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Not Written in Stone

How sunset laws can improve North Carolina's regulatory climate

KEY FACTS: • **Overregulation is a well-recognized problem by members of both political parties. Regulation imposes significant costs on the economy through deadweight loss — i.e., labor and capital employed in complying with government edicts and red tape, as opposed to being used for productive purposes.**

• **Unlike cutting taxes, cutting regulations doesn't require having government make do with less revenue in Year One.**

• **Regulations are taxes on *time*, which for industry translate into real monetary costs. Reducing regulation allows more time to be spent instead on productive activities, encouraging more entrepreneurship, more job opportunities, and more economic growth — which in turn means government collecting more revenue in a more vibrant economy.**

• **A stronger form of periodic review, sunsetting is having government regulations, programs, and agencies conclude after a set period of time unless positive action is taken by the government to reauthorize them.**

• **A 2012 study conducted by the Mercatus Center of George Mason University of different kinds of regulatory review processes used in all 50 states found that the presence of a sunset provision was "robustly statistically significant" in reducing a state's regulatory burden.**

• **Furthermore, the Mercatus study found that a sunset provision's impact was also *economically* significant.**

• **With North Carolina bound up in over 22,500 permanent administrative rules, Democrat and Republican leaders alike have recently taken actions against overregulation. A measure before the current General Assembly would institute a process for periodic review and sunset of rules.**

• **An effective sunset approach needs an effective "sunrise" approach, including a REINS law, strong cost/benefit analysis, requiring agencies to consider alternatives to regulation, stating regulations' objectives and outcome measures by which to hold them accountable, no-more-stringent laws, regulatory reciprocity, and small business flexibility analysis.**

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The menace of overregulation has been acknowledged for years by leaders of both political parties as well as citizens, businessmen, and scholars. Taming the regulatory beast has historically been difficult at the national level, however; it frustrated reform-minded Democrats in the mid-1970s, lead by Pres. Jimmy Carter, and reform-minded Republicans in the mid-1990s, led by House Speaker Newt Gingrich.

Republicans in North Carolina have accomplished regulatory reforms in consecutive years, in part by building on reforms espoused — at least when they were her idea — by then-Gov. Bev Perdue, a Democrat. Republican reformers have promised to continue improving the state's regulatory climate in ensuing years.

Cutting deadweight loss, not government revenue

One of the strengths of reforming regulatory policy is its minimal negative effect on government revenue in the short term and a strong positive effect in the long term. Unlike tax reform, which deals with monetary distribution, cutting burdensome regulations essentially just gets rid of deadweight loss — i.e., the problem of labor and capital employed in complying with government edicts and red tape, as opposed to being used for productive purposes. Lessening that burden will make room for more productive activity.

In other words, regulatory reform doesn't require government making do with less revenue in Year One. Regulations are taxes on *time*, which for industry translate into real monetary costs, but their compliance yields nothing remunerative for government. Restoring lost time to industry doesn't reduce the General Fund.

Not only do regulatory hurdles prevent companies from employing more resources in productive activities, they also force some entrepreneurs out of an industry and dissuade others from getting into it. Reducing the hurdles means encouraging more entrepreneurship, more job opportunities, and more economic growth — which in turn means government collecting more revenue in a more vibrant economy.

Sunsetting: A robust way of eliminating unnecessary regulations

In 2012 the Mercatus Center of George Mason University conducted a study of different kinds of regulatory review processes used in all 50 states. The study, by College of Charleston visiting scholar Russell S. Sobel and Mercer University assistant professor of economics John A. Dove, used six different measures of regulation levels in examining regulatory reviews according to the source of review (attorney general, other executive, legislative, or independent), the type of metrics by which the regulations are judged (legality, authority, efficiency, cost/benefit, etc.), and the kind of periodic review (agency, non-agency, and sunset provision). They also looked at voter initiatives.

