"Unfunded Mandates and Regulatory Overreach Part II"

Testimony of

Raymond J. Keating
Chief Economist
Small Business & Entrepreneurship Council

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The Honorable James Lankford, Subcommittee Chairman
The Honorable Gerald Connolly, Ranking Minority Member

SBE Council · 2944 Hunter Mill Road · Suite 204 · Oakton, VA 22124 · 703-242-5840
www.sbecouncil.org
Protecting Small Business, Promoting Entrepreneurship

Chairman Lankford, Ranking Member Connolly, and members of the Committee, the Small Business & Entrepreneurship Council (SBE Council) is pleased to provide testimony today regarding the 1995 Unfunded Mandates Reform Act and how it relates to small business and the economy in general.

My name is Raymond J. Keating, chief economist with SBE Council, a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship. With nearly 100,000 members and 250,000 small business activists nationwide, SBE Council is engaged at the local, state, federal and international levels where we collaborate with elected officials, policy experts and business leaders on initiatives and policies that improve the environment for entrepreneurship and enhance competitiveness.

Unfortunately, government erects significant obstacles to improving the climate for entrepreneurship, and to enhancing the competitiveness of U.S. businesses. Taxes, regulations and mandates, excessive government spending, uncertainty surrounding monetary policy, and trade barriers, for example, all serve to raise costs, diminish incentives and resources for risk taking, reduce opportunities, and/or create uncertainty.

For our purposes today, the focus is on unfunded mandates, i.e., on federal legislation and regulations that impose costs on private-sector entities and/or other levels of government in order to achieve certain goals without covering those costs with federal funding.

In addition to being chief economist with SBE Council, I also am an adjunct professor in the business school at Dowling College in New York. One of the courses I frequently teach in the MBA program is "Public Sector Economics." In that class, I emphasize the importance of understanding the incentives at work not just in the private sector, but in the public sector as well. In fact, powerful incentives exist within the governmental and political spheres when it comes to imposing mandates on other levels of government or on the private sector. After all, considerable political costs or risks exist when government raises taxes or increases debt in order to fund a new or expanded undertaking. Therefore, the ability to take – and take credit for – governmental action, while having others – whether it be private businesses or other governmental entities – deal with the costs provides a powerful incentive to regulate and mandate.

Of course, it must be noted that such incentives are not just at work at the federal level, but also in state and local governments. States often impose unfunded mandates on localities and businesses, and local governments regulate private enterprises as well.

It is critical to understand that the costs of regulations and mandates fall much harder on small businesses. Other levels of government can tap the taxpayers to cover the costs of unfunded mandates. Large businesses, though without a doubt negatively impacted, often have the resources to better deal with the costs of mandates and regulations. However, small businesses often lack adequate resources – both in terms of dollars and staff – to deal with the additional costs that come with governmental mandates.

The U.S. Small Business Administration's Office of Advocacy provides an idea of how much more burdensome regulations are for small businesses. Advocacy's most recent regulatory impact study found that per-employee federal regulatory costs in 2008 for small businesses with fewer than 20 employees registered $10,585, compared to $7,755 for firms with more than 500 employees. So, on a per-employee basis, the federal regulatory burden on small businesses came in at 36 percent higher than the burden on large companies.

For good measure, the small business community has reason to be concerned about federal mandates on other levels of government, as the state and/or local taxes needed to fund such mandated activities come from small businesses and their customers.

Given the powerful incentives at work and the often-substantial costs, it is important to have some kind of institutional (whether constitutional or legislative) counterbalances, or checks and balances, in the system when it comes to unfunded mandates.

The Unfunded Mandates Reform Act (UMRA), which SBE Council supported, is one counterbalancing measure. The following from a U.S. Government Accountability Office report ("Unfunded Mandates: Views Vary About Reform Act's Strengths, Weaknesses, and Options for Improvement," GAO-05-454, March 2005) sums up the key purpose and points of UMRA:

> The Unfunded Mandates Reform Act of 1995 was enacted to address concerns expressed about federal statutes and regulations that require nonfederal parties to expend resources to achieve legislative goals without being provided funding to cover the costs. Although UMRA was intended to curb the practice of imposing unfunded federal mandates, the act does not prevent Congress or federal agencies from doing so. Instead, it generates information about the potential impacts of mandates proposed in legislation and regulations. In particular, title I of UMRA requires Congressional committees and the Congressional Budget Office (CBO) to identify and provide information on potential federal mandates in certain legislation. Title I also provides opportunities for Members of Congress to raise a point of order when covered mandates are proposed for consideration in the House or Senate. Title II of UMRA requires federal agencies to prepare a written statement identifying the costs and benefits of federal mandates contained in certain regulations and consult with affected parties. It also requires action of the Office of Management and Budget (OMB), including establishing a program to identify and test new ways to reduce reporting and compliance burdens for small governments and annual reporting to Congress on agencies' compliance with UMRA. Title III of UMRA required the Advisory Commission on Intergovernmental Relations to conduct a study reviewing federal mandates. Title IV establishes limited judicial review regarding agencies' compliance with certain provisions of title II of the act.

In terms of the definition of an "unfunded mandate," the GAO report added: "UMRA generally defines a federal mandate as any provision in legislation, statute, or regulation that would impose an enforceable duty on state, local, or tribal governments (intergovernmental mandates) or the private sector (private sector mandates) or that would reduce or eliminate the funding authorized to cover the costs of existing mandates." As for the threshold levels in the UMRA, they were $50 million or more for mandates on other levels of government and $100 million or more on the private sector via legislation, and $100 million for mandates via federal agencies. These levels are indexed for inflation, with the 2011 levels being $71 million for intergovernmental mandates and $142 million for private-sector mandates via congressional legislation, and $142 million for federal agency mandates.

The UMRA has been beneficial by providing additional information about the direct costs of unfunded federal mandates. For all involved in the policymaking process, more information is always better. That's especially the case with policymakers gaining a better understanding of the costs being imposed through regulation and mandates. Injecting the issue of costs further into the debate and discussion when it comes to regulations and mandates is a positive development from the perspective of small business growth and survivability, investment, economic growth, and job creation.

Consider the following points from a 2004 GAO analysis ("Unfunded Mandates: Analysis of Reform Act Coverage," GAO-04-637, May 2004):

> CBO stated in its July 2003 congressional testimony that "both the amount of information about the cost of federal mandates and Congressional interest in that information have increased considerably. In that respect, title I of UMRA has proved to be effective." The Chairman of the House Rules Committee was quoted in 1998 as saying that UMRA "has changed the way that prospective legislation is drafted... Anytime there is a markup [formal committee consideration], this always comes up." Although points of order are rarely used, they may be perceived as an unattractive consequence of including a mandate above cost thresholds in proposed legislation.

In addition, in congressional testimony in March 1999, Angela Antonelli, a former Director of the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation, reported: "During 1996 and 1997, I studied the initial implementation of UMRA to determine how well the act was living up to Congress's intent. My research led me to conclude that the contribution of the Congressional Budget Office's (CBO) analysis of the cost of new mandates had resulted in Members seeking more information at an earlier stage in the development of their legislative proposals and that the information provided by the CBO often helped to produce more sensible policy outcomes."

However, problems exist with UMRA, or perhaps more accurately, there are shortcomings.

Consider the following examples of regulations and mandates that will directly and indirectly affect small businesses, but will elude or fall outside UMRA:

• The Dodd-Frank Wall Street Reform and Consumer Protection Act

New regulations being proposed (and to be proposed) under the auspices of Dodd-Frank have the potential to restrict access to, and raise the cost of, capital and credit for small business owners. Proposed Federal Reserve rules regarding interchange fees, for example, could make a currently challenging problem much worse for small business owners. The financial industry - including small banks and credit unions - and consumers - including small businesses using debit card and related banking services - will be impacted by the Federal Reserve's interchange price regulations that would reduce debit card interchange revenue by an expected 70 percent. After all, whenever government overrules prices set in the competitive marketplace, increased costs are inevitable. Those costs can come in various forms. Providers of a price-controlled good or service can reduce the supply of the product, diminish the quality (including through reduced investment and innovation), and/or raise prices of related goods or services.

Interchange fee regulation is but one of many ways that Dodd-Frank will affect small business owners and their access to capital and its cost. Yet, most of the rules to implement this legislation will be exempt from UMRA due to being issued by independent regulatory agencies, such the Federal Reserve, the Securities and Exchange Commission, and the forthcoming Consumer Financial Protection Bureau (CFPB).

• The FCC’s Net Neutrality Regulations

The Federal Communications Commission (FCC) voted in December, by a 3-2 margin, to impose net neutrality regulations on Internet broadband providers. In effect, the FCC will insert itself into pricing and operational decisions. This step was taken despite the fact that a federal appeals court in April 2010 ruled that the FCC lacked such regulatory authority. For good measure, members of Congress, from both sides of the political aisle made clear that this should be a congressional decision. Clearly, a government agency inserting itself into broadband network pricing and management decisions would have a negative effect on investment and innovation in broadband, with small businesses experiencing negative consequences as consumers, content providers, app entrepreneurs, and in other roles dealing with broadband innovation and development. Nonetheless, the FCC is another independent regulatory agency not covered by UMRA.

• The Patient Protection and Affordable Care Act

The major health care measure signed into law by the President in March 2010 included unfunded mandate burdens that far exceeded the thresholds in UMRA. In a late 2009 analysis, for example, CBO reported that the private and the intergovernmental mandate costs “greatly exceeded” the threshold levels.

Regarding the private sector, CBO noted:

> The most costly mandates would be the new requirements regarding health insurance coverage that apply to the private sector. The legislation would require individuals to obtain acceptable health insurance coverage, as defined in the legislation. The legislation also would penalize medium-sized and large employers that did not offer health insurance to their employees if any of their workers obtained subsidized coverage through the insurance exchanges. The legislation would impose a number of mandates, including requirements on issuers of health insurance, new standards governing health information, and nutrition labeling requirements.

And in terms of intergovernmental mandates:

> The provisions of the legislation that would penalize those entities—if they did not offer health insurance to their employees and any of their workers obtained subsidized coverage through the insurance exchanges—account for most of the mandate costs.

The CBO analysis also brings up a point on mandated costs that are excluded under UMRA:

> As conditions of federal assistance (and thus not mandates as defined in UMRA), the legislation would require state and local governments to comply with "maintenance of effort" provisions associated with high-risk insurance pools. New requirements in the Medicaid program also would result in an increase in state spending. However, because states have significant flexibility to make programmatic adjustments in their Medicaid programs to accommodate changes, the new requirements would not be intergovernmental mandates as defined in UMRA.

The question, of course, is: just how much flexibility does state and local governments have in actually dealing with these added costs? And the reality is: Very little.

And make no mistake, all of these costs affect, either directly or indirectly, small businesses.

While it was acknowledged that this massive health care measure did indeed exceed the threshold levels of UMRA, it mattered little in terms of legislative reality, and the measure was passed and signed into law. This raises questions about UMRA's ultimate impact, and its lack of teeth.

Following are six key problems or limitations with UMRA that require remedies:

• First, among the most glaring and troubling is that the law does not cover a large swath of federal mandates.

UMRA "does not apply to conditions of federal assistance; duties stemming from participation in voluntary federal programs; rules issued by independent regulatory agencies; rules issued without a general notice of proposed rulemaking; and rules and legislative provisions that cover individual constitutional rights, discrimination, emergency assistance, grant accounting and auditing procedures, national security, treaty obligations, and certain elements of Social Security." (Robert Jay Dilger and Richard S. Beth, "Unfunded Mandates Reform Act: History, Impact, and Issues," Congressional Research Service, January 25, 2011.)

Again, that exemption for independent regulatory agencies is a stunning omission. After all, among such agencies are the Commodity Futures Trading Commission, the Consumer Product Safety Commission, the Federal Reserve, the Federal Communications Commission, the National Labor Relations Board, and the Securities and Exchange Commission.

Given the largely informational nature of UMRA, no sound reasons exist for any of these exemptions. All regulations, rules and mandates should be covered with the understanding that more information makes for better decision-making.

• Second, there are problems with UMRA's point-of-order provisions. They are limited to unfunded mandates through legislation, excluding agency mandates. In addition, while an informational point of order – i.e., against a measure whereby the congressional committee has not provided the estimated costs of a mandate – applies to both governmental and private-sector mandates, the substantive point of order – i.e., against the consideration of a measure exceeding the mandate threshold level – only applies to governmental mandates, not mandates on private-sector enterprises.

These shortcomings need to be remedied by having both informational and substantive points of order apply to legislative and agency mandates on both levels of government and the private sector.

In addition, some kind of supermajority vote should be required to overcome a point of order, as a necessary counterbalance given the strong incentives within government to regulate and impose mandates. Interestingly, in 2005, the Senate increased the vote needed to waive a point of order from a majority to 60 votes, but in 2007, the required vote was pushed back to a majority once more. (Robert Jay Dilger and Richard S. Beth, "Unfunded Mandates Reform Act: History, Impact, and Issues," Congressional Research Service, January 25, 2011.) A sixty percent or two-thirds majority to waive a point of order would add some much-needed teeth to the point-of-order provision.

• Third, it is crucial that problems and limitations in terms of assessing costs be remedied. For example, UMRA is limited to estimating only direct costs. That is a worrisome shortcoming given the costs and incentive effects that regulations have on business and

investment decisions, as well as the similar costs and incentive effects that the taxes needed to fund intergovernmental mandates impose. Therefore, indirect costs, impacting such areas as prices, risk taking, economic growth and employment, need to be considered.

In addition, assessing the costs of mandates on a national basis can wind up missing instances whereby costs fall disproportionately and heavily on particular states and regions.

Also, a major error under UMRA is to have a higher threshold level for private enterprises compared to state and local governments – again, the 2011 levels being $71 million for intergovernmental mandates and $142 million for private-sector mandates via congressional legislation, and $142 million for federal agency mandates. Given the role that private enterprise plays in our economy – i.e., the engine of innovation, invention, economic growth and job creation – UMRA's threshold for private enterprises should be, at the very least, just as low as is the case for intergovernmental mandates via legislation. Again, given the potential effects on private enterprises and therefore on the overall economy, the bias under UMRA clearly should be on the low side in terms of threshold levels.

• Fourth, the incentives at work in government must be kept in mind. These incentives work against agencies doing a thorough, substantive and realistic evaluation of the costs of regulations and mandates that the agency itself is creating and imposing. When it comes to agency mandates, an independent entity – such as the GAO, a separate entity within OMB or an independent office – should have responsibility for evaluating the costs of such mandates.

Consider the following example offered in the May 2005 GAO analysis: "In one case, which we observed in a prior report, the U.S. Department of Agriculture (USDA) appeared to have developed a range of costs associated with implementing its rule on retained water in raw meat and poultry products. However, USDA provided only a lower bound estimate of $110 million, but did not quantify median or upper bound cost estimates. Because the lower bound was so close to the inflation adjusted threshold of $113 million, it is reasonable to assume that the median or upper bound estimate would have exceeded the threshold and been a mandate under UMRA."

There should be no questions about the legitimacy of the efforts to estimate the costs of mandates.

• Fifth, the judicial review included in UMRA lacks any substance. As the GAO (May 2005) explained: "Specifically, the judicial review is limited to requirements that pertain to preparing UMRA statements and developing federal plans for mandates that may significantly impact small governments. However, if a court finds that an agency has not prepared a written statement or developed a plan for one of its rules, the court can order the agency to do the analysis and include it in the regulatory docket for that rule but the court may not block or invalidate the rule." That lacks teeth, to say the least, and offers

no real incentives to challenge agencies, or for agencies to deal legitimately with UMRA requirements.

• Sixth, UMRA needs to be built upon or amended to establish means for evaluating the effectiveness, the actual costs, and the emergence of unintended consequences of existing regulations and mandates. A process for periodically evaluating the cost and effectiveness of mandates makes sense from the standpoint of getting policymaking right. Markets are constantly changing, including, for example, advancements in technology, enhanced global competition, and growing levels of entrepreneurship. Businesses need to adjust their products and strategies accordingly. The same should go for how government regulates and mandates. Requiring sunsetting and periodic evaluation of existing regulations and mandates make sense given the realities of a dynamic economy. Along with this, a required congressional vote on all rules, mandates and regulations being proposed would enhance accountability, again, serving as a needed check and balance on the regulating and mandating process.

Thank you for your attention to this most important issue. SBE Council appreciates the opportunity to provide input to the Committee and I look forward to your questions.