

**Testimony of Tom Carper
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Good morning, Mr. Chairman and members of the committee. I am Tom Carper, Chairman of the National Governors' Association. I appreciate the opportunity to appear before you today on behalf of the nation's Governors to testify in support of the bipartisan Federalism Accountability Act of 1999. We appreciate yours and Senator Levin's willingness to work with the staffs of our organizations. As the nation heads towards some of the greatest changes in the history of our economy, we think we now have a critical opportunity to ensure a dynamic federalism for the future.

Strengthening our federalism partnership is a consistent priority of the National Governors' Association. During the last several years, Congress has accomplished much on behalf of state and local governments. We are here to express our appreciation for your work and urge you to keep moving forward on a number of major issues. We are especially grateful to the sponsors of this legislation, you, Mr. Chairman, and Senators Roth, Levin, Robb, Cochran, Breaux, Lincoln, Enzi, Bayh, and Voinovich. I am here today to urge swift action on this bipartisan bill, and to urge a constant effort to maintain the bipartisan nature of this proposed legislation.

As the new information economy transforms this nation, we believe that this legislation will take a key step towards ensuring the ability to innovate and experiment at the state and local level, and that it will better ensure that all levels of government are more accountable to our citizens.

Federalism Progress

In the last decade, we have witnessed major advances as Congress and the Administration have entrusted state and local governments with national goals while using state and local laws, rules, and procedures for effective implementation. We have made major progress in moving from the micro-management historically imposed by the federal bureaucracy toward performance goals and results that foster innovations by states, cities, and counties. We also have achieved significant progress on the judicial front with a series of recent Supreme Court decisions that begin to reassert the federalist principles upon which our country was founded.

Our nation's "laboratories of democracy" are shining brightly all across America in crime reduction, education reform, employment practices, pollution prevention, broad-based health coverage, and multi-modal transportation. Congress and the Administration gave states our

version of the Safe Drinking Water Act, stopped the wholesale passage of unfunded mandates, reduced agency micro-management, and gave us new block grants in welfare, transportation, children's health, child care, drug prevention, and statewide health expansions. More recently enacted laws have expanded education flexibility and provided tobacco recoupment protection.

Despite all the benefits conferred to states by devolution, its aggregate impact on federalism has at times been exaggerated. Many of the devolutionary initiatives are better in theory than in practice, either lacking enforcement to make them effective or imposing new burdens on states as conditions of funding. Also, while devolution has occupied center stage during the past few years, another story has unfolded in the wings with much less fanfare.

I am here today on behalf of the nation's Governors not only to thank Congress and this committee, in particular, but also to express our growing concerns about this new trend. While we appreciate the considerable reduction in the number of unfunded mandates that force the spending of our own funds, states now often face broad preemptions that restrict access to our own funds, laws, and procedures for meeting the people's needs. We must maintain a commonsense approach to government services that makes sense to the people. Only a full partnership between elected officials of all levels of government can make it work.

The New Problem – Preemption of State Authority

While shifting power to the states with one hand, Congress and the Administration also have been busy taking power away from the states with the other. The independence and responsibility that devolution has given states in certain areas has been offset by preemption elsewhere. Even as states have benefited enormously from block grants over the past few years, the federal government has preempted state laws affecting trade, telecommunications, financial services, electronic commerce, and other issues.

Federal preemption of state laws has not occurred as the result of a malicious desire to undermine states' sovereignty. Rather, preemption often has occurred as the unintended byproduct of other issues. Unfortunately the outcome is the same for states, regardless of the motive.

To varying degrees, the federal government has often ignored the powerful role and the constitutional rights of states in the American system of government that enables elected officials of all levels of government to best serve the people. Recent examples of federal preemptions include:

- The Internet Tax Freedom Act, which preempted state and local authority over taxing authority on the Internet.
- The National Securities Markets Improvement Act of 1996, which weakened states' capacity to protect consumers on securities activities conducted within state boundaries and preempted revenue sources for the investigation and enforcement of fraud and other abusive practices;
- The consolidated Farm and Rural Development Act of 1991 preempted state annexation laws making it difficult to provide utility and economic development services in rural areas under state laws; and
- The Telecommunications Act of 1996, which preempted regulation of inherently local business to federal regulators.

Pending bills in Congress that demonstrate this emerging trend include bills on:

- financial services modernization;
- electric utility deregulation;
- electronic signatures;
- the American Homeownership and Economic Opportunity Act;
- broadband Internet access;
- financial records privacy;
- Religious Liability Protection Act;
- teacher liability;
- medical records privacy; and
- The Year 2000 Y2K issues.

We are also concerned about federal preemption made by federal agencies without any clear direction from Congress, much less consideration of consequences to state and local governments. For example, in the April 12, 1999, Federal Register, the U.S. Department of the Interior published a final rule that would authorize the Secretary to permit casino gambling on

Indian lands without the state-tribal compact required in the Indian Gaming Regulatory Act of 1988. The rule became final on May 12, 1999.

Under the Indian Gaming Regulatory Act of 1988, authority for Indian tribes to conduct Class III gaming is made conditional upon compacts negotiated with states. Under IGRA, Congress recognized that states are the traditional regulators of gambling. Thus, while Congress permitted the tribes the authority to engage in Class I gaming under their own authority, and Class II gaming also under tribal regulation (so long as states had no criminal laws against such games), the operation of Class III gaming requires that the tribes negotiate with states. In the proposed amendments to 25 CFR 291, the Secretary has proposed that tribes may come to the Secretary for an alternative method of establishing Class III gaming. The nation's Governors strongly believe that no statute or court decision provides the Secretary with authority to intervene in disputes over compacts between Indian tribes and states about casino gambling on Indian lands. The Secretary's inherent authority includes a responsibility to protect the interests of Indian tribes, making it impossible for the Secretary to avoid a conflict of interest or exercise objective judgment in disputes between states and tribes.

This rule is not only a preemption of gubernatorial authority, but also a violation of the Indian Gaming Regulatory Act.

The Future Federalism Problem

Unfortunately, we believe the problem of preemption will worsen. The rise of the new global economy, rapid advances in modern technology, and efforts toward industrial deregulation have accelerated the pace of preemption. To compete with international competitors, respond quickly to technological developments, and maximize opportunities created by deregulation, businesses seek to streamline legal and regulatory requirements. Efforts to substitute uniform national legislation for disparate state laws comprise an important part of this process and have led to federal preemption of state authority in many areas.

Businesses understandably do not want to contend with a myriad of state and local codes, statutes, and rules that prevent them from responding effectively to the rapidly changing dynamics of the domestic and world marketplaces. If industry has to be regulated at all, a standard set of federal laws and regulations presents a far more compelling alternative. However, just as federal laws and oversight serve important purposes that include preventing monopolies, raising revenues to fund national defense, and financing social security, state and local laws fulfill a variety of critical functions as well.

State and local taxing authority provides funds for education, roads, law enforcement, health care, and environmental protection. State banking, insurance, and securities laws impose capital adequacy requirements, underwriting standards, and licensing procedures that safeguard consumers' deposits and investments and protect against fraud and abuse. State utility regulations ensure that citizens receive high-quality water, electric, sewage, and telephone services at reasonable rates.

The important role of state laws and regulatory responsibilities should not be forgotten in the midst of the scramble to accommodate businesses and react to the forces of globalization, technology, and deregulation. States and their citizens stand to benefit as much as businesses from these changes, but not at the cost of continuing federal preemption of state laws.

The Similarity Between Mandates and Preemption

Nearly four years ago, many of us joined together to halt a rising tide of unfunded federal mandates. We succeeded in the enactment of legislation that helped provide better information and analysis about unintended consequences of federal action before they happened, instead of after the fact. The reports from the Congressional Budget Office demonstrate this bill has not had the impact many in Congress feared—that it would erect significant hurdles to consideration of legislation. Rather the new law seems to have led to much closer consultation between Congress and state and local elected leaders. We believe it has been an effective law that has improved, not hindered governance or accountability.