Sobel and Dove found little evidence that the source of the review matters or correlates with reducing a state's overall level of regulation. They also found weak evidence overall for the significance of the type of metric by which regulations are judged, though they did find evidence that government cost/benefit analysis (which measures how regulations affect government budgets, as opposed to economic cost/benefit analysis, which measures how regulations affect the economy as a whole) mattered. They also found some evidence that requiring a cost/benefit review to present alternative scenarios lowers a state's total amount of regulation. They found very little evidence, however, that who conducted periodic review mattered.[1]

Sobel and Dove's findings for sunset provisions were neither weak nor uncertain, however. As they write,

> The final independent variable in the periodic review section, **the presence of a sunset provision, is robustly statistically significant — in fact, the most significant finding in our initial results**. Sunset provisions are negative and significant in all six different measures of state regulatory climates. The coefficients are sizeable as well, implying that **the impact is not only statistically but economically significant**.[2] (Emphasis added.)

So whereas other kinds of regulatory review used in states across the nation proved to have little to no effect on reducing a state's total level of regulation, sunset provisions had significant effect, which translated into a strong, positive economic impact for a state.

Furthermore, Sobel and Dove report that this robust finding holds for reducing the flow of new regulations as well as reducing the total stock of regulations in a state. They conclude that, for leaders seeking policies to bring about effective regulatory reform, "The single most important policy in a state is the presence of a sunset provision."[3]

For a summary of Sobel and Dove's results, see Table 1.

Table 1: Which review processes work to reduce a state's level of regulation?

Summarized findings from the Mercatus Center's 50-state analysis

Regulatory Review Variable	Overall General Finding
Source of review	
Attorney General	inconsistent evidence
Other executive	no evidence
Legislature	some evidence
Independent party	some evidence
Type of review (judgment metrics)	
Legality	inconsistent evidence
Authority	no evidence
Efficiency	inconsistent evidence
Any factor	some evidence
Government cost/benefit	some evidence
Economic cost/benefit	no evidence
Alternative cost/benefit	some evidence
Kind of periodic review	
Agency review	no evidence
Non-agency review	no evidence
Sunset provision	strong evidence
Other	
Voter initiative	inconsistent evidence

Limiting duration, changing assumptions

Writing to James Madison on the many impediments to good governance even in a representative government, Thomas Jefferson suggested what is essentially the forerunner of a sunset provision. The problems described by Jefferson are still all too familiar today: cronyism, petty partisanship, corruption, and a public generally harmed by unbalanced laws and regulations but unable to organize against them, especially when special interests who particularly benefit from them are already organized if not downright cozy with legislators.

All those things Jefferson saw as "impediments" to getting rid of bad, counterproductive, or obsolete laws. His proposed solution was structural:

> The people cannot assemble themselves. Their representation is unequal and vicious. Various checks are opposed to every legislative proposition. Factions get possession of the public councils. Bribery corrupts them. Personal interests lead them astray from the general interests of their constituents: and other impediments arise so as to prove to every practical man that **a law of limited duration is much more manageable than one which needs a repeal**.[4] (Emphasis added.)

Sunsetting is *limiting the duration* of government regulations, laws, programs, and agencies — having them conclude after a set period of time unless positive action is taken by the government to reauthorize them. It is a stronger form of periodic review, which is an ex post facto review of existing regulations.

The presence of a sunset law makes the necessary but tedious process of revisiting old ideas more manageable by shifting the assumptions. Without sunsetting, all rules and programs are assumed to continue on indefinitely, and it would require the deliberative process of government, with all its factions, to eliminate any of them. With sunsetting, all rules and programs are assumed to end in the near future, so for any one to be re-upped, it must be compelling enough to use the deliberative process of government to keep it.

Recent rules-review attempts in North Carolina

North Carolina is bound up in over 22,500 permanent administrative rules.[5] Fortunately, state policymakers seem to understand the problem of overregulation, as recent actions by Democrat and Republican leaders have shown.

