a single day pass in which pay parity funds are available, but are not used, to increase the pay of all employees of the Commission. Assuming that the Commission implements pay parity as set forth in our Pay Parity Plan and Implementation Report, the Commission currently has available sufficient funding to increase the pay of all employees starting May 19th. As I indicate below in response to another question, the Agency has been advised that, except in limited circumstances, employees are not entitled, under federal law, to retroactive back pay. This means that, if the Commission does not implement its new pay system on May 19th, it will be unable to provide back pay for any time between May 19th and when the new system is implemented. Employees who are in the bargaining unit can start to accrue increased pay on May 19th, but only if the Union agrees to permit them to start accruing increased pay (assuming no final agreement is reached with the Union on pay matters generally). I want to reiterate, however, the Chairman's desire that all employees start accruing increased pay on May 19th.

Question: How long has SEC management been negotiating with the NTEU bargaining team?

Answer: Negotiations began on January 29, 2001, when both the SEC and Union negotiating teams attended joint training in "interest-based" negotiation techniques. SEC management had indicated to the Union a willingness to begin negotiations before January 29, 2001. The Union declined, indicating that it needed to wait for the election of Union officials before deciding who would be on its team. At the Union's request, SEC management agreed to a former NTEU-employee as the training instructor.

Face-to-face negotiations using interest-based methods began on February 5, 2001.¹ After three weeks, the parties had not reached agreement on one article² and the Union

¹ Around the same time, both sides recognized that the term agreement would take some time to negotiate and that employees were interested in the opportunity to work an alternate work schedule. The parties negotiated and implemented a side agreement providing a 5-4/9 pilot work schedule program in February 2001.

² Notably, during interest-based negotiations, all members of the management team, and all but two members of the Union team, agreed to several issues regarding the first article. The lack of unanimity of the 16 persons on both teams, however, meant in an interest-based approach that there could be no agreement on the article as a whole.

asked us to consider another approach. The Union submitted written proposals on four articles, and this began a “traditional” bargaining approach by the parties.

The Union began exchanging written proposals with management on the remaining articles later in March, and gave us the last of its proposals on May 18, 2001. Management gave the Union the last of its first “counter-proposals” on July 20, 2001. At various times during this period, the Union refused to respond to our first counters, saying that it would wait until all of management’s counters were submitted.

On May 15, 2001, management’s chief negotiator, Marisa Lago, announced that she had accepted a job in the private sector and would resign from the Agency in June. Tracey Aronson was introduced to the Union on May 18th as the new chief negotiator. In late August, Ms. Aronson announced that she would be going on maternity leave and would be stepping down as chief negotiator. Michael Lainoff was appointed chief negotiator in September, and his first negotiating session was September 10, 2001.

During the summer months, both teams cancelled negotiating sessions for personal or business reasons. The Union cancelled the scheduled July 9th bargaining session, and we cancelled a one-week session scheduled for August.

On September 20, 2001, SEC management informed the Union that it had not received for many months from the Union even a first counter-proposal (counters to the very first counters) on more than 25 of the 46 contract articles. The Union still had not responded for over 100 days or more to many of our proposals, and had refused to negotiate off its positions in those articles at the negotiating table. On October 4, 2001, in similar fashion, we informed the Union that while we owed the Union 4 counters, the Union still owed management 38. In that letter, Mr. Lainoff also pointed out the following:

“[SEC management] gave you many of our counter proposals on these matters months ago. Several times recently, you’ve indicated that your team does not intend to provide a first counter-proposal a (“U-2”) on 18 of these 38 articles and, possibly, on as many as 31 articles. . . .I hope you reconsider countering on these 18/31 articles. While we see places in many of these articles where we could move closer to your positions, not having your counter proposals (or even a sense that you are willing to negotiate with respect to these articles) makes it difficult for us to proceed. Similarly your unwillingness to [sign-off in agreement on] those articles where you have agreed that we are in complete agreement makes us wonder what purpose is served by your delay.”

In the letter, management also expressed interest in scheduling face-to-face negotiations in November and December, which the Union’s Chief Spokesperson had refused to do up to that point.

On October 22, 2001, Mr. Lainoff sent another letter to Mr. Keller describing where he thought we stood in the process. This letter pointed out that, for the second time in negotiations, the Union had called in a federal mediator from the Federal Mediation and

Conciliation Service (“FMCS”) without consulting our team. Notably, the mediator the Union unilaterally asked management to accept Lynn Sylvester, who also was a former Union employee. Although there was some reluctance on our side to agree to mediation at this point, we recognized that the process could not remain the same: nothing had been agreed to date. While we believed then, and continue to believe, that we did not shoulder the primary blame for the lack of progress to that point, we knew that some delays were caused by the changes in our chief spokespersons. On October 25th, Ms. Sylvester came to the negotiations for the first time. That morning, our team informed Ms. Sylvester that the parties had in fact agreed to five matters over the previous few months, but that the Union had refused to sign off in writing on any of the five. The Union informed Ms. Sylvester, in our team’s presence, that it had no intention of agreeing to any of the articles – even the ones we had in fact orally agreed to approve months before. Instead, Union team members expressly stated their desire to take all 46 articles to impasse, and “take their chances before the [Federal Services Impasses] Panel.”

The mediator indicated to both sides her first day that such a strategy would not work while we were in her charge, and she chastised both sides repeatedly that day to start negotiating and stop complaining. She also said that at the rate both sides were moving, we all would be seeing her “for another year before she was willing to agree to declare an impasse.” With those words and with the mediator’s firm guidance, four of the five articles at issue were signed-off on that very first day.

The parties were able to agree to several other articles during the first days with the mediator. Unfortunately, despite this first-time progress after what had been eight months of unsatisfactory negotiations, Mr. Keller, the Union’s Chief Spokesperson, asked that we not meet in face-to-face negotiations from mid-November through early-January, because of his paternity leave. We did, however, exchange counter-proposals during this time on those articles the Union was willing to allow us to actually negotiate.

Negotiations resumed on January 22, 2002, and the mediator has continued to assist the parties. As of May 2nd, the parties had agreed to 28 of the 46 articles, and were close on perhaps five to seven more. Because of the strict agenda the mediator has asked the parties to follow (generally, the agenda has up-front the articles where the parties are closest), many of the remaining articles haven’t been discussed in more than six months. SEC management believes that we will be able to agree on all, or virtually all, of the articles over the next few months. But we can do that only if the parties schedule additional negotiation sessions, and only if both sides have, as their primary objective, reaching agreement. The federal mediator has told the management team that she believes we can get to agreement on virtually the entire contract, and we must assume that she has conveyed the same message to the Union team.

The pace of the negotiations, however, is not as slow as the Union submits it to be in its routine communications with our employees. But it is admittedly much slower than we all hoped it would be. Often, only one or two matters are agreed to in a negotiating week. Nevertheless, the parties move closer on other articles during those weeks, so that in the next session, the parties are able to agree to four or five articles during that week.

Throughout this process, management has made a conscious decision not to provide our employees its view of what was happening in the negotiations. We believe that if we are going to get a contract with the Union team, and achieve a reasonably constructive on-going relationship with the Union, then circumventing the team and appearing critical of it would be unproductive. Looking back, that may not have served our employees as well as we had hoped. We apologize to our employees for not providing them the facts as we saw them during these months, letting the Union have the chance to say whatever it wished in rebuttal, responding in kind if necessary, and then letting our employees decide.

Unfortunately, no negotiations are formally scheduled after the week of May 10th. The Union's Chief Spokesperson has indicated that he is unavailable the weeks of May 13th and May 20th. Because of this, members of the management team have made work and other plans those weeks. Nevertheless, the Chief Spokespersons for both teams privately asked the mediator to "pencil-in" one week in early-June. Finally, the Union's Chief Spokesperson has rejected our requests to schedule negotiating sessions in June and, if needed, in July.

The fact that it has taken this long to negotiate a first contract should not be surprising. Only days before the NTEU was elected the exclusive representative of SEC employees, the President of the NTEU was quoted publicly regarding how it often took 18 months or longer to negotiate a first contract.

We believe that it is important for both sides to hear once again the message that it is time to start negotiating and to stop complaining. In this regard, management offers to schedule three weeks of negotiations in June and/or July, to see if we can be in full agreement on the contract at the end of that time.

Question: Let's say the bargaining units agree to a contract and it's ratified. Will the 2,000 employees of the bargaining unit be given retroactive pay from May 19th just like the other employees?

Answer: The Agency has been advised that in the absence of an administrative error or a violation of a specific law, employees are not entitled to retroactive back pay as a matter of course. Non-bargaining unit employees will not be paid retroactively; they will begin accruing increased pay on May 19th, but there will be a delay before they actually receive their money because it takes time to program the new payroll system. Thus, employees who start accruing increased pay on May 19th are not being paid retroactively.

Question: Will you agree to interim implementation of all agreed-to contract articles (23 articles to date) and expedited binding arbitration if a contract isn't agreed to by, say, June 1 or a mutually-agreed-upon date?

Answer: Management believes that there is a very good chance that we will be able to complete negotiations by the end of the summer if we are able to maintain our current rate of progress. As a general matter, however, the Agency does not think it would be appropriate to implement all agreed to contract articles on an interim basis. First, it is not the practice in the labor relations community to partially implement agreed-to contract articles on an interim basis. Second, it would severely disrupt Agency operations to implement a contract on a piecemeal basis. The Agency is not accustomed to working in a unionized environment so a great deal of training is required of the supervisors, managers, and employees with respect to how they should conduct themselves under the new agreement to prevent problems from arising. Third, the Agency is also trying to implement a new pay system and a new employee evaluation system that will result in a significant amount of questions and training. Fourth, the Agency does not have the personnel to implement all of these things immediately. Last, the Agency needs to see the complete agreement and an opportunity to conduct Agency Head review in accordance with the Labor Management Relations Statute. Notwithstanding these concerns, we will keep an open mind about this issue and revisit it if negotiations are not completed by the end of the summer.

With respect to binding arbitration, the Labor Management Relations Statute states that if the parties are unable to agree or if they reach impasse they are first required to go to the Federal Mediation and Conciliation Service for mediation. If mediation is unsuccessful, the parties are required to go to the Federal Service Impasses Panel. The parties have been working with a mediator from the Federal Mediation and Conciliation Service and have been making significant progress. Also, the mediator must certify that the parties are at impasse before they can go to the next stage and the mediator has found that the parties are continuing to make significant progress. The mediator also knows that the first contract is usually the most difficult and usually takes longer to complete. The Agency believes it is appropriate to follow the processes that are already in place by statute for resolving impasses. Nevertheless, the Agency will keep an open mind about binding arbitration and will revisit it if there are a small number of relatively insignificant issues remaining.