Recruitment of American Presidential Nominees and Appointees: Divestiture and Deferred Taxation of Gain

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It is the thesis of this article that the deferred taxation of gain provision of the Ethics Reform Act of 1989,[1] has become an extremely important tool for easing the transition of individuals from the private sector into positions as presidential nominees and appointees. The success of the deferred taxation of gain provision has ended the search for an effective remedy for the financial conflict-of-interest problems of presidential nominees and other political appointees.

A president, prior to the Second World War, could pick up the phone and ask an individual to serve in his administration and announce the nomination in less than twenty-four hours. Today, the process of selecting a presidential nominee for a high-level administration position can take weeks. Ethics officials working in the White House Counsel's Office, the Office of Government Ethics, the Department of Justice, and the nominee's designated agency ethics official must spend hours carefully reviewing the financial affairs of the prospective nominee, the nominee's spouse, and minor children to see whether they present conflict-of-interest problems. If conflict-of-interest problems appear, additional time must be spent to resolve these problems prior to any announcement of a nomination.

The passage of the deferred-taxation-of-gain provision of the Ethics Reform Act has greatly simplified the process of working with presidential nominees and other political appointees to resolve financial conflict-of-interest problems.

Mandated Divestitute and Deferred Taxation of Gain

The 1992 election of Bill Clinton as President of the United

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[1]. Pub. L. No. 101-194, 103 Stat. 1755 (1989).

States ended twelve years of Republican control of the White House. President Clinton faced the difficult task of filling hundreds of high level positions with individuals who could withstand intense public scrutiny of their personal and financial affairs.[2] Like all presidential transitions since the early 1960s,[3] the Clinton transition carefully reviewed the financial affairs of potential nominees and appointees for possible financial conflicts of interest.[4] Compliance actions by presidential nominees and appointees, prior to the passage of the Ethics Reform Act of 1989, most often involved: (1) creation of either a "qualified" or "diversified" blind trust, (2) executed recusal or disqualification agreements, (3) resignation from positions in corporations or other organizations, and (4) the sale of stock or other assets.[5] The Clinton transition was the first to have the opportunity to make use of the non-recognition-of-gain provision of the Ethics Reform Act of 1989.

The Ethics Reform Act of 1989 added section 1043(a) to title 26 (federal tax laws), *United States Code*. This section is entitled "Sale of property to comply with conflict-of-interest requirements."[6] The new tax provision "permits an officer or employee of the executive branch of the federal government to rollover any gain on property sold in order to comply with any conflict of interest requirements into

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[2]. For a complete listing and biographical data on high-level Clinton Administration political appointees and nominees see: Jeffrey B. Trammell and Gary P. Osifehin, *The Clinton 500: The New Team Running America* (Washington, D.C.: Almanac Publishing, Inc. 1994).

[3]. G. Calvin Mackenzie, "If You Want to Play, 'You've Got to Pay,' Ethics Regulation and the Presidential Appointments System, 1964-1984," in G. Calvin Mackenzie, editor, *The In-and-Outers* (Baltimore, Johns Hopkins University Press, 1987), pp. 83-87 (hereafter cited as Mackenzie, "Regulation").

[4]. The president appointed Beth Nolan, Associate Counsel to the President with primary responsibility for screening nominees and appointees for ethics violations. See Trammel and Osifehin, p. 13.

[5]. Mackenzie, "Regulation," p. 84.

[6]. "Tax Notes: Executive Officials May Be Entitled to Deferral of Gain," *The Army Lawyer*, (July 1990) DA PAM 27-50-211, p. 52.

permitted property."[7]

Besides permitting the covered executive branch officer or employee to make use of the provision, the law permits the spouse or minor children to apply for and receive a certificate of divestiture from the Director of the Office of Government Ethics OGE) or the President of the United States.[8] Trustees, finally, have the right to request a certificate of divestiture on behalf of a federal employee who has given the trustee responsibility for managing his or her financial holdings.[9] The law does not limit the number of certificates of divestiture an employee or family member of the employee can receive or the amount of capital gain subject to the rollover provision. These features make certificates of divestiture an extremely effective remedy for financial conflicts of interest.

The Evolution of Financial Conflict Resrictions and Remedies

Since the early 1950s, federal ethics officials and presidential transition scholars have searched for ways to balance the need to prevent financial conflicts of interest with the impact of financial conflict-of-interest rules on the recruitment and retention of presidential appointees and nominees.[10] Critics of conflict-of-interest regulation argued that these restrictions deterred many individuals

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[7]. "Qualified Rollover Can Also Avoid Conflict of Interest," *The Journal of Taxation*, v. 73 (September 1990), p. 138 (hereafter cited as "Qualified Rollover").

[8]. Ibid.

[9]. This situation most often occurs when an executive branch employee has set up a "qualified " or "diversified" blind trust under the provisions of the Ethics in Government Act of 1978. To comply with the provisions of the Ethics Act, trustees frequently must sell certain financial assets. The Ethics Reform Act of 1989 did not permit trustees to apply for a certificate of divestiture. The 1990 Amendments to the Ethics Reform Act added this provision. Eleven trustees received certificates of divestitures for the reporting years of 1990, 1991, 1992 and 1993.

[10]. See Robert N. Roberts, *White House Ethics* (Westport, Conn.: Greenwood Press, 1988)(hereafter cited as Roberts, *Ethics*); Mackenzie", "Regulation"; and G. Calvin Mackenzie, "Presidential Transitions and The Ethics in Government Act of 1978," *Sourcebook on Government Ethics for Presidential Appointees* (Washington, Administrative Conference of the United States, December 1988)(hereafter cited as Mackenzie, "Transitions").

from accepting high-level positions in government.

The search intensified after the confirmation problem of a number of Eisenhower Administration appointees. President-elect Eisenhower, one month after his election, nominated Charles E. Wilson as secretary of defense. Federal law did not require that nominees to Defense Department positions sell financial holdings in companies doing business with the Department. However, the Senate Armed Service Committee had a policy requiring presidential nominees to the "Defense Department divest themselves of stocks valued at $10,000 or more in defense-related companies."[11] Wilson subsequently informed the Armed Services Committee that he had severed all ties with General Motors but intended to retain 39,400 shares of stock.[12] Wilson made matters worse, when responding to a question from a senator regarding his ability to be objective with respect to matters involving General Motors, he stated "I cannot conceive of one because for years I thought what was good for our country was good for General Motors, and vice versa."[13] The Senate Armed Service Committee refused to back down and Wilson sold his General Motors stock. It is assumed that the sale subjected Wilson to significant unanticipated capital gains taxes. Partisan politics, throughout the 1950s, prevented serious deliberations regarding how to ease the transition of business executives into positions as presidential nominees.