RMIP and RRA 11: Passive review

In 2010, Gov. Perdue issued an executive order establishing the Rules Modification and Improvement Program (RMIP) within the Office of State Budget and Management (OSBM). The RMIP required annual review of rules issued by Cabinet agencies and their associated boards and commissions. Its goal was to identify and eliminate rules that had become outdated, unnecessary, unduly burdensome, vague, or otherwise inconsistent with clear, well-developed, and efficient rule-making. The program involved OSBM inviting public comment and suggestions on those agencies' existing rules and requirements, then reviewing the merits of the reform suggestions and following through on those deemed meritorious.[6] Within months the governor credited RMIP with culling 900 outdated, excessive, unnecessary rules.[7]

The next year, the General Assembly passed the Regulatory Reform Act (RRA) of 2011. Among other things, RRA 11 expanded RMIP to apply to all state agencies. It also required each state agency "to conduct an annual review of its rules to identify existing rules that are unnecessary, unduly burdensome, or inconsistent" with its reform of the rule-making process.[8]

This annual review offered only a passive approach to regulatory reform, however, since it relied on public input and knowledge of the RMIP process. Furthermore, by involving all existing rules in the review, it stymies the process by the sheer weight of the demand. A more effective periodic review, on the other hand, would mandate an active review of rules, but only of those slated for sunset in a given year.

H.B. 74, "Periodic Review and Expiration of Rules"

A bill before the General Assembly, House Bill 74 (third version as of this writing),[9] would bring periodic review to North Carolina and have the Rules Review Commission (RRC) set expiration dates for all rules according to where they appear in the Administrative Code, barring review by the agency that adopted them. Afterwards, rules would have to be reviewed by their originating agencies at least once every ten years; without review, they would expire.

The RRC would be a busier commission under the provisions of H.B. 74. Its workload and costs would likely increase. Nevertheless, those would be more than offset by the positive economic effects that would result from weeding out unnecessary, outdated, excessive, or controversial regulations.

H.B. 74 would institute a three-step process for reviewing rules. First, the agency would initially determine whether it considered the rule necessary or unnecessary. If necessary, the agency would determine whether it affected the property interest of the regulated public or did or would have people objecting to it — i.e., whether the agency would classify the rule as necessary with or without what is called "substantive public interest."

The agency would seek public comment on that initial determination on its web site as well as submit its determination to the Office of Administrative Hearings for online posting and reception of public comments for at least 60 days. Afterwards, the agency would submit a report to the RRC with its initial determination, public comments about it, and its response to those comments.

Next, the RRC would review the report and the public comments. Part of this review would be deciding whether each public comment has merit (i.e., whether a comment addressed the substance of the rule and related to the

RRC's statutory standards for review). Based upon that, the RRC could change the agency's designation of a rule as "unnecessary" or "necessary without substantive public interest" to "necessary with substantive public interest."

The RRC would then draft a final determination report to submit to the Joint Legislative Administrative Procedure Oversight Committee, which comprises eight members apiece from the House and Senate. This report would include the agency's report items along with the RRC's determinations of public comments.

The following regulatory actions would result from that report once it became effective:

- Rules deemed "unnecessary" would expire on the first day of the month after the report's effective date
- Rules deemed "necessary without substantive public interest" would remain in effect
- Rules deemed "necessary with substantive public interest" — including, based on public comments of merit, rules initially deemed by the agency as "unnecessary" or "necessary without substantive public interest" — would have to be readopted as new rules

In the final step, the RRC's final determination report would become effective either when the agency consults with the oversight committee or, barring a consultation, on the 61st day following delivery of the report.

Should the oversight committee disagree with the determination of a specific rule, it could recommend that the General Assembly direct the agency to review that rule within a year.

Two factors would greatly affect the strength of the review process outlined in H.B. 74. First, as with RMIP and RRA 11, this review would put much weight on public input and knowledge of the process. At the agency level, H.B. 74 makes space for acknowledging that regulating parties may not know their interests are affected and would object if they did. There is no such allowance afforded the RRC in its review of the agency's initial determination, however.

The review process could therefore be strengthened by a simple definitional change. The proposed change would be under Section 2 in the bill, from

> A rule is also "necessary with substantive public interest" if the rule affects the property interest of the regulated public and the agency knows or suspects that any person may object to the rule.[10]

to

> A rule is also "necessary with substantive public interest" if the rule affects the property interest of the regulated public ~~and~~ or if the agency or Commission knows or suspects that any person may object to the rule.

The second factor relates to having controversial rules — those the agencies consider necessary but which the regulated public finds (or would likely find) objectionable — go through the adoption process again as proposed new rules. The idea is welcome, but its effectiveness ultimately hinges on the process for adopting proposed new rules.

Sunrise and sunset

An effective sunset approach needs an effective "sunrise" approach. Rules slated for review would have to undergo the same scrutiny given to proposed new rules. For that reason, the state needs a solid policy foundation for new rules. Sunrise complements to sunset laws would include a REINS law, strong cost/benefit analysis, requiring agencies to consider alternatives to regulation, stating regulations' objectives and outcome measures by which to hold them accountable, no-more-stringent laws, regulatory reciprocity, and small business flexibility analysis.

REINS

The present structure of regulation in North Carolina is heavily biased toward expanding regulation. Procedural hurdles make successfully blocking a proposed rule extremely rare.

The REINS approach (from the "Regulations from the Executive In Need of Scrutiny" Act proposed before Congress) would require an affirming vote in the General Assembly before allowing to proceed any proposed rule that would have a major impact on the economy, cause significant cost or price increases on consumers, or bring about significant harm to competition, employment, productivity, and other healthy economic activities.[11]

Strong cost/benefit analysis

RRA 11 included a foundation of cost/benefit analysis but didn't go far enough — it didn't require agencies to reject rules if they find the costs of a proposed rule to exceed its benefits. An ideal regulatory process would have good, narrowly tailored rules adopted only when the rules are absolutely necessary, so a rejection requirement should not be twisted into an "adoption requirement" just because benefits are found to exceed costs. Furthermore, "benefits" are not benefits if they trespass individual rights, stand in as a measurable proxy for an immeasurable good (i.e., reduced carbon dioxide emissions assumed to mean a reduced global-warming risk), or are forced changes in behavior caused by mandates, etc.[12]

Consideration of alternatives to regulation

An important reform in RRA 11 was to require an agency proposing a rule with substantial economic impact to consider at least two alternatives and explain why the alternatives were rejected.[13]

In considering alternatives to rules, the agency should be required to include *making no change* as one of the alternatives to consider and quantify. (In the case of existing rules reviewed and deemed "necessary with substantive public interest," the alternatives should include *no longer having the specific rule*.) Agencies should be required to choose the least burdensome alternative.[14]

Stated objectives and outcome measures

Any regulation, no matter how well conceived, poses a real risk of unintended, unforeseen negative consequences. Agencies should therefore be required to include stated objectives and outcome measures for regulations and state programs, so that when the time for review arrives, they can be held accountable to them. The "winners" of any regulation would be able to point to positive effects among themselves, so it is important to be able to test it according to its foundational purposes.[15]

Requiring stated objectives and outcome measures up front is also an important feature of transparent government.

No-more-stringent laws

Given the burden of compliance costs of regulation, if North Carolina is to have a stricter regulation than that imposed by federal regulators, then it should be the elected representatives of the people (legislators), not agency bureaucrats, who make that decision. "No-more-stringent" laws would prohibit state agencies from imposing stricter regulations in areas also covered by federal regulations.

RRA 2011 addressed the lack of no-more-stringent laws in state environmental policy. The General Assembly should extend this reform to all state agencies, not just ones dealing with the environment.

No-more-stringent laws would not, however, prevent the legislature from passing stricter laws in areas covered by federal regulations. In that case it would be proper for directly accountable representatives of the people to make those decisions, not unelected, unaccountable bureaucrats.

Regulatory reciprocity, a.k.a. the "Stossel Rule"

Even if periodic review were in place, there would be no cap on the total stock of state regulation. An idea promoted by consumer reporter and Fox Business Network host John Stossel would require agencies to trade in old rules for every new rule.

If North Carolina were to adopt a form of the "Stossel Rule" — "For every new rule, repeal two old ones"[16] — it would reduce the total number of regulations over time. A policy of regulatory reciprocity would also introduce opportunity cost to agency rulemaking, as agencies would have to consider the tradeoffs of creating a new rule. It could also lead to a voluntary speeding up of a periodic review if one were in place; i.e., agencies might face internal pressure not to wait the full ten years to report its "unnecessary" rules if identifying and culling them now would clear the path for a new rule it considered necessary. (A rule readopted under periodic review would not count as a new rule for the purpose of regulatory reciprocity.)

To be the most effective, however, regulatory reciprocity should trade *like rules for like*. In other words, trading in two unnecessary minor rules for one major rule could have a net negative impact on the state's economic climate, even though it would reduce the total number of rules. Therefore, a Stossel Rule approach for North Carolina would best require trading in old major rules if an agency wanted a new major rule.

Incidentally, regulatory reciprocity need not be limited to a "two-for-one" reciprocity arrangement. Stossel favored each new rule costing as much as 10 old rules.[17]

Small business flexibility analysis

Small businesses comprise 98 percent of employers in North Carolina, but they typically struggle with higher costs to comply with state and federal regulations because unlike big firms, they generally lack their own compliance and legal staffs. Recognizing this cost disparity, the federal government has since 1980 used small business flexibility analysis, which offers small businesses less stringent compliance and reporting requirements, less onerous scheduling or reporting deadlines, use of performance standards rather than design or operational standards, and exemption from some or all requirements of particular regulations. A majority of states have adopted it as well.

Adopting small business flexibility analysis in North Carolina would not only help protect small businesses trying to comply with state regulations, but it would also extend to them protections afforded their peers in many other states.[18]

Conclusion

Overregulation is a significant drag on the North Carolina economy. It causes businesses to shift resources away from productive tasks into chasing compliance. It raises the cost of doing business, keeping some businesses from getting started while driving some establishments out of business. Furthermore, it dampens investment, harms job creation and employment, and reduces state revenues.

Leaders across the political spectrum have long recognized the ill effects of overregulation and have sought ways to get rid of unnecessary, harmful, or out-of-date rules. Once regulations are put into place, however, they draw factions and special interests, making it politically difficult to attempt to end them.

Sunsetting is a highly effective way of fighting overregulation. A stronger form of periodic review, sunsetting takes politics out of the decision to revisit a rule by slating all rules to end after a certain amount of time without readoption or amendment.

Sunsetting works best in combination with effective "sunrise" policies — ones that ensure only good, necessary proposed rules are ultimately adopted, since those same standards would also be applied to rules slated to sunset. Such policies include a REINS approach, strong cost/benefit analysis, requiring agencies to consider alternatives to regulation, stating regulations' objectives and outcome measures by which to hold them accountable, no-more-stringent laws, regulatory reciprocity, and small business flexibility analysis.

To its credit, the General Assembly has passed regulatory reform packages in two straight years. A measure before the current General Assembly would institute a process of periodic review and expiration of rules.

Effective periodic review, especially in combination with good regulatory sunrise policies, would further the legislature's recent accomplishments in regulatory reform. More importantly, as the state recovers from a recession and years of lagging economic performance, it would help reduce the state's regulatory burden and thereby help jumpstart entrepreneurship, job creation, investment, economic growth, and government revenue.

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End notes

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