This new bill is not dissimilar. It focuses on federal preemption of historic and traditional state and local authority. The result of months of negotiations with state and local leaders, it is focused on providing information and consultation prior to action by either Congress or any federal agency taking any action with federalism implications. The bill would require federal courts to defer to states in any instance in which a federal law does not explicitly preempt states or, alternatively, if there is no direct conflict between the statute and state or local laws, ordinances, or regulations that cannot be reconciled. The bill would enable us to ensure that Congress' intentions are made clear and that they are enforceable to hold federal agencies accountable to Congress and the people.

Practical Consequences of Preemption

Federal preemption of state laws affects states in a number of ways. It can restrict their ability to raise revenue, promote economic development, meet the needs and priorities of the citizens of an

individual state or community, and protect their citizens. The following examples, as well as the attachment, illustrate the practical consequences of federal preemption in these four areas:

- revenues (e.g.: Internet Tax Freedom Act);
- sovereignty (e.g. medical records privacy);
- business development and innovation (e.g.: Financial Services Modernization); and
- ability to protect consumers and exercise state enforcement authority. (e.g.: Food Quality Protection Act).

Unlike unfunded mandates, however, once the federal government has preempted traditional state or local authority, that authority is unlikely to ever be returned.

NGA Principles of Federalism

The American federal system established a strong union while preserving the diversity reflected in individual states. State and local governments—governments close to the people—provide the needed opportunities for flexibility and innovation, and by their decentralization of decision-making and responsive nature, encourage citizen participation and support.

Although there is a clear need for national role in a variety of domestic issues, the principles of local determination and diversity require a careful balance of federal and state roles. It is vital to ensure that states have the authority and flexibility needed to respond to the needs of those who live within their boundaries.

We believe the following principles of federalism are essential to the major issues facing states today.

Principles of Federalism

- The U.S. Constitution assigns certain responsibilities to the federal government and reserves the balance to states. Congress should limit the scope of its legislative activity to those areas that are enumerated and delegated to the federal government by the Constitution.
- In cases where Congress expressly determines that federal preemption of state laws is in the national interest, the federal statute should accommodate state actions taken before its enactment.

- The federal government should exercise prudential restraint by refraining from enacting legislative and regulatory measures that preempt the states' ability to craft innovative solutions in areas of state responsibility.
- It is essential that the federal government not preempt, either directly or indirectly, sources of state revenues, state tax bases, or state taxation methods.

State Recommendations

NGA supports this bill, Mr. Chairman, and we urge you to schedule a mark-up as soon as possible. While we do support the legislation, there are a number of important changes that we believe should be made to the bill. First, in Section 5, we believe that the analysis required in committee or conference reports should be expanded. We believe it is critically important for federal officials to understand the effects of legislative and regulatory preemptions on costs, economic development, consumer protections, and state and local enforcement authorities.

Additionally, to ensure greater accountability by Congress, we would encourage amending the bill to provide for a point of order. We believe the point of order under the Unfunded Mandates Reform Act has achieved its purpose without obstructing the process; we believe it an important addition to this bill. Without such a provision, we fear there will be no effective mechanism for enforcing the requirements for an analysis of preemption impacts prior to final passage of a bill.

Finally, in Section 6(b), the Rule of Construction would apply to all rules promulgated after enactment of this legislation. We believe that this subsection should be amended so that the Rule of Construction applies only to federal rules promulgated pursuant to legislation enacted after this legislation.

Conclusion

Because federalism legislation can never be perfect or finished, we are here today to encourage each of you to continue your efforts and expand your good work to this new threat to federalism. We support your efforts to apply these principles of enforceable federalism to legislative and regulatory preemptions of state revenues, laws, and administrative procedures.

When we fail to use these federalism principles^¾consultation, disclosure, impact statements, deference, and enforcement^¾we spend even more effort to correct the problems created in areas such as telecommunications, the Internet, environmental laws, local zoning, regulatory

preemption, and long-term tax policy. Our message to you is to move forward towards an “enforceable” federalism partnership between elected officials of all levels of government.

We urge you to join us in a revived working partnership involving all of America in our system of government through all of its elected officials. We can best meet the single and special needs of some of the people, while also meeting the collective needs of most of the people.

Thank you very much.

EXAMPLES OF MAJOR PREEMPTION IMPACTS

Consumer Protection

The Senate Banking Committee is considering legislation, the Securities Markets Enhancement Act of 1999 (SMEA), that would undermine states’ ability to protect investors from harm. If enacted, SMEA would:

- *Prevent states from denying licenses to rogue brokers.* States would only be allowed to license brokers who are physically located in the state. In most states, however, 90 percent of stockbrokers conducting business in the state are located elsewhere. States would lose the ability to prevent out-of-state brokers with histories of disciplinary action from selling securities to unsuspecting investors.
- *Limit the information that states can collect and disclose.* States would lose control of their public records. The National Association of Securities Dealers (NASD) would be given the authority to decide what information about state-licensed firms and brokers would be made available to the public. Currently, state securities regulators have the power to provide investors with the information they need to make informed decisions about their stockbrokers.
- *Weaken states’ enforcement authority.* If the Securities and Exchange Commission (SEC), the NASD, or a stock exchange has already imposed a financial penalty on a firm or broker, states would be prevented from imposing their own penalty. This would weaken states’ ability to enforce state securities laws and protect state residents.

Revenue Generation

Congress passed the Internet Tax Freedom Act in 1998, imposing a three-year moratorium on the imposition of new taxes on Internet access. The legislation also established an advisory commission to study issues related to the taxation of electronic commerce and present recommendations to Congress by April 2000.

The Internet Tax Freedom Act prevents states from imposing taxes on Internet access. For a period of three years after enactment of the legislation, states cannot tax Internet access as a means of raising revenues to pay for education, safety, economic development, and other essential public services. It sets a precedent for federal limitation of states' taxing authority. Among other issues, the Internet Tax Freedom Act directs the Advisory Commission to examine "the effects of taxation, including the absence of taxation, on all interstate sales transactions." The commission could recommend imposing a new, expanded moratorium on taxing Internet sales or even an outright ban on such taxes. Senator Robert Smith (R-N.H.) has already introduced legislation this year to extend the existing moratorium permanently. Others, such as House Majority Leader Dick Armey (R-Texas) have recommended not only making the preemption of state and local authority permanent, but also expanding it to state and local sales and use taxes. States that rely on sales taxes to finance government activities would increasingly have to rely on different mechanisms to raise revenues.

Economic Development

In addition to the Internet legislation, which is already harming Main Street retailers through creation of an uneven playing field—so that the bill provides a federally preempted tax haven for some of the world's most powerful corporations--and proposals to preempt state authority with regard to electric utility deregulation—federal action that could force the cost of electricity higher in many states, especially as it would affect small businesses and consumers--one of the best examples was the HUD Fair Housing rule proposed late last year. This federal regulation would have permitted the agency to withhold any housing, community, or economic development assistance to a state or local government if there were an allegation about fair housing practices—whether proven or not, and whether within the authority of that state or local government to act upon it or not. This rule was issued in the Federal Register without any express direction from Congress and without any consultation with leaders of states and local governments. According to the agency, they foresaw no federalism consequences.

Preemption Issues: State & Local Impact

Finance & Administration

National Securities Markets Improvement Act of 1996:

- Preempts state regulation of "covered" securities, including nationally traded securities and investment company securities.
- Weakens state oversight of securities activities conducted within state boundaries and jeopardizes funding source for investigation and enforcement of fraud and other abusive practices.

Financial Services Modernization:

- Legislation would prevent state insurance commissioners from approving mergers or “restricting” or “significantly interfering” with banks’ insurance activities.
- Would weaken oversight of insurance industry, endangering policyholders and potentially causing states to lose millions of dollars in premium taxes.

Bank Powers:

- Legislation would render state legislative authority to determine state bank powers null and void.
- Could create uneven playing field for bank branches depending upon their state of chartering, rather than the state law where they are conducting business. Could create some competitive disadvantages for home-based state-chartered banks.

Provider Service Organizations:

- Legislation would exempt Medicare managed-care operations from state insurance regulation.
- Would put pros on same playing field as self-insureds under ERISA. Could expose policyholders to solvency and consumer protection inadequacies without recourse.

Community & Economic Development

Municipal Annexation:

The consolidated Farm and Rural Development Act of 1961 preempts state and local governments from providing a full range of infrastructure and services in an annexed area if a rural utility service has a protected federal loan or loan guarantee on a facility in the area. This makes it difficult for localities to carry out growth and economic development plans under state law.

Public Safety

Police Officers’ Bill of Rights:

- Potential preemption of local labor-management policies and practices.
- Federal interference with state authorities and local law enforcement polices and procedures. Would make it very difficult for state and local governments to discipline police officers, and create different treatment for public safety employees than any other state and local employees.

Juvenile Justice:

- Would federalize certain juvenile crimes and impose federal restrictions, requirements, and guidelines.
- Provides unprecedented opportunities to circumvent state law.
- Would require states to prosecute juveniles as adults in certain circumstances and require states to pay costs for released prisoners who are subsequently convicted of other crimes.

Natural Disaster Insurance:

- Contemplated imposition of federal building codes to reduce loss of life and physical damage resulting from catastrophic natural disasters.
- Would mandate that localities pass and enforce certain building standards, notwithstanding state law.

Technology & Communications

Electronic Signatures

- Bills establish a uniform national baseline governing the validity of electronic signatures and records.
- Would preempt existing laws in more than forty states governing the use of electronic signatures and records, forcing conformity with federal law.

Y2K Liability Legislation:

- Establishes a federal law dealing with lawsuits resulting from Year 2000 failures.
- Preempts state contract and tort laws as they affect Y2K related lawsuits, makes it easier to remove class-action suits to federal court.

Telecommunications Act of 1996:

- Strips state and local regulators of authority over numerous aspects of local telephony.
- Preempts local taxes on broadcast satellite services.
- Transfers regulation of inherently local business to federal regulators.
- Forces higher taxes and fees on other businesses and residents.

Internet Taxes:

- Preempts state and local taxes and fees on Internet transactions for three years.

- Forces higher taxes and fees on all other businesses and residents and strips states of authority to determine tax policy.

Zoning Authority:

- Industry petition before the FCC would preempt state and local authority over the siting of wireless broadcast transmission facilities.
- Would lose ability to make land use and zoning decisions, to preserve the integrity of local neighborhoods, protect property values, and public health and safety.

Energy, Environment, and Natural Resources

Electric Utility Deregulation legislation:

- jeopardizes state and local authority in many areas.
- State and local governments could lose policymaking and revenue-raising capacity.

Rights-of-Way legislation would:

- jeopardize state and local control over the public rights-of-way.
- States and local governments would lose ability to make decisions regarding the use of public streets, lose compensation in the way of franchise fees.

Food Quality Protection Act:

- Preempts state authority to regulate the use of pesticides.
- State regulations affecting the shipping, handling, and production of food have to conform to federal standards.

Human Development

Medical Records Privacy:

- Would establish a federal standard for the privacy of medical records.
- State laws that establish different standards for privacy would not be valid.
- States would not be able to address special privacy needs in their individual states.

Minimum Wage Increase:

- Requires state and local governments to increase minimum wage paid to employees.

- Would increase salary costs for state and local government employees.

Workplace Safety and Ergonomics Standard:

- Preempts local laws for workplace standards for municipal workers in OSHA state plan states.
- Would create federal standards for workplace safety programs that may require additional staff funding.