Ethics Reform: Financial Self-Dealing and the Disqualification Rule

On October 23, 1962, President Kennedy signed into law the most significant revision of federal bribery and conflict-of-interest laws this century.[14] Few at the time realized the impact the law would have on the regulation of federal executive branch ethics and

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[11]. Roberts, *Ethics*, p. 59.

[12]. Ibid.

[13]. U.S. Congress, Senate, *Hearings before the Senate Committee on Armed Services on the Nomination of Charles E. Wilson to be Secretary of Defense, 83rd Cong., 1st Sess.* (Washington, D.C.: Government Printing Office, 1953), p. 15.

[14]. Public Law 87-849; See "Congress Amends Conflict-of-Interest Laws," 1962 *Congressional Quarterly Almanac*, p. 385.

the impact of its provisions on the recruitment of presidential appointees and nominees.[15] Besides bringing together the major federal bribery and conflict-of-interest laws into one section of the federal criminal code,[16] the revised law expanded the scope of these statutes.

Most important to future presidential nominees, the law put on the statute books a new criminal financial self-dealing rule for all executive branch employees and officials.[17] Section 208 of title 18, *United States Code*, prohibits an executive branch official from taking action with respect to particular matters in which the official, his or her spouse, minor children, business associates, or entities in which he or she holds a fiduciary position have a financial interest.[18] "Section 208 does not prohibit any executive branch official from holding any particular type of financial interest or engaging in any type of financial transaction. Section 208 is a disqualification or recusal statute, in that it only prohibits an executive branch official from participating in an official capacity in any particular matter which may affect a financial interest held by the official, the official's spouse, minor children, business associates and certain other entities."[19]

The language of section 208 has created numerous problems for federal ethics officials. Even though the language of section 208 does not require an official to sell a financial asset, disqualification has serious disadvantages. Frequent recusals may prevent presidential

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15. See Roberts, *Ethics*, pp. 99-103.

16. 18 U.S.C. 201-209 (1988).

17. "Congress Amends Conflict-of-Interest Laws," 1962 *Congressional Quarterly Almanac*, p. 386.

18. Ibid.

19. Robert N. Roberts, "A Guide To Federal Ethics Laws For Presidential Appointees, Report to the Administrative Conference of the United States, November 1988," in, Office of the Chairman Administrative Conference of the United States, *Sourcebook On Governmental Ethics for Presidential Appointees* (Washington, D.C.: Administrative Conference of the United States, December 1988), p. 18. (Hereafter cited as Roberts, Guide.)

appointees and nominees from effectively discharging the duties of the position to which they have been appointed.[20] "Depending on the extent of a given official's holding and the scope of his responsibilities," argues one commentator, "an effective disqualification could prevent an official from participating in a great many actions that would otherwise require his attention and at some point thoroughly undermine his ability to function."[21]

When Congress enacted the 1962 bribery and conflict-of-interest reform legislation, it included provisions for agency and presidential waiver of the section 208 self-dealing prohibition at the urging of the Kennedy White House.[22] However, Congress sharply limited the grounds for granting section 208 waivers.[23] Congress and the Kennedy White House, more importantly, underestimated the reluctance of future presidents to grant waivers to high profile presidential appointees and nominees. Waivers are not guaranteed to end public criticism of an official who holds on to stock after obtaining a waiver.[24]

The 1962 law provides for two statutory waivers. First, if the president or other appointing authority determines that a given financial interest is "not so substantial as to be deemed likely to affect the integrity of the services which government may expect from such officer or employee," a waiver may be granted.[25] Second, the 1962 law permits an agency to publish regulations in the *Federal Register* waiving from section 208's coverage a specific type of financial interest held by the agency's employees if it is determined that the

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[20]. Ibid, p. 16.

[21]. Eric J. Murdock, "Finally, Government Ethics as if People Mattered: Some Thoughts On the Ethics Reform Act of 1989," *George Washington Law Review, v. 58* (February, 1990), p. 506.

[22]. "Congress Amends Conflict-of-Interest Laws," *1962 Congressional Quarterly Almanac*, p. 386.

[23]. Murdock, p. 509.

[24]. W. John Moore, "Hands Off," *National Journal*, July 1, 1989, p. 1681.

[25]. Murdock, p. 509 and 18 U.S.C. 208 (b)(1)(1988 & Supp. IV 1993).

financial interest is "too remote or too inconsequential to affect the integrity of the Government officers' or employees' services."[26]

Conflict-of-interest experts provide various explanations why the section 208 waiver provisions never became a major tool for resolving the conflict-of-interest problems of federal personnel. One critic places the blame on the Justice Department's Office of Legal Counsel for narrowly construing the grounds for issuing section 208 waivers.[27] Two other commentators point to administrative problems associated with obtaining section 208 waivers. "First," they argue, "waivers may prove time consuming to the federal official because of the need to explain the possible conflict to the appropriate authority."[28] "Second," the argument continues, "the federal official must pay close attention to his financial interests in order to determine whether there may be a conflict between matters on which he or she is working and those interests."[29] "Third," the commentators argue, "if a waiver is not granted, the federal official then must take steps to eliminate the conflict either through disqualification or divestiture of the conflicting financial interests."[30] Section 208 waivers, whatever the reason, have never lived up to expectations.

Ethics Reform: Financial Self-Dealing and the Mandatory Divestiture Rule

The Kennedy White House, early in the administration, concluded that it could no longer rely primarily on criminal conflict-of-interest statutes to protect public trust in the objectivity and impartiality of executive branch employees, including presidential nominees and appointees. It decided to issue a series of executive orders designed to supplement criminal prohibitions with administrative

[26]. Roberts, *Guide*, p. 20.

[27]. Murdock, p. 509.

