

# Regulating *the Regulators*

Seven Reforms for Sensible Regulatory Policy in North Carolina

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### CONTENTS

2	Executive Summary
3	Introduction
3	What Are Regulations?
3	The Importance of Strong Oversight
4	Existing Oversight in North Carolina
5	REFORM ONE: The Legislature Should Not Delegate an Excessive Amount of Power to Agencies
5	REFORM TWO: The Legislature Should Give the RRC the Power to Require Clear Statutory Authority
6	REFORM THREE: The Legislature Should Empower the RRC to Reject Regulations Inconsistent with Legislative Intent
6	REFORM FOUR: The Legislature Should Require Agencies to Conduct Cost-Benefit Analysis with Proper Oversight
9	REFORM FIVE: The Legislature Should Require Agencies to Conduct Small Business Regulatory Flexibility Analysis
11	REFORM SIX: The Legislature Should Require Periodic Review of Regulations
12	REFORM SEVEN: The Legislature Should Prohibit Agencies from Passing Rules that Exceed Federal Standards
12	Conclusion
13	End Notes

## EXECUTIVE SUMMARY

Unelected and unaccountable bureaucrats and appointees regularly make major policy decisions that affect the lives of North Carolinians.

They have the power to issue regulations affecting almost every facet of our lives, from the air we breathe to who may attend community colleges.

The people of North Carolina need protections put in place to provide oversight over government agencies so that their rule-making decisions represent the will of the legislature and not the whims of the agencies.

Most state governments and even the federal government have far better controls over the regulatory power of government agencies than does North Carolina.

The excessive regulatory power allowed by North Carolina imposes great costs on its citizens and businesses and hurts the economic competitiveness of the state.

This report identifies seven reforms that North Carolina should adopt to improve the regulatory environment in the state:

### *1) The Legislature Should Not Delegate an Excessive Amount of Power to Agencies*

When legislation is drafted, clear parameters should be in place so that there are limits as to what an agency can do when implementing specific legislative provisions.

### *2) The Legislature Should Give the Rules Review Commission the Power to Require Clear Statutory Authority*

Agencies are tasked with rulemaking and are unlikely to constrain their own power voluntarily. They will tend to take the most expansive reading of their statutory powers when developing regulations.

When statutory authority is in question, the presumption by the Rules Review Commission should be against statutory authority, not in favor of it.

If questions regarding statutory authority are such that it is reasonably unclear whether an agency headed by unelected bureaucrats may make major policy decisions (i.e., through regulations), then the Rules Review Commission should presume that those decisions rest with the state legislature, the representative body accountable to all citizens.

### *3) The Legislature Should Empower the Rules Review Commission to Reject Regulations Inconsistent with Legislative Intent*

Often an agency can have statutory authority but still take action beyond the scope of the legislature's intent. An example of this problem is the State Board of Community Colleges' proposed regulations to admit illegal immigrants into community colleges.

It would be difficult to argue that the Board does not have the authority to determine whether illegal immigrants can be admitted to community colleges. It would also, however, be very difficult to argue that the legislature intended to delegate this major policy decision to the Board when it passed language giving the Board power to set admissions standards. The people need protections put into place to ensure that an agency's actions are consistent with the intent of the legislature when it decided to delegate power to the agency.

### *4) The Legislature Should Require Agencies to Conduct Cost-Benefit Analysis with Proper Oversight*

For nearly 40 years, the federal government has used some form of cost-benefit analysis to review regulations. The North Carolina General Assembly should pass a law that also requires cost-benefit analysis.

The cost-benefit analysis process should include:

- Rejection of rules if costs exceed benefits.
- Consideration of alternatives to achieve the stated objective and selection of the alternative that imposes the least cost to society.
- Selection of the least burdensome regulatory option.

### *5) The Legislature Should Require Agencies to Conduct Small Business Regulatory Flexibility Analysis*

One-size-fits-all regulation can cause significant problems, especially when it comes to compliance. Small businesses simply are not in as good of a position to meet regulatory mandates as larger businesses.

To address the differences between small businesses and larger businesses, agencies should be required to consider regulations that reduce the impact on small businesses. That consideration would include having less stringent compliance requirements for small busi-

nesses or even exempting small businesses from regulations. Regulatory flexibility analysis requires this kind of analysis to ensure that regulations are developed with enough flexibility to address the needs of small businesses.

According to the U.S. Small Business Administration, there are 35 states with small business regulatory flexibility analysis. Thirty years ago, Congress passed the Regulatory Flexibility Act, which established regulatory flexibility analysis for small businesses on the federal level. The General Assembly needs to pass a law so that small businesses in North Carolina will have the same protections as their counterparts in most other states.

#### *6) The Legislature Should Require Periodic Review of Regulations*

The passage of new laws or changes in technology can cause regulations to become outdated or unnecessary. They also may prove to be ineffective at achiev-

ing their objectives. For those reasons, 32 states have periodic review of regulations. The General Assembly should pass a law to create a process whereby all agencies review their regulations on a periodic basis.

#### *7) The Legislature Should Prohibit Agencies From Passing Rules that Exceed Federal Standards*

The legislature should prohibit state agencies from passing regulations that exceed federal standards. This type of law, sometimes referred to as a “no more stringent” law, ensures that legislators — as opposed to bureaucrats — determine if North Carolinians should suffer a greater regulatory burden than citizens in other states.

According to the U.S. Environmental Protection Agency, about one-third of all states already have “no more stringent” prohibitions that apply to at least some areas of state law. A strong “no more stringent” law would be an important component in developing a better regulatory environment in North Carolina.

## INTRODUCTION

Unelected, unaccountable bureaucrats and appointees regularly make major policy decisions that affect the lives of North Carolinians. These largely unseen individuals, who lead numerous state agencies and commissions,<sup>1</sup> issue regulations that can have a major impact on every citizen.

This power in the hands of the unelected is inconsistent with a representative form of government. Unfortunately, as with Congress and with other state legislatures, the North Carolina General Assembly has delegated significant power to these agencies and will likely continue to do so.

While vesting these agencies with enormous power, legislatures have long wrestled with how to provide proper oversight and controls over their actions. It is a challenge that persists to this day. This report recommends seven simple reforms North Carolina should adopt to rein in excessive agency power and to promote sound regulatory policy.

## WHAT ARE REGULATIONS?

Regulations are agency-created rules that help to implement or interpret enacted legislation.<sup>2</sup> They have the

full force of law and can subject those being regulated to fines and even imprisonment. State regulations address almost every facet of our lives, from the air we breathe to who may attend community colleges.

Agencies sometimes develop regulations that mirror the exact language used in the bill passed by the state legislature. Since legislation often fails to provide specific details on what lawmakers expect of regulated parties, agencies are left to develop regulations that provide the missing details. The legislation also can be very vague and overbroad in scope, thereby giving agencies wide discretion in determining what should be regulated.

## THE IMPORTANCE OF STRONG OVERSIGHT

### *“Good Government”*

The legislature often delegates significant power to agencies. Regardless of whether it is necessary, the legislature will continue to delegate to agencies, and the courts will almost always allow legislative delegation of power. As the North Carolina Court of Appeals has said, “Some delegation is inescapable.”<sup>3</sup>

Therefore, procedures need to be put into place within the regulatory process so that agencies truly implement

**Figure 1. Rules subject to legislative review and rules disapproved, 2004-09<sup>†</sup>**

<i>Fiscal year</i>	<i>Rules introduced*</i>	<i>Rules subject to legislative review</i>	<i>Number of bills introduced to disapprove rules**</i>	<i>Number of enacted bills disapproving rules</i>
2004-05	1,078	56	3	0
2005-06	1,320	15	5	1
2006-07	1,299	22	2	0
2007-08	1,548	54	8	4
2008-09	1,265	71	10	2
<b>Total</b>	<b>6,510</b>	<b>218</b>	<b>28</b>	<b>7</b>

\* Permanent rules only.

\*\* Even when disapproving a rule, the legislature could simply make changes to it while keeping a significant part of it.

<sup>†</sup> The Rules Review Commission is the source of the data on rules introduced and rules subject to legislative review. Since RRC rules data are based on the fiscal year of July 1-June 30, introduced and enacted bills were placed in the corresponding fiscal year. Introduced and enacted bills data were calculated by searching for the bills on the North Carolina legislature's web site.

the will of the legislature and make sound regulatory decisions. If the unelected and unaccountable individuals in agencies are going to make major policy decisions, there should be some common-sense oversight protections to ensure their decisions are consistent with the intent of the legislature.

#### *Economic Growth*

The regulatory burden on businesses in North Carolina is a significant problem. In a 2005 John Locke Foundation survey of more than 600 North Carolina business leaders, regulatory burden was ranked as the second most important factor reducing the state's economic competitiveness (only North Carolina's tax burden ranked higher).<sup>4</sup> About 81 percent of N.C. business leaders said that the cost of most government regulations exceeded their benefits.<sup>5</sup>

Other states, including neighboring states, have oversight procedures in place that genuinely take into consideration the impact regulations have on businesses. North Carolina does not, giving the other states a major advantage in encouraging new businesses to come to their states.

Too many policymakers in North Carolina think that the way to promote economic growth is to give money to select businesses in the form of incentives. A more beneficial approach would be to take some simple steps to create a friendlier regulatory environment for all businesses.

#### **EXISTING OVERSIGHT IN NORTH CAROLINA**

The state's Administrative Procedure Act (APA) is the law that governs the regulatory process in the state.<sup>6</sup> One key protection established under the APA is the power of the Rules Review Commission (RRC).<sup>7</sup> The RRC, a ten-member commission appointed by the House and Senate leaders, is a body that must approve regulations prior to them becoming finalized.<sup>8</sup>

This much-needed Commission is generally limited to, among other things, making sure that an agency has followed proper procedures, had statutory authority for its regulation, and developed clear rules.<sup>9</sup> The RRC is expressly prohibited from evaluating the merits of regulations.<sup>10</sup>

The APA also includes a process for the public to object to a rule. If 10 objections to a rule are filed with the RRC, the rule is delayed, giving the legislature a chance to pass a bill disapproving of the rule. If the legislature takes no action, the rule goes into effect.<sup>11</sup>

While this check is very important, it is not as valuable as it seems. A legislative block of a proposed regulation must pass both chambers and be signed by the governor, all of which can be quite challenging (see Figure 1).

Current protections are all useful, but they do not go far enough. Other state governments and the federal government have much greater oversight protections in place. Moreover, they represent simple reforms North Carolina needs to adopt.

**REFORM ONE*****The Legislature Should Not Delegate an Excessive Amount of Power to Agencies***

When legislation is drafted, clear parameters should be in place so that there are limits as to what an agency can do when implementing specific legislative provisions. This is the simplest and most important reform.

Unfortunately, many legislators often want to delegate away responsibility to agencies to deflect hot-button issues — and the political repercussions — from themselves.

There is, however, no way to mandate this reform. Excessive delegation of power should be a concern regardless, something lawmakers need to bear in mind when drafting legislation.

Even a small number of legislators could call attention to vague and overbroad bills that would give agencies too much regulatory power.

**REFORM TWO*****The Legislature Should Give the RRC the Power to Require Clear Statutory Authority***

For an agency to have statutory authority means, in simple terms, the agency has been granted permission from the legislature to issue regulations on the specific subject matter. Under the Administrative Procedure Act (APA), the Rules Review Commission (RRC) does review rules to make sure that they are “within the authority delegated to the agency by the General Assembly.”<sup>12</sup> That language, however, in no way prevents an agency from taking an unreasonably expansive view of its power and the RRC from approving those regulations.

The RRC may be hesitant to challenge statutory authority out of fear that agencies may bring lawsuits. In 1999, the Pharmacy Board sued the RRC, challenging its decision that the Board had exceeded its statutory authority by trying to regulate pharmacists’ working hours.<sup>13</sup> The Board did not stop there — they also argued that the RRC was unconstitutional.<sup>14</sup> In 2006, the North Carolina Supreme Court rejected the RRC’s decision regarding statutory authority but did not address the constitutional questions.<sup>15</sup>

In 1996, the RRC rejected an Environment Management Commission (EMC) rule on wetlands, arguing that the EMC did not have statutory authority.<sup>16</sup> The EMC ignored the RRC decision<sup>17</sup> and moved ahead with the publication of the rule anyway. The North Carolina

Homebuilders Association and other organizations sued the EMC, arguing that the EMC did not have authority to adopt the rules.<sup>18</sup> In 2002, the North Carolina Court of Appeals ruled in favor of the EMC.<sup>19</sup>

Owing to those cases and in light of the fact that courts are more than willing to support the expansive readings of statutes, the RRC may be a bit gun-shy regarding future challenges to statutory authority. Since statutory language usually is broad, courts often are correct in finding that statutory authority exists for regulations.

Here, however, is not a question of how the courts will rule; instead, it is question of what standard should apply in the regulatory review process to prevent agencies from pushing their authority beyond what has clearly been delegated to that agency. When statutory authority is in question, the presumption should be against statutory authority, not in favor of it. If questions regarding statutory authority are such that it is reasonably unclear whether an agency headed by unelected bureaucrats may make major policy decisions (i.e., through regulations), then the RRC should presume that those decisions rest with the legislature, a representative body accountable to all citizens.

If the RRC does not believe that statutory authority exists, it should not fear drawing that conclusion. Through stronger and more precise review language, the RRC would be more empowered to reject rules where statutory authority is in question.

Specifically, the legislature should amend the APA. The RRC should review rules to make sure they are “*clearly* within the authority delegated to the agency by the General Assembly” (emphasis added). In addition, to define what “clearly within the authority” means, the law should clarify that clear statutory authority exists when no reasonable argument can be made that statutory authority does not exist.

When a reasonable argument against statutory authority does exist, the RRC should be required to reject the rule.

Agencies are tasked with rulemaking and are unlikely to constrain their own power voluntarily. They will tend to take the most expansive readings of their statutory powers when developing regulations.

If North Carolina had higher standards for proving the existence of statutory authority, agencies would be prevented from adopting regulations inconsistent with the will of the legislature.

**REFORM THREE*****The Legislature Should Empower the RRC to Reject Regulations Inconsistent with Legislative Intent***

Often an agency can have statutory authority but still take action beyond the scope of the legislature's intent. An example of this problem is the State Board of Community Colleges' proposed regulations to admit illegal immigrants into community colleges.<sup>20</sup>

The statutory authority is derived from statutory language that authorizes the Board "to establish and administer standards for ... admissions."<sup>21</sup> It would be difficult to argue that the Board does not have the authority to determine whether illegal immigrants can be admitted to community colleges. The language is clear on its face that the Board has the broad power to set admissions standards, which presumably would include developing regulations on whether admitted students can be illegal immigrants.

It would also, however, be very difficult to argue that the legislature intended to delegate this major policy decision to the Board when it passed language giving the Board power to set admissions standards. The legislature most likely figured that the Board would sort out more mundane details such as whether students needed high school diplomas, not major issues of social policy.

*Determining the Legislature's Intent When Delegating Its Power*

Establishing a standard by which to determine whether the legislature intended for an agency to take certain actions under their delegated power is very difficult. North Carolina case law on the delegation of legislative power can help to provide useful guidance. The North Carolina Supreme Court has explained:

*A modern legislature must be able to delegate – in proper instances – “a limited portion of its legislative powers” to administrative bodies which are equipped to adapt legislation “to complex conditions involving numerous details with which the Legislature cannot deal directly.”...[S]uch transfers of power [delegation] should be closely monitored to insure that the decision-making by the agency is not arbitrary and unreasoned and that the agency is not asked to make important policy choices which might just as easily be made by the elected representatives in the legislature.<sup>22</sup> [Internal citations omitted.]*

Using that explanation as guidance, the legislature

should amend the Administrative Procedure Act (APA) to clarify that the Rules Review Commission (RRC) may approve regulations only if the agency has proven that:

- The legislature when enacting the statute likely believed the agency, due to its expertise, was in a better position than the legislature to address the specific subject matter of the regulation; and
- The legislature likely believed that it was delegating to the agency the power to issue the proposed regulations.

These requirements are subjective, but they would help to provide some protection to ensure the intent of the legislature is respected. Taking the admissions of illegal immigrants as an example, the legislature likely did not believe the State Board of Community Colleges was in a better position to address that issue than the legislature itself.

While the Board members may know the issues facing community colleges, they probably do not have expertise on immigration issues. Further, the legislature likely would have thought an issue of such magnitude, which involves so many issues unrelated to admissions, would not have been best served by the Board.

As for whether the legislature believed it was delegating this power to the Board, similar arguments as above would apply. It is unlikely the legislature thought it was giving the Board the power to set immigration policy when it authorized it to set admissions standards.

**REFORM FOUR*****The Legislature Should Require Agencies to Conduct Cost-Benefit Analysis with Proper Oversight****Background*

If an agency does choose to adopt regulations, it should do so after considering that decision properly and carefully. For nearly 40 years, the federal government has used some form of cost-benefit analysis to review regulations.<sup>23</sup> The General Assembly should pass a law that also requires cost-benefit analysis.

*What is Cost-Benefit Analysis?*

At its most basic level, cost-benefit analysis is an attempt to evaluate a regulatory proposal by comparing its costs to its benefits. Costs and benefits are quantified in

monetary terms and should examine the impact on all affected parties, not just regulated entities.

A central requirement of cost-benefit analysis is to determine opportunity costs. It is important to know what would happen if there were no regulations, including how resources (e.g., money and time) would have been used.

The application of opportunity costs can be seen in our own personal lives. For example, if an accountant needs his front lawn mowed, he could take time to mow the lawn or hire someone for \$50. If he decides to mow the lawn himself, he has just saved \$50. But if he otherwise would have used that time at work earning \$500, he would not have been better off in monetary terms. By mowing the lawn himself, he incurred an opportunity cost of \$500; in terms of costs and benefits, by hiring someone else to mow his lawn for \$50, he would wind up \$450 ahead.

The same concept applies to cost-benefit analysis for regulations. For example, assume that regulations impose \$1,000 in compliance costs on a business. If the business could have used that money on an investment that would have yielded \$10,000, the true cost to the business is \$11,000 (\$10,000 for the lost investment and \$1,000 for the compliance costs).

Cost-benefit analysis also requires an evaluation of various alternatives to determine the best possible policy option. In evaluating different options, there should be an option with no regulations.

There are many more details to proper cost-benefit analysis, but providing a comprehensive discussion would involve a report unto itself. There are some additional key points though that should be highlighted.

### *Key Points*

- *Taking Action Based on Cost-Benefit Analysis.* Requiring agencies to perform cost-benefit analysis is not very helpful if there is no requirement for them to take action based on the findings. If costs exceed benefits, then a rule should be rejected.<sup>24</sup>
- *Rights Are More Important Than “Benefits.”* There are many imaginable scenarios where a cost-benefit analysis could be used to justify some chilling policies. The individuals that pushed for the sterilization of the “feeble-minded” in North Carolina claimed that there were significant benefits, including fewer individuals on the welfare rolls.<sup>25</sup> Certainly, individ-

ual rights should have trumped any alleged benefits in that situation.

- *Requiring Regulations to Achieve a Clearly Stated Purpose.* Each agency should identify, in specific terms, what goals are being met by adopting the regulations. Regardless of what costs and benefits are identified, if the regulations do not achieve their stated purpose, the RRC should reject the regulations.
- *Alternatives.* As stated above, various alternatives need to be considered. Similar to the federal level,<sup>26</sup> agencies should be required to identify alternatives to achieve their stated purpose — which is crucial to cost-benefit analysis. The alternative with the largest benefit-to-cost ratio should be chosen. As stated in President Reagan’s Executive Order 12291, “Among alternative approaches to any given regulatory objective, the alternative involving the least cost to society shall be chosen.”<sup>27</sup>
- *Reducing Regulatory Burden.* The burden on regulated entities should be given serious consideration. As stated in President Jimmy Carter’s Executive Order 12044, regulation should be approved if “the least burdensome of the acceptable alternatives has been chosen.”<sup>28</sup>
- *Benefits Should Really Be Benefits.* Just because an agency claims something is a benefit does not mean that it is a benefit. For example, the Environmental Management Commission (EMC) may want to regulate carbon dioxide (CO<sub>2</sub>) emissions for the purpose of addressing global climate change. They may claim that a benefit of regulating CO<sub>2</sub> emissions is the reduction in CO<sub>2</sub> emissions. However, a reduction in CO<sub>2</sub> emissions is not a benefit in and of itself. The benefit would be a reduction in global temperature. The emissions reduction is simply a means to the end (i.e., the purpose). Cost-benefit analysis that relies on these non-benefits should be rejected.

### *Current Cost-Benefit Analysis in North Carolina: In General*

The Administrative Procedure Act (APA) does not have a cost-benefit analysis requirement.<sup>29</sup> However, North Carolina’s Office of State Budget and Management (OSBM), which reviews the fiscal and economic impact



**Figure 2. Required Analysis for Rules: Current vs. Recommended Requirements**

<i>Type of Rule</i>	<i>Required Analysis</i>	
	<i>Current</i>	<i>Recommended</i>
Non-significant rule change with state or local fiscal impact*	Brief impact analysis	Brief impact analysis (maintain status quo)
Significant rule change without state or local fiscal impact or substantial economic impact*	None	Extensive cost-benefit analysis (as discussed in this paper)
Significant rule change with state or local fiscal impact*	Basic economic impact analysis	Extensive cost-benefit analysis (as discussed in this paper)
Significant rule change with substantial economic impact†	OSBM's more extensive analysis (the only level of analysis that appears to be a true cost-benefit analysis; for example, it requires the evaluation of policy alternatives)	Extensive cost-benefit analysis (as discussed in this paper)

\* OSBM defines a significant rule change as “a proposed rule change that may have a significant effect on the economy, state, or local funds; create an inconsistency with an action taken or planned by another agency; or raise novel policy issues.”

† The Administrative Procedure Act defines substantial economic impact as “an aggregate financial impact on all persons affected of at least \$3 million dollars in a 12-month period.” It is possible, though unlikely, that a rule with a substantial economic impact might not be a significant rule change. In such a situation, however, it is unclear what level of analysis would apply.

of regulations, does require agencies to do some form of cost-benefit analysis on three types of regulations:

- 1) Non-significant rule changes that impact state or local funds;
- 2) Significant rule changes that impact state or local funds; and
- 3) Significant rule changes that have a substantial economic impact.<sup>30</sup>

Limiting cost-benefit analysis to certain types of regulations does make sense owing to practical concerns regarding workload. Regulations that would be significant rule changes, however, should be analyzed regardless of whether there is an impact on state or local funds or a substantial economic impact. OSBM defines a “significant rule change” as a

*proposed rule change that may:*

- (a) have a significant effect on the economy, state, or local funds;*
- (b) create an inconsistency with an action taken or planned by another agency; or*
- (c) raise novel policy issues.<sup>31</sup>*

The APA defines regulations with a “substantial economic impact” as “an aggregate financial impact on all persons affected of at least \$3 million dollars in a 12-month period.”<sup>32</sup> An impact includes both costs and benefits. As a result, a rule that may have \$2.1 million dollars in benefits and \$1 million dollars in costs has a substantial economic impact.<sup>33</sup>

OSBM requires agencies to do a very limited analysis for non-significant rule changes that have an impact on state or local funds (what it calls a brief impact analysis)<sup>34</sup> and a more extensive analysis for significant rule changes that have an impact on state or local funds (what it calls a basic economic impact analysis).<sup>35</sup> Agencies are required to do the most extensive analysis for regulations that have a substantial economic impact. This analysis includes the consideration of policy alternatives.<sup>36</sup> All significant rule changes should be subject to true cost-benefit analysis, as described in Figure 2.

#### *Oversight of Cost-Benefit Analysis*

Existing cost-benefit analysis in North Carolina has a catch, however. Agencies have to submit their rules for OSBM's review only if the *agency* has determined that there would be an impact on state or local funds, or there

**Figure 3. APA Oversight of Agency Decisions Determining that a Rule Does Not Impact State or Local Funds, or the Rule Does Not Have a Substantial Economic Impact**

	<i>Reviewing Whether State or Local Funds Are Affected</i>	<i>Reviewing Whether There Is a Substantial Economic Impact</i>
<i>Does Review Exist?</i>	No *	Yes. There is a limited review.
<i>Type of Review</i>	N/A	1) RRC may ask OSBM to review whether there is a substantial economic impact. 2) An individual may submit a request to the RRC regarding whether there is a substantial economic impact. The RRC is then required to contact OSBM about reviewing the rule.

\* There is no oversight to determine whether rules have an impact on state or local funds. This omission affects rules that could have an impact on state or local funds and also be significant rule changes. It is of particular importance because the only significant rule changes subject to some form of cost-benefit analysis, other than rules that also have a substantial economic impact, are rules that have an impact on state or local funds.

would be a substantial economic impact.<sup>37</sup> If the agency incorrectly makes this assessment or just does not want OSBM to review the rule, there is little that can be done (see Figure 3).

The APA does not include any oversight mechanism to ensure that a rule would actually not be a significant rule change with a state or local fiscal impact. Agencies just have to be trusted.

The APA does *allow* the RRC to ask OSBM if a rule would have a substantial economic impact.<sup>38</sup> This allowance, however, is not a requirement imposed on the RRC.

In addition, an individual can submit a request to the RRC for clarification of whether a rule would have a substantial economic impact. Upon receiving a written request, the RRC is required to ask OSBM whether the rule would have a substantial economic impact.<sup>39</sup> With so many rules being produced, however, it would be unrealistic to expect individuals to provide the necessary oversight.

The RRC should be required to ask OSBM whether a rule would be a significant rule change or a rule with a substantial economic impact so long as the rule could reasonably fall into one of those two categories or upon receiving a written request by an individual.

There also needs to be stronger oversight over whether cost-benefit analysis has been conducted properly. Currently, OSBM reviews the cost-benefit analysis for agen-

cies. OSBM should continue in that oversight capacity, but the RRC should have final say on whether the cost-benefit requirements have been met.

#### REFORM FIVE

*The Legislature Should Require Agencies to Conduct Small Business Regulatory Flexibility Analysis*

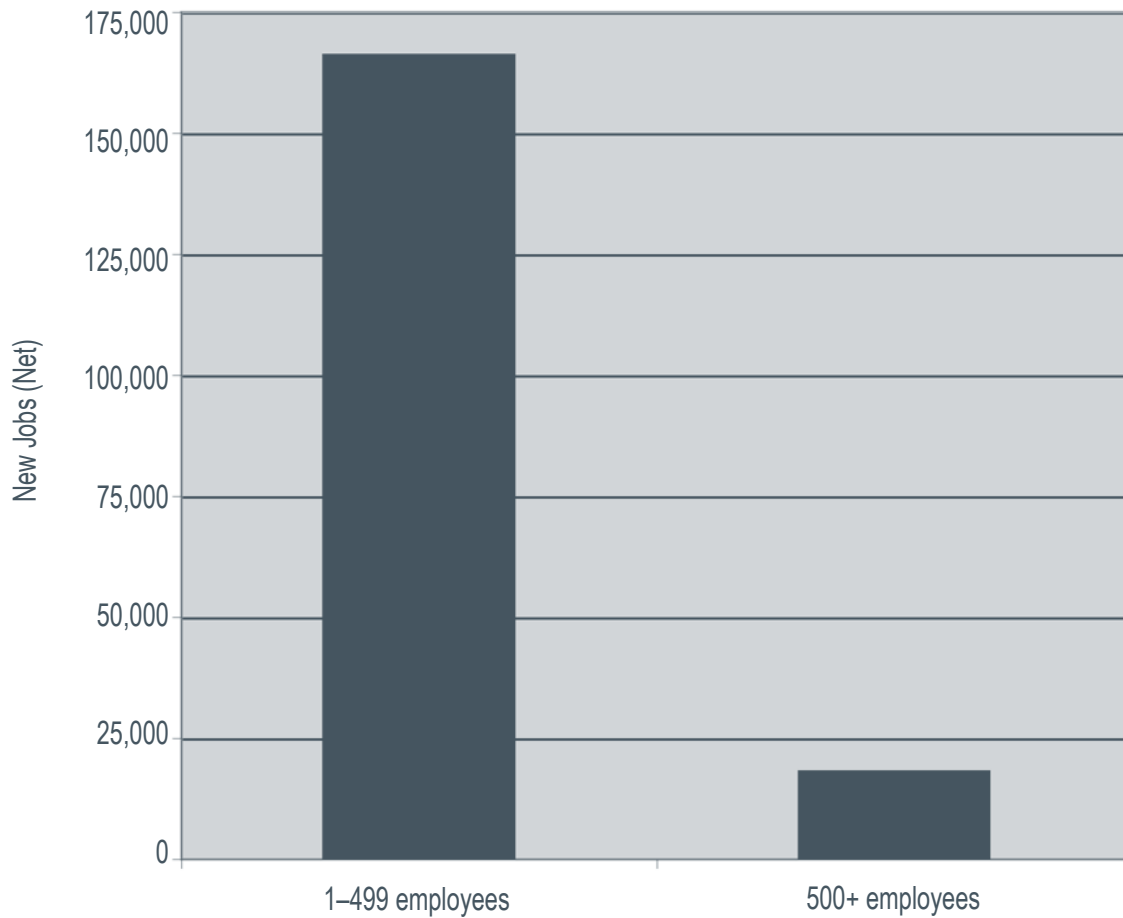
##### *The Importance of Small Businesses in North Carolina*

Small businesses, defined by the United States Small Business Administration (SBA) as businesses with fewer than 500 employees,<sup>40</sup> account for 98.1 percent of all employers in North Carolina.<sup>41</sup> They employ 48.6 percent of the state's private-sector workforce.<sup>42</sup>

In terms of total net new jobs, small businesses recently have been far more important than larger businesses. From 2003 to 2006, small businesses had total net new jobs of 166,083, compared with only 18,171 for large businesses.<sup>43</sup> That means small businesses accounted for nine times more net new jobs than large businesses. In addition, small businesses had more total net new jobs than large businesses in each of the years between 2003 and 2006 (see Figure 4).<sup>44</sup> As can be seen from the data, small businesses are critical to our economy.

##### *Disproportionate Regulatory Costs on Small Businesses*

One-size-fits-all regulation can cause significant problems, especially when it comes to compliance. Small busi-

**Figure 4. Net job change by firm size in North Carolina, 2003-06\***

Years	Total net new jobs	Employment size of firm	
		1-499	500+
2003-04	21,218	56,559	-35,341
2004-05	48,872	26,767	22,105
2005-06	114,164	82,757	31,407
<b>2003-06</b>	<b>184,254</b>	<b>166,083</b>	<b>18,171</b>

\* Includes non-farm positions only.

Source: United States Small Business Administration

nesses simply are not in as good of a position to meet regulatory mandates as larger businesses.

Small businesses do not have the in-house legal or compliance personnel that larger businesses do. Compliance costs take a larger share of small businesses' resources than they do of large businesses'.

The SBA points out that "small businesses spend \$6,975 each year per employee just to comply with fed-

eral regulations and mandates. That is 60 percent more than large firms."<sup>45</sup>

#### *Regulatory Flexibility Analysis for Small Businesses*

To address the differences between small businesses and larger businesses, agencies should be required to consider regulations that reduce the impact on small businesses. That consideration would include having less

stringent compliance requirements for small businesses or even exempting small businesses from regulations. Regulatory flexibility analysis requires this kind of analysis to ensure that regulations are developed with enough flexibility to address the needs of small businesses. The RRC should have oversight to ensure that the needs of small businesses have been properly considered.

The SBA has developed model language for state regulatory flexibility analysis — it is listed in Figure 5. According to the SBA, there are 35 states with small business regulatory flexibility analysis.<sup>46</sup>

Thirty years ago, Congress passed the Regulatory Flexibility Act, which established regulatory flexibility analysis for small businesses on the federal level.<sup>47</sup> The General Assembly needs to amend the APA so that small businesses in North Carolina have the same protections as their counterparts in most other states.

#### REFORM SIX

##### *The Legislature Should Require Periodic Review of Regulations*

The passage of new laws or changes in technology can cause regulations to become outdated or unnecessary. They also may prove to be ineffective at achieving their objectives. For those reasons, 32 states have periodic review of regulations,<sup>48</sup> and the SBA also recommends periodic review.<sup>49</sup>

The General Assembly should amend the APA in order to adopt a process whereby all agencies review their regulations on a periodic basis. The SBA recommends that reviews be carried out every five years.<sup>50</sup> In making this decision, agencies should examine, among other things:

- 1) The success or failure of the regulations in achieving the stated objectives.
- 2) Whether compliance with the regulations is too complicated or costly.
- 3) Whether new laws, including federal laws, make the regulations duplicative.

#### Figure 5. United State Small Business Administration's Model Regulatory Flexibility Analysis Legislation

(a) Prior to the adoption of any proposed regulation on and after January 1, 2007,\* each agency shall prepare a regulatory flexibility analysis in which the agency shall, where consistent with health, safety, environmental, and economic welfare consider utilizing regulatory methods that will accomplish the objectives of applicable statutes while minimizing adverse impact on small businesses. The agency shall consider, without limitation, each of the following methods of reducing the impact of the proposed regulation on small businesses:

- (1) The establishment of less stringent compliance or reporting requirements for small businesses;
- (2) The establishment of less stringent schedules or deadlines for compliance or reporting requirements for small businesses;
- (3) The consolidation or simplification of compliance or reporting requirements for small businesses;
- (4) The establishment of performance standards for small businesses to replace design or operational standards required in the proposed regulation; and
- (5) The exemption of small businesses from all or any part of the requirements contained in the proposed regulation.

(b) Prior to the adoption of any proposed regulation that may have an adverse impact on small businesses, each agency shall notify the [Department of Economic and Community Development or similar state department or council that exists to review regulations] of its intent to adopt the proposed regulation. The [Department of Economic and Community Development or similar state department or council that exists to review regulations] shall advise and assist agencies in complying with the provisions of this section.

\* Reflects only the date this model legislation was drafted.

- 4) Whether new technology, economic conditions, or other factors make the regulations unnecessary or in need of change.

Agencies would submit their findings to the RRC, which would draw its own conclusions based on the arguments made by the agencies.

As in Tennessee, agencies should have the burden to justify the continued existence of their regulations.<sup>51</sup> If the regulations were no longer needed, they would be repealed.

## REFORM SEVEN

### *The Legislature Should Prohibit Agencies From Passing Rules that Exceed Federal Standards*

The legislature should amend the APA to prohibit state agencies from passing regulations that exceed federal standards. This kind of law, sometimes referred to as a “no more stringent” law, would ensure that legislators — as opposed to bureaucrats — determine whether North Carolinians should suffer a greater regulatory burden than citizens in other states.

According to the EPA, about one-third of all states already have “no more stringent” prohibitions that apply to at least some areas of state law.<sup>52</sup> A strong “no more stringent” law would be an important component in developing a better regulatory environment in North Carolina.<sup>53</sup>

Recent state regulations provide a great example of why such a reform is needed. In 2005, the United States Environmental Protection Agency (EPA) issued regulations that required coal-fired power plants to reduce mercury emissions by 70 percent.

To put these regulations in context, they were the first regulations ever issued in the United States that concerned coal-fired power plant mercury emissions.<sup>54</sup> Furthermore, as a result of these regulations, the United States became the first country in the world to regulate mercury emissions from coal-fired power plants.<sup>55</sup>

Environmental extremists in North Carolina, however, were not satisfied. Instead, they pressured the state’s Environmental Management Commission (EMC) to adopt even tougher standards. The EMC passed regulations, giving in to the environmental groups.<sup>56</sup>

To be very clear, the question is not *whether* North Carolina should exceed federal standards. The question is *who should decide* if North Carolina exceeds federal standards, the legislature or political appointees and bureaucrats. Clearly, as a matter of good government, it should be the legislature.

“No more stringent” laws are far from new in North Carolina. Between the 1970s and ‘90s, North Carolina used them to prohibit state agencies from exceeding federal standards in numerous environmental areas.<sup>57</sup> By the

mid-1990s, however, the environmental extremists succeeded in repealing those protections.<sup>58</sup>

Why environmental groups prefer that the legislature not make major policy decisions is not hard to understand. Those groups can “capture” relevant agencies and commissions. It is much easier to influence a small number of unelected individuals, who often have close connections to these environmental groups, than to convince a large number of legislators, who are also beholden to voters. Also, because of the nature of the legislative process, it is difficult to get laws passed.

Opponents of “no more stringent” laws often argue that prohibiting state agencies from exceeding federal standards would amount to the federal government dictating the standards that would apply in the state, completely ignoring the legislature (the actual lawmaking body of the state).

The General Assembly always could decide that the state should have tougher standards. North Carolina’s state sovereignty is not violated because state bureaucrats or political appointees are prohibited from deciding for themselves that North Carolina should exceed federal standards.

North Carolina should apply “no more stringent” requirements to all laws, and at a minimum to environmental laws. The RRC should review all proposed regulations to ensure agencies are meeting these requirements.

## CONCLUSION

The reforms discussed in this report would improve decision-making by agencies, properly restrain agency power, and help to ensure that agencies implement laws as opposed to create laws. Unfortunately, North Carolina has been slow to adopt meaningful reforms compared with other states and even the federal government — the federal government is decades ahead of North Carolina when it comes to real regulatory reform. The General Assembly should take action soon and develop a regulatory process that eases the burdens on business and the economy, is mindful of liberty and the democratic process, and remains attentive to achieving real social benefits.

## END NOTES

1. For purposes of this report, whenever the word “agencies” are used in regards to North Carolina, it also encompasses state boards and commissions. Also, the Council of State agencies *do* have elected officials, so to the extent those officials can have final say on the promulgation of regulations, the unelected problem does not apply for those select agencies.
2. The *legal* definition of “rule” in the state Administrative Procedure Act (APA) is broader than “regulation” (regulation is a subcategory of a “rule”); however, for the purposes of this report, “rule” and “regulation” are used interchangeably, in keeping with common usage, not the legal usage, of the terms.
3. *Town of Spruce Pine v. Avery County*, 123 N.C. App. 704 (1996).
4. Chad Adams and John Hood, “Unsteady Ground: A Survey of North Carolina Business Leaders on Competitiveness, Taxes, and Reform,” John Locke Foundation *Policy Report*, November, 2005, [http://www.johnlocke.org/acrobat/policyReports/unsteadyground\\_bussnsurvey2005.pdf](http://www.johnlocke.org/acrobat/policyReports/unsteadyground_bussnsurvey2005.pdf).
5. *Ibid.*
6. N.C. Gen. Stat. § 150B-1 *et seq.*
7. *Ibid.* The statutory section creating the Rules Review Commission (RRC) is N.C. Gen. Stat. § 143B-30.1, [http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_143B/GS\\_143B-30.1.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_143B/GS_143B-30.1.html).
8. N.C. Gen. Stat. § 143B-30.1(a).
9. N.C. Gen. Stat. § 150B-21.9(a).
10. *Ibid.*
11. N.C. Gen. Stat. § 150B-21.3(b1)-(b2).
12. *Op. cit.*, note 9.
13. *North Carolina Board of Pharmacy v. The Rules Review Commission*, 174 N.C. App. 301 (2005), <http://www.aoc.state.nc.us/www/public/coal/opinions/2005/040929-1.htm>.
14. *Ibid.*
15. *North Carolina Board of Pharmacy v. The Rules Review Commission*, No. 673A05, November 17, 2006, <http://www.aoc.state.nc.us/www/publicsc/opinions/2006/673-05-1.htm>.
16. *N.C. Home Builders Ass’n v. Envtl. Mgmt. Comm’n (In re Declaratory Ruling by the Envtl. Mgmt. Comm’n)*, 155 N.C. App. 408 (2002).
17. Through discussions with RRC staff, it was clarified that the old regulatory process was in effect at the time of the EMC rule. Therefore, the EMC ignored the RRC decision applying this old process that allowed such an action.
18. *Op. cit.*, note 16.
19. *Ibid.*
20. Proposed Rule Amending 23 NCAC 02C .0301, North Carolina State Board of Community Colleges, *North Carolina Register*, Oct. 13, 2009, Vol. 24, No. 8, page 568-569, <http://www.oah.state.nc.us/rules/register/Volume24Issue08October152009.pdf>.
21. N.C. Gen. Stat. § 115D-5(a).
22. *Adams v. North Carolina Department of Natural and Economic Resources*, 295 N.C. 683 (1978).
23. Dave Mason, “Executive Order on Regulatory Review,” Comments to the Office of Management and Budget, March 16, 2009, <http://www.heritage.org/Research/Regulation/tst032309a.cfm>.
24. If an agency is simply implementing the specific requirements of a statute, then a rule should not be rejected if costs exceed benefits.
25. Adrienne Dunn, “Human Betterment League of North Carolina,” North Carolina History Project, John Locke Foundation, <http://www.northcarolinahistory.org/encyclopedia/314/entry>.
26. See, *e.g.*, Exec. Order No. 12044, 43 Fed. Reg. 12661 (Mar. 24, 1978). Exec. Order No. 12291, 46 Fed. Reg. 13193 (Feb. 19, 1981), Exec. Order No. 12866, 58 Fed. Reg. 51735 (Oct. 4, 1993).
27. Exec. Order No. 12291, 46 Fed. Reg. 13193 (Feb. 19, 1981).
28. Exec. Order No. 12044, 43 Fed. Reg. 12661 (Mar. 24, 1978).
29. The APA does require fiscal notes, but in no way would these notes qualify as cost-benefit analyses. For example, the most extensive analysis deals with rules with a substantial economic impact; however, all that is required is a description of benefits, not an analysis quantifying the benefits. There is no requirement to identify costs except for expenditures necessary for compliance.
30. According to discussions the author had with OSBM, it is possible that a rule with a substantial economic impact may not be a significant rule change; however, such an outcome is unlikely. It is unclear what level of analysis would apply in such a situation.
31. *State of North Carolina Budget Manual*, Office of State Budget and Management, April 2009, page 172.
32. N.C. Gen. Stat. § 150B-21.4(b1).
33. “Fiscal Note Training,” slide 10, Office of State Budget and Management, [http://www.osbm.state.nc.us/files/pdf\\_files/FiscalNoteTraining.pdf](http://www.osbm.state.nc.us/files/pdf_files/FiscalNoteTraining.pdf).
34. *Op. cit.*, note 31, page 174.
35. *Ibid.*, page 175.
36. *Ibid.*, page 176.
37. *Ibid.*, page 173.
38. *Op. cit.*, note 9.
39. *Ibid.*
40. “Frequently Asked Questions,” U.S. Small Business Administration: Office of Advocacy, September 2009, <http://www.sba.gov/advol/stats/sbfaq.pdf>.
41. “Small Business Profile: North Carolina,” U.S. Small Business Administration: Office of Advocacy, October 2009, <http://www.sba.gov/advol/research/profiles/09nc.pdf>.
42. *Ibid.*
43. *Ibid.*

44. *Ibid.*

45. “Small Business Regulatory Flexibility Model Legislation Initiative,” U.S. Small Business Administration: Office of Advocacy, September 2005, [http://www.sba.gov/advo/laws/law\\_modeleg.html](http://www.sba.gov/advo/laws/law_modeleg.html).

46. *Ibid.* The SBA identifies 42 states with regulatory flexibility analysis. Seven of those states, however, do not have small business–specific regulatory flexibility analysis. Although regulatory flexibility analysis does not necessarily have to be small business–specific, in this author’s opinion it should adjust regulatory requirements according to the size of businesses. For example, Maryland’s regulatory flexibility analysis is not small business–specific but it does require agencies to consider the impact of regulations based on the different sizes of businesses.

The other six states without small business–specific regulatory flexibility analysis did not have language that was comparable to Maryland’s. The number of states with regulatory flexibility analysis probably should be 36, not 35, but to establish a bright line distinction, I did not include Maryland in the number of states with regulatory flexibility analysis.

47. Regulatory Flexibility Act of 1980, P. L. 96-354 codified at 15 U.S.C. §§ 601–612, <http://www.sba.gov/advo/laws/regflex.html>.

48. *Op. cit.*, note 45.

49. *Ibid.*

50. *Ibid.*

51. Tenn. Code Ann. § 4-5-226.

52. United States Environmental Protection Agency web page entitled “State ‘No More Stringent’ Laws,” <http://www.epa.gov/nps/elistudy/appendix.html>.

53. “EPA Announces First-Ever Rule to Reduce Mercury Emissions from Power Plants,” United States Environmental Protection Agency press release, March 15, 2005, <http://yosemite.epa.gov/opaladmpress.nsf/b1ab9f485b098972852562e7004dc686/91ab7266e65751b985256fc50067d9b0!OpenDocument>.

54. *Ibid.*

55. *Ibid.*

56. North Carolina Administrative Code, 15A NCAC 02D .2503, <http://ncrules.state.nc.us/ncac/title%2015a%20-%20environment%20and%20natural%20resources/chapter%2002%20-%20environmental%20management/subchapter%20d/15a%20ncac%2002d%20.2503.html>.

57. Milton S. Heath, Jr. and Alex L. Hess, “The Evolution of Modern North Carolina Environmental and Conservation Policy Legislation,” 29 *Campbell L. Rev.* 535, Spring 2007.

58. *Ibid.*

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Daren Bakst, J.D., LL.M., is the Director of Legal and Regulatory Studies for the John Locke Foundation. In this position, he analyzes numerous public-policy issues affecting North Carolinians, including regulatory reform, environmental and energy issues, and property rights. He regularly drafts comments on regulatory proposals, produces reports, and makes a wide range of media appearances and presentations to organizations. His op-eds have been published in many newspapers in North Carolina and nationally in publications such as *National Review Online* and *American Enterprise Online*.

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“To prejudge other men’s notions  
before we have looked into them  
is not to show their darkness  
but to put out our own eyes.”

**JOHN LOCKE (1632–1704)**

Author, *Two Treatises of Government* and  
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