[28]. Charles D. Fox and David A. Herpe, "Blind Trusts: Easing The Burdens Of Government Service," *Trusts & Estates*, v. 132 (March 1993), p. 30.

[29]. Ibid.

[30]. Ibid.

conflict-of-interest rules.[31] The 1961 Dutton memorandum, for instance, stated that employees "may not have direct or indirect financial interests that conflict substantially, or appear to conflict substantially, with their responsibilities and duties as Federal employees."[32] However, the Kennedy White House did not try to force federal agencies to enforce the Dutton self-dealing standard.

It would take the issuance of Executive Order 11222 by President Johnson, in May 1965, for the White House to make clear that it expected agencies to enforce a mandatory divestiture rule in certain situations.[33] The White House, after considerable internal debate, included the financial self-dealing language of the Dutton memorandum in Executive Order 11222.[34] White House officials realized that the language would give federal ethics regulators the authority to direct federal employees and officials not purchase certain types of financial assets or to sell off other assets.[35] Regulations issued by the Civil Service Commission implementing President Johnson's standards-of-conduct Executive Order stated that an executive branch officer or employee may not "have a direct or indirect financial interest that conflicts substantially, or appears to conflict substantially with his Government duties and responsibilities."[36] Federal ethics officials, under the authority granted by the Executive Order, clearly had the "authority to order their officials and employees to divest themselves of specific financial interests if those interests [conflicted or appeared to conflict substantially] with their official duties and responsibilities."[37]

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31. Roberts, *Ethics*, pp. 93-110.

32. Ibid, p. 117.

33. "Prescribing Standards of Ethical Conduct for Government Officers and Employees," Executive Order 11222.

34. Roberts, *Ethics*, p. 117.

35. Ibid.

36. Roberts, *Guide*, p. 21.

37. Ibid.

The mandatory divestiture rule of Executive Order 11222 remained in force until President Bush, on April 12, 1989, issued Executive Order 12674.[38] The new order replaced President Johnson's 1965 standards-of-conduct order and included a new mandatory divestiture rule. Regulations issued by OGE implementing President Bush's executive order, gave federal agencies the authority to prohibit employees from acquiring or holding financial interests that "would cause a reasonable person to question the impartiality and objectivity with which agency programs are administered."[39] The Bush White House had made a conscious decision to remove the "appearance standard" from the administrative self-dealing prohibition.

Equally important, OGE regulations give agency ethics officials authority to order executive branch employees to sell financial assets when these officials determine that the acquisition or holding of a financial interest may require "(1) the employee's disqualification from matters so central or critical to the performance of his official duties that the employee's ability to perform the duties of his position would be materially impaired" or the acquisition or holding of the financial interest may "(2) adversely affect the efficient accomplishment of the agency's mission because another employee cannot be readily assigned to perform work from which the employee would be disqualified by reason of the financial interest."[40]

Besides the Executive Order mandatory divestiture rules, Congress has enacted a number of individual divestiture statutes. Officers and employees of certain federal departments and agencies, consequently, are prohibited by specific statute or regulation from holding certain types of financial interests.[41]

Financial Reporting, Blind Trusts and Watergate

On September 27, 1951, President Truman sent to Congress a

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38. Stuart C. Gilman, "Presidential Ethics and the Ethics of the Presidency," *The Annals*, v. 537 (January 1995), p. 73.

39. 5 CFR 2635.402 (1995).

40. Ibid.

41. Roberts, *Guide*, p. 18.

Message on Ethical Standards in the Executive Branch.[42] The message asked Congress to enact a law requiring "all presidential appointees, elected federal officials, military aides, and certain other federal official earning more than $10,000 a year to file disclosure statements, revealing income and such other income sources as investments in real estate, securities, gifts, and loans."[43] The Truman White House proposed the law in an effort to deal with growing criticism directed at the ethical standards of officials in his administration.[44]

Little happened to the idea of government-wide financial reporting by federal officials until President Johnson issued Executive Order 11222. The order directed the Chairman of the Civil Service Commission (CSC) to establish a confidential financial reporting system for high level federal officials.[45] Subsequently, CSC required thousands of federal employees to file annual confidential disclosure statements with their agency ethics officials. Presidential appointees filed their statements with the CSC.

The fact that federal agencies and departments now had information regarding the financial holdings of their employees and officials meant that they had to do more than simply collect the statements and file them away. Executive Order 11222 required that each agency and department take steps to resolve those financial conflicts of interest which appeared on the disclosure statements. The fact that many federal agencies and departments failed to carry out this duty played a major role in persuading Congress to require public financial disclosure in the aftermath of the Watergate

42. President Harry Truman, Message to Congress, September 21, 1951.

43. Roberts, *Ethics*, p. 49.

44. For a Republicn view of the ethics record of the Truman Administration see Republican National Committee, *Crook & Crony government: the story of Democrat fraud and graft: documented and indexed* (Washington, D.C., 1952).

45. Roberts, *Ethics*, p. 123.

scandal.[46]

Between the issuance of President Johnson's standards-of-conduct executive order and the Watergate scandal, problems continued to persist regarding how to resolve potential conflict-of-interest problems resulting from presidential nominees entering the federal government with substantial private assets. In December 1968, the Nixon transition team made clear that it wanted to recruit business executives for high-level federal policy-making positions.[47] The Nixon White House personnel operation found this goal much more difficult to accomplish than initially anticipated[48] because they underestimated the unwillingness of individuals to subject themselves to scrutiny by a democratically controlled Senate and the Washington media who put the financial affairs of Nixon nominees under a microscope.[49] In fact, the majority of Nixon nominees experienced little trouble receiving confirmation from the appropriate Senate committee.

Yet, a number of well publicized confirmation battles highlighted serious deficiencies with ethics compliance remedies. The confirmation problems of David Kennedy, President's Nixon's nominee for Secretary of the Treasury, raised serious questions regarding the use of blind trusts to as a remedy for financial conflicts of interest. Kennedy, former chairman of the Board of Continental Illinois Bank, refused to sell his stock in the bank because of the capital gains implications of a forced sale.[50] However, Kennedy agreed to place his bank stock in a blind trust.

Since the Second World War, presidents and presidential

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[46]. Comptroller General of the United States, *Action Needed to Make the Executive Branch Financial Disclosure System Effective, FPCD-27-23*, February 28, 1977.

[47]. "Nixon Talent Bank is Open for Business," *Business Week*, December 26, 1968, pp. 98-99.

[48]. Don Bonafede, "Nixon Personnel Staff Works To Restructure Federal Policies," *National Journal*, v.3 (November 12, 1971), p. 2446. Also see "Nixon headhunters bag few Trophies," *Business Week*, January 27, 1973, p. 20.

[49]. Roberts, *Ethics*, p. 131.

[50]. Ibid, p. 133.

nominees have made increasing use of blind trusts to shield themselves from criticism that their official actions might increase the value of their financial holdings. For example, in the early 1960s, Robert McNamara placed his financial holdings in a blind trust.[51] Lyndon Johnson, upon assuming the Presidency in late 1963, placed his substantial financial holdings in a blind trust.[52] However, the lack of statutory requirements for the establishment of blind trusts made compliance with the agreements voluntary.[53] This fact angered critics of existing ethical standards who believed the lack of clear blind-trust rules let wealthy individuals entering federal service avoid complying with conflict-of-interest laws and regulations.

The arrangement proposed by David Kennedy, consequently, did not constitute a major departure from past practice. The committee balked at the arrangement. Kennedy subsequently agreed to a series of complex steps to shield him from any control over the trust and to require the trustee, over time, to diversify the assets of the trust.[54] However, Senator Gore of Tennessee objected to this ad hoc arrangement on the grounds that the time had come for Congress to pass statutory blind trust requirements.

During the 1960s and early 1970s, "[t]he typical blind-trust agreement required the nominee to place the offending financial interests in a trust and appoint a trustee to make investment decision regarding the trust corpus. The agreement gave the trustee the authority to make any reasonable investment decision without influence from the nominee. Finally, the trustee agreed not to inform

[51]. Ibid, p. 122.

[52]. "Johnson's holdings put on ice: in trust for the duration," *Business Week*, December 7, 1963, p. 23.

[53]. The Justice Department typically worked with presidents and presidential appointees in the establishment of blind trusts. If a president or presidential appointee agreed to comply with the provisions of the agreement, the Justice Department agreed not to regard the assets placed in the trust as assets of the president or nominees for purposes of Section 208, the criminal self-dealing statute.

[54]. *Congressional Record*, v.115, p. 1293, January 23, 1969.

the nominee about the details of investment decisions."[55]

The Nixon nomination of David Packard, founder of Hewlett-Packard Corporation, as Deputy Secretary of Defense resulted in another confrontation over the requirement that nominees to the Department of Defense divest themselves of holdings worth more than $10,000. Packard and his family held stock in Hewlett-Packard valued at some $300 million.[56] A forced sale of the stock would have cost Packard and family members millions of dollars in capital gains taxes. The Armed Services Committee permitted Packard to establish a blind trust to avoid a forced sale.[57] Packard, in an unprecedented step, agreed to donate to charity any increase in value of the trust corpus. The Senate confirmed Packard by a vote of 82 to 17.

Watergate, as is well documented, transformed the ethical landscape Washington. Shortly after his 1976 election victory, President-elect Carter announced he would require his appointees to sign a letter of agreement pledging to abide by set of rigorous ethical guidelines.[58] Much more significantly, the Carter guidelines made divestiture, rather than disqualification, the preferred remedy for financial conflict-of-interest problems of nominees.[59] "The guidelines," however, "recognized blind trusts as appropriate methods of divestiture provided the trustee is 'truly independent,' the assets are either cash or diversified assets, and the trustee is given discretion and direction to sell or buy without discussion with the official."[60]

Most Clinton appointees had little trouble complying with the new guidelines. Burt Lance, President Carter's nominee for Director

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[55]. Roberts, *Ethics*, pp. 132-133.

[56]. G. Calvin Mackenzie, *The Politics of Presidential Appointments*, (New York: Free Press, 1980), p. 100.

[57]. Roberts, *Ethics*, p. 133.

[58]. Bruce Adams and Kathryn Kavanagh-Baran, *Promise and Performance: Carter Builds a New Administration* (Lexington, MA: Lexington Books, 1979. pp. 88-89.

[59]. Ibid, p. 89.

[60]. Ibid.

of the Office of Management and Budget, faced a nightmare. Lance had agreed, as a condition of confirmation, to establish a blind trust by the end of 1977 and "have his trustee sell his National Bank of Georgia stock."[61] The value of the bank stock dropped so much after he entered into the agreement that a forced sale of the stock would have resulted in a huge loss for Lance and raised questions whether he had the means to repay the loan he had taken from the bank to purchase the stock. To relieve the pressure on Lance, President Carter asked the Senate Committee on Governmental Affairs to modify the agreement.[62] A subsequent investigation of Lance's banking and personal financial practices forced Lance to resign on September 21, 1977.

The Ethics in Government Act of 1978 made major changes in the process of reviewing the financial affairs of presidential nominees for possible conflict-of-interest problems.[63] It led to an explosion in the size of the executive branch ethics program.[64] More importantly, Watergate led to intense scrutiny of the federal ethics program. The Ethics Act required high-level federal officials of the legislative, judicial, and executive branches to file annual public financial disclosure statements.[65] The Ethics Act gave the newly created Office of Government Ethics primary responsibility for reviewing the public financial disclosure statements of presidential nominees subject to Senate confirmation and resolving any financial conflict-of-interest problems which appeared on the statements.[66] After the passage of

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[61]. Ibid, p. 92.

[62]. Ibid. p. 92.

[63]. See Mackenzie, "Transitions"; Also see James D. Carroll and Robert N. Roberts, "If Men Were Angels": Assessing The Ethics In Government Act of 1978," *Policy Studies Journal*, v. 17 (Winter, 1988-89), pp. 439-440.

[64]. Gilman, p. 72.

[65]. Ibid.

[66]. Deanne C. Siemer, "Enforcement of the Federal Ethics Laws As Applied to Executive Branch Personnel" Issues and Options Paper, Prepared For the Working Conference on Ethics in Government (Washington, D.C.: Administrative Conference of

the Ethics Act, Senate committees would not proceed with confirmation hearings until they received a letter from the Director of OGE certifying that the nominee had resolved all outstanding conflict-of-interest problems.[67]

The Ethics Act established two types of blind trusts. The "qualified blind trust" and the "qualified diversified blind trust."[68] The "qualified blind trust" (QBT) does not automatically exempt federal officials from having to comply with the provisions of section 208 and administrative conflict-of-interest regulations. The "qualified diversified blind trust" (QDT) does provide immediate protection.[69]

The QBT is the simplest and least restrictive of the two types of blind trusts authorized by the Ethics Act.[70] As with the QDT, OGE must review the trust to determine that it complies with strict guide lines for establishing blind trusts. However, the QBT has one major limitation. An asset placed in a QBT "continues to be a financial interest of the person" who established the blind trust "for purpose of 18 U.S.C. 208 until the trustee sells the assets or their value is less than $1,000."[71] Consequently, federal officials who establish QBTs must continue to disqualify themselves from participating in particular matters which might affect their financial interests until the trustee of the blind trust notifies the official of the sale of the problem asset. Unless the trustee obtains a certificate of divestiture from the president or the director of OGE, federal tax law requires the official to pay any capital gains taxes due upon the sale of trust assets.

The QDT, in contrast, immediately protects federal officials from section 208 liability. Federal law does not treat assets placed in a

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the United States, March 1, 1988), pp. 25-26.

[67]. See J. Jackson Walter, "The Ethics in Government Act, Conflict of Interest Laws and Presidential Recruiting," *Public Administration Review*, v. 41 (November-December 1981), pp. 659-665.

[68]. Fox and Herpe, pp. 28-35.

[69]. Ibid, p.34.

[70]. 5 C.F.R. 2634.401(a)(ii) and (iii), 2634.403, and 2634.404 (1995).

[71]. "Qualified Rollover," p. 138.

QDT as assets of the official for purposes of section 208 or other administrative conflict of interest regulations.[72] The restrictions placed on the establishment of QDTs make them much more difficult to establish. QDTs must have a "widely diversified portfolio" of "readily marketable securities."[73] The initial trust portfolio may not contain "securities of issuers having substantial activities in the official's primary area of responsibility."[74]

In the long run, Ethics Act blind trusts have proved too cumbersome and costly for the majority of presidential nominees looking for ways to resolve financial conflict-of-interest problems. The 1980s saw a sharp decline in the use of blind trusts as the a way to resolve the conflict-of-interest problems of federal officials.[75] By the mid 1980s, recusal became the most frequently used to tool to resolve actual or apparent conflicts of interest.[76] Bush Administration presidential nominees made heavy use of recusal or disqualification agreements to resolve conflict of interest problems.[77]

The demise of the blind trust, as a commonly used method of resolving the conflict-of-interest problems of presidential nominees, raised serious concerns with Washington ethics experts. Many feared that excessive use of disqualification agreements seriously reduced the effectiveness of presidential nominees and other federal officials. They feared that "high-level appointees [had become] so wary of any possible conflicts that could cost them their job that they [went] overboard in disqualifying themselves."[78] How effective could a

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72. Ibid.

73. Fox and Herpe, p. 31.

74. Ibid, p. 32.

75. See Margaret Carlson, "Going Blind for the Public Trust: Is the Price Too High?" *Washington Dossier*, 9 (June 1983), pp. 37-42; Arlende J. Hershman, "They Put Their Trust in Blind Trust," *Dun's Business Month*, v. 119 (May 1982), pp. 42-45, 48-49.

76. Moore, p. 1679.

77. Ibid, p. 1682.

78. Ibid, p. 1680.

presidential appointee be if he or she had to check constantly whether an action or decision might have an impact on a financial interest held by an appointee?

Divestiture and non-Recognition of Gain: "The Stealth Remedy"

The early 1980s saw a growing consensus within federal agencies that section 208 waivers, disqualification by federal officials, and blind trusts did not deal adequately with the hardship experienced by presidential nominees required to comply with conflict-of-interest restrictions.[79] Presidential-appointment-process scholar G. Calvin Mackenzie wrote in 1987:

> In many ways, the costs of this movement to tighten the regulation of public ethics are more apparent than the benefits. Recent changes in ethics laws have diminished the privacy of all public officials and increased the direct financial costs of public service for many of them. That has made public service less attractive and thus had a negative impact on the federal government's ability to recruit talented presidential appointees. In the long run, the continuance of this cannot help but undermine effective governance.[80]

Ronald Reagan promised to bring into government individuals with strong business backgrounds if he won the 1980 presidential election. Reagan believed individuals with strong business backgrounds could make government organizations run much more efficiently.[81] Like previous administrations, the Reagan White House found that it took time painstakingly to go over the financial affairs of possible nominees and the members of their immediate family during the process of selecting these nominees for high-level federal positions.[82] It took long negotiations to work out conflict-of-interest compliance

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[79]. See Mackenzie, "Regulation," p. 98-99.

[80]. Ibid.

[81].. Dick Kirsheten, "Wanted: 275 Reagan Team Players, Empire Builders Need Not Apply," *National Journal*, (December 6, 1980), p. 2077.

[82]. Mackenzie, "Transition," pp. 2-10.

measures. This experience led the Reagan White House to look for ways to make it easier for presidential appointees to comply with conflict-of-interest restrictions.

The Reagan White House and other government ethics experts began to look closely at amending the *Internal Revenue Code*[83] to permit federal employees to defer capital gains from the sale of assets necessary to comply with conflict-of-interest rules. Like the waiver provisions of the 1960s and the blind trusts of the 1970s, supporters of the deferred-taxation remedy believed it "would go a long way toward making government service less burdensome."[84]

In 1982, the staff of OGE prepared a draft paper entitled *Nontaxable Divestiture of Property*,[85] which proposed to permit high-level federal officials to defer paying taxes on the proceeds of financial assets sold to comply with conflict-of-interest restrictions. A number of factors delayed legislative consideration of the proposal to the end of the decade.

First, the Department of the Treasury, in 1982, notified the Reagan White House that it opposed the proposal.[86] The Treasury Department noted that personal circumstances often forced individuals to sell assets and the tax code did not permit these individuals to defer paying capital gains on the sale. The Treasury Department feared that the availability of the rollover provision might induce some individuals to enter government to take advantage of rollover opportunities. The Treasury Department argued that the twenty-percent capital gains tax did not work an undue hardship on federal

83. Title 26, *United States Code*.

84. Robert E. Norton, "Who Wants to Work In Washington," *Fortune*, (August 14, 1989), p. 82.

85. Stuart A. Smith, "Deferred Taxation of Gains Realized Upon Divestiture of Property to Avoid Conflicts of Interest: A Proposal," *Federal Bar News & Journal*, v. 36 (March/April 1989), p. 128.

86. Ibid, Note 10: Letter from Assistant Treasury Secretary John E. Chapoton to Fred F. Fielding Counsel to the President, (Jan. 7, 1982).

officials required to divest themselves of specific financial assets.[87] Finally, the Treasury Department criticized the proposal because it only allowed presidential nominees to take advantage of the rollover provision.[88]

Second, ethics problems experienced by a large number of Reagan administration officials made it difficult for the Reagan White House to propose this change in the tax code. The media and administration critics, on a daily basis, chronicled the conflict-of-interest problems experienced by members of the Reagan administration.[89] Despite the continuing debate over the substance of many of the allegations, the Reagan administration faced certain defeat of any proposal to allow presidential appointees to rollover capital gains from the forced divestiture of financial assets.

Government Ethics and the Level Playing Field: The Bush Offense

During the 1988 Presidential campaign, George Bush made clear that he would expect his appointees to maintain the highest standards of conduct. The emphasis the Bush White House placed on ethics reform gave supporters of deferred taxation for conflict-of-interest divestiture a new opportunity to lobby for the new remedy.

Instead of focusing public attention on executive branch ethics problems, the Bush White House focused on establishing uniform ethics rules for all three branches of the federal government. The Bush White House realized that Congress, for decades, had imposed new ethics rules on members of the executive branch but did not apply the same rules to members of Congress, congressional staffs, and employees.[90] If Congress refused to apply to itself the ethics rules that it applied to the executive branch, it should relax the most burdensome executive branch ethics rules. The Bush White House

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87. Ibid. It is important to note that the Tax Reform Act of 1987 eliminated the lower tax rate for capital gains. Congress, in 1993, passed legislation significantly raising tax rates on higher income individuals.

88. Smith, p. 128.

89. See for example, Thomas Riehle, "Scandals, Etc. from A to Z," *National Journal*, v. 16, (January 14, 1984), p. 92-94.

90. Gilman, pp. 73-74

wanted a level ethics playing field.

Shortly after taking office, President Bush announced the establishment the President's Commission on Federal Ethics Law Reform.[91] President Bush established four key principles to guide the work of the Commission. First, "ethical standards for public servants must be exacting enough to ensure that the officials act with the utmost integrity and live up to the public confidence in them." Second, "standards must be fair, they must be objective and consistent with common sense." Third, "the standards must be equitable all across the three branches of the federal government." Fourth, the country "cannot afford to have unreasonably restrictive requirements that discourage able citizens from entering public service."[92]

The final report of the Commission included numerous proposals designed to simplify ethics management and to ensure "that all federal employees abide by similar guidelines."[93] Recommendations dealing specifically with the regulation of financial conflicts of interest included: (1) extension of section 208 of title 18 to the judicial branch and to non-member employees of the legislative branch,[94] (2) giving OGE the authority to grant section 208(b) individual waivers,[95] (3) providing tax relief for persons required to divest assets to avoid conflicts of interest,[96] and (4) allowing agencies to grant

[91]. On January 25, 1989, President Bush issued Executive Order 12668 creating the eight-member President's Commission on Federal Ethics Law Reform. *Congressional quarterly weekly report*, v. 47 (January 28, 1989), p. 199.

[92]. President's Commission on Federal Ethics Law Reform, *Fact Sheet, To Serve With Honor: Report of the President's Commission of Federal Ethics Law Reform*, (March 10, 1989).

[93]. "Bush Special Ethics Panel Releases Proposals," *Congressional quarterly weekly report*, v. 47 (March 11, 1989), p.
523.

[94]. President's Commission On Federal Ethics Law Reform, *To Serve With Honor*, (March 9, 1989), Recommendation No. 2.

[95]. Ibid, Recommendation 3.

[96]. Ibid, Recommendation 4.

special section 208(b) waivers to advisory committee members.[97] Press reports discussing the recommendations of the panel did not mention the deferred taxation proposal.[98] They did mention proposals to strengthen ethics rules for Congress.[99] On April 12, 1989, President Bush sent legislation to Congress to "toughen some federal ethics standards, loosen some others, make the laws more uniform across the three branches and give federal judges a 25 percent pay raise."[100] The legislation included provisions permitting (1) the tax deferral of proceeds from divestitures required to comply with conflict-of-interest rules and (2) expanded authority to grant section 208 waivers to members of federal advisory committees.[101]

In a speech to the American Society of Newspaper Editors Convention announcing his ethics in government proposals, President Bush stressed that "the same standard that applies to a staff person at HUD should also apply to housing subcommittee staff on Capitol Hill. And a practice is either ethical or it is not. And if Washington is to be a level playing field, then every player should be treated the same."[102]

The Bush White House could not have picked a better time to criticize the ethical climate of Congress. On June 6, 1989, Speaker of the House Jim Wright had announced his resignation. Wright resigned amid allegations that he had received improper gifts from a

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97. Ibid, Recommendation 5.

98. See "Ethics Panel to Push Bush to Act on Own," *Washington Times*, (March 13, 1989), p. A3; "Ethics in Washington," *St. Louis Post-Dispatch*, (March 21, 1989), p. B2.

99. David Lauter, "Tighter Ethics Rules for Congress Urged," *Los Angeles Times*, (March 11, 1989), I2.

100. David S. Cloud, "Bush's Package on Ethics, Pay Seeks Uniform Standards," *Congressional quarterly weekly report*, v. 47 (April 15, 1989), p. 817.

101. Ibid.

102. President George Bush, "Remarks by the President To American Society of Newspaper Editors," The White House, Office of Press Secretary, April 12, 1989.

Texas developer.[103] A week earlier, House Majority Whip Tony Coelho had announced his intention to resign after revealing he had failed to report a $50,000 loan used to buy junk bonds.[104]

Equally significant, during 1989, the national good government watchdog organization Common Cause directed its lobbying activities to persuading Congress to clean up its act.[105] Common Cause lobbied Congress to prohibit members from accepting honoraria from private sources, to place limits on campaign spending, to provide low cost mail, television, and public financing of elections, and to stop political parties from collecting soft money.[106]

In June 1988, the prospects for congressional approval of the deferred taxation proposal increased when the Administrative Conference of the United States, established by Congress to study and make recommendations concerning administrative procedure,[107] issued "Recommendation 88-4. Deferred Taxation for Conflict-of-Interest Divestitures."[108]

The Administrative Conference recommended that Congress amend the *Internal Revenue Code* "to permit deferred taxation of gains for presidential appointees subject to Senate confirmation and other individuals entering the government to accept high level executive branch positions, whenever they are requested or ordered by an appropriate authority to divest themselves of property to avoid

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103. Janet Hook, "Passion, Defiance, Tears: Jim Wright Bows Out," *Congressional quarterly weekly report*, v. 47 (June 3, 1989), p. 1289.

104. Ibid.

105. Chuck Alston, "Common Cause: A Watchdog That Barks at Its Friends," *Congressional quarterly weekly review*, v. 47 (August 26, 1989), p. 2204.

106. Ibid, p. 2207.

107. 5 U.S.C. 571-576 (Supp. IV 1993).

108. Administrative Conference of the United States, *Deferred Taxation for Conflict-of-Interest Divestiture* (Washington, D.C.: Administrative Conference of the United States. 53 FR 26025, 26029. Recommendation 88-4.); Also see Stuart A. Smith, *Deferred Taxation of Gains Realized Upon Divestiture of Property to Avoid Conflicts of Interest: report to the Administrative Conference of the United States* (Washington: Administrative Conference, 1988).

actual or potential conflicts of interests."[109]

Under the recommendation, title 26 would permit presidential appointees and the spouses and dependent children of appointees to reinvest the proceeds of divested property into neutral investment vehicles and "thereby defer realization of taxable gains."[110]

The support of the Administrative Conference proved vital to the subsequent passage of the deferred-taxation provision of the Ethics Reform Act of 1989. Critics could no longer attack the measure as a partisan Republican attempt to make it easier to recruit their wealthy supporters for high profile positions.[111] In March 1988, a few months before the Administrative Conference released its proposal, presidential-transition scholar G. Calvin Mackenzie warmly endorsed the deferred taxation remedy in a paper prepared for the Working Conference on Ethics in Government. Quoting from the paper:

> In every future transition, it is inevitable that some appointees will have to divest assets in order to avoidconflicts of interest. The burden of that was magnifiedin 1980-81 by the heavy capital gains taxes that some appointees incurred when they were forced to sell appreciated assets. That burden should be diminished by allowing those assets to be rolled over, without tax liability, into some investment vehicle that poses no potential conflict of interest.[112]

The 1989 Act and the Deferral of Gain from Forced Divestitures

Passage of the Ethics Reform Act of 1989 represented a major victory for the Bush White House.[113] Media coverage focused almost exclusively on the fact that the law prohibited members of Congress from accepting honoraria and that the act granted large pay

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109. 53 FR 26025, 26029 (1988).

110. 53 FR 26030 (1988).

111. See Marshall J. Breger, "Can corporate masters afford to become public servants," *Business and Society Review*, n. 71 (Fall 1989), p. 42-6.

112. Mackenzie, "Transitions," p. 19.

113. Pub. L. No. 101-194 section 502, 103 Stat. 1716, 1754 (1989).

raises to members of Congress and high-level officials in the three branches of government. Enactment of the non recognition-of-gain provision received practically no coverage. The non recognition provision of the Ethics Reform Act turned out to be much broader than that of the draft proposal prepared by OGE in 1982. First, the Ethics Reform Act permits any executive branch employee to apply to the Director of OGE for a certificate of divestiture (CD).[114] Second, the Ethics Reform Act permits spouses and minor dependent children of a executive branch employee to apply for a CD.[115] The 1990 amendments to the Ethics Reform Act, equally important, authorized trustees of OGE approved blind trusts to apply for CDs.

Third, the Ethics Reform Act gave the president and director of the OGE considerable discretion to grant or deny a request for a CD. The law permits the issuance of a CD upon a finding that "divestiture of specific property is reasonably necessary to comply with any federal conflict-of-interest statute, regulation, rule or executive order (including section 208 of title 18, *United States Code*), or requested by a congressional committee as a condition of confirmation."[116]

Fourth, the act permits those who receive a CD to rollover the proceeds of the sale, including any capital gainss into "permitted property."[117] The statute defines "permitted property" as any obligation of the United States or any diversified investment fund approved by OGE. This definition means that recipients of CDs have a large number of investment options. More than 3,000 diversified mutual

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[114]. The Ethics Reform Act permitted "special government employees" as well as regular executive branch employees to apply for a certificate of divestiture. The 1962 Conflict-of-Interest Act created a class of federal employees classified as special government employees. These employees serve as federal employees less than 60 days a year. Several federal conflict-of-interest statutes exempt special government from their provisions. See for example 18 U.S.C. 203 and 205.

[115]. 26 U.S.C. 1043 (Supp. IV 1993).

[116]. 26 U.S.C. 1043(b)(2)(B) (Supp. IV 1993); Also see "New Conflict-of-Interest Nonrecognition Provision Creates Planning Opportunities," *Tax Management Memorandum*, v. 31 (February 26, 1990), p. 65.

[117]. Section 1043(b)(3) (Supp. IV 1993). Permitted Property.

funds operate in the United States.[118]

Fifth, section 1043 permits the rollovers of capital gains to continue "until the sale of the replacement assets."[119] This provision, according to one commentator, permits recipients of CDs to hold on to replacement assets until death. The *Internal Revenue Code* permits heirs of official "to step up the replacement assets to their market value at death."[120]

Applying for a Certificate of Divestiture

The Office of Government Ethics has issued easy to understand rules to guide federal employees and officials wishing to apply for a CD.[121] The application process begins with the employee or official contacting the employees' "designated agency ethics official" (DAEO)-.[122] If the DAEO determines the employee is eligible to receive a CD, the DAEO files a formal request with the director of OGE. The director then conducts an independent review to determine whether the DAEO correctly applied the statutory requirements for issuing a CD.[123] If the director grants the request, the employee receives a document from OGE stating OGE has granted the employee a CD. The employee submits the form with his or her taxes in order to rollover any capital gains resulting from an involuntary divestiture.

It is important to stress, that the Ethics Reform Act only permits OGE to issue a CD for involuntary divestiture. An individual entering the federal government may have other reasons for wanting

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118. Janet Novack, "Easing the way," *Forbes*, v. 151(8) (April 12, 1993), p. 42.

119. Ibid.

120. Ibid.

121. Subpart J. Certificates of Divestiture, 5 CFR 2634.1001 Nonrecognition for sales to comply with conflict of interest requirements; general considerations.

122. 5 CFR 2634.1002 (1995) Issuance of Certificates of Divestiture.

123. According to information provided by the White House, President Clinton has not issued any certificates of divestiture.
The authors have been unable to obtain information whether or not President Bush personally issued any certificates of divestiture during 1990, 1991, and 1992.

to divest financial holdings. These types of divestiture do not qualify for a CD.

Certificates of Divestiture: The First Four Years:

The years from 1990 through 1993 saw the director of OGE issue 461 CDs. These went to federal employees, spouses of federal employees, dependent children of federal employees and trustees responsible for managing blind trust set up on behalf of federal employees. Three hundred fifty-three family units received 461 CDs.[124] Eleven trustees, over the same period, received Cds. The Director of OGE issued 259 CDs for the years 1990, 1991, and 1992.[125] The director of OGE issued 202 CDs in 1993.[126] Experts expected a significant increase in the number of CDs issued the year after the election of a new president. They proved correct in this judgement.

At least 145 family units of presidential nominees and other political appointees received 225 CDs during 1990, 1991, 1992 and 1993.[127] The Bush Administration, for the years 1990, 1991 and 1992, saw 55 family units of presidential nominees and political appointees received 83 Cds. The family units of 48 presidential nominees received 72 Cds. The Clinton Administration, for the year of 1993, saw 90 family units of presidential nominees and political

[124]. Family units refers to the federal employee or official, the spouse of the employee or official and the minor children of the officer or employee.

[125]. OGE issued 107 CDs in 1990, 86 CDs in 1991, 66 CDs in 1992.

[126]. It is important to remember that 1993 was the beginning the Clinton Administration. The Bush transition took place in 1989 before the certificate of divestiture provision became law.

[127]. The authors were unable to obtain full lists of presidential nominees and other political appointees for the Bush and Clinton administrations. The Clinton White House refused to provide such a list. Similar lists proved unavailable for the Bush White House. Consequently, the authors checked the names of CD recipients received from the Office of Government Ethics with several staff directories which specifically identify presidential nominees and appointees for the years 1990 through 1993. These include the *Federal Executive Directory* (Washington, Carroll Publishing Company, July/June 1994), *Federal Yellow Book* (Washington, Monitor Leaderhsip Directories, 1994), and *Federal Staff Directory* (Mount Vernon, VA: Staff Directories, LTD, 1990, 1991, 1992, 1993, 1994).

appointees receive 142 Cds. The family units 72 of presidential nominees received 118 CDs. The family units of presidential nominees and other political appointees received at least 49% of CDs issued over the four year period. The family units of presidential appointees received at least 41% of CDs issued over the four years period.

Public Policy, Public Trust and Certificates of Divestiture

The *Washington Post*, on February 10, 1993, published an article entitled "A Deputy Secretary's Complex Task: Treasury's Altman Seeks to Avoid Potential Conflicts of Interests."[128] The reporter noted "Altman and government ethics officials have agreed that he should sell his interest to avoid a potential conflict of interest."[129] The article noted that Robert Rubin, Clinton's economic policy advisor, would go through a similar clearance process. In contrast, Secretary of the Treasury Lloyd Bentsen established a blind trust to resolve his conflict-of-interest problems.[130] The article, interestingly, failed to note that Robert Rubin, who subsequently became Secretary of the Treasury after the resignation of Lloyd Benson, received two certificates of divestiture in late January 1993.[131]

Forbes magazine, two months later, in an article entitled "Easing the way,"[132] reported that a number of high level Clinton administration officials including Robert Rubin, Roger Altman, and White House Chief of Staff Thomas F. McLarty, III had received certificates of divestiture from OGE.[133] The *Forbes* article discussed the fact

[128]. David S. Hilzenrath, "A Deputy's Secretary's Complex Task," *The Washington Post*, (February 10, 1993), pp. C1 and C10.

[129]. Ibid.

[130]. Ibid.

[131]. Records provided by the Office of Government Ethics indicate that Robert and Judith Rubin received certificate 93-005 on January 25, 1993. Robert Rubin received certificate 93-006 on the same date, January 25, 1993.

[132]. Novack, p. 42.

[133]. Ibid.

that the earlier *Washington Post* article did not mention that Rubin or Altman had received CDs which permitted them to rollover capital gains from forced divestitures of assets.[134] The article made clear that the Clinton White House had not gone out of its way to publicize the receipt of CDs by members of the administration.

It appears, after decades of searching, that an extremely effective way for resolving the financial conflict-of-interest problems of presidential nominees, political appointees and other federal employees now exists. Hopefully, in future years, the provision will help persuade successful men and women to accept positions as presidential nominees and appointees.

134. Ibid.

The Theories of Capitalistic Exploitation: An Examination of their Context and Validity

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Theories of capitalist exploitation have long been central to the Left's worldview. The British Socialist Union saw this clearly when it declared that "the starting point of all socialist thought has been the condemnation of capitalist exploitation."[2]

Eugen von Böhm-Bawerk, one of the leading members of the Austrian School of Economics a century ago, wrote as though exploitation theory were a single concept – which in a certain sense it is since all of the variants are inspired by a single impulse. I prefer in my own analysis, however, to identify at least four distinguishable ideas. This article will discuss each of these in turn. The reader will notice that I see little merit in the first three, but that the fourth will cause me to examine at length what I see to be an historic weakness in the classical liberal theory of a free society. The fourth is pointing to problems of considerable importance in the operation of a capitalistic system.

My discussion will seek to go to the heart of the supposed injustices of the market, and will be broader than a discussion of just labor-management relationships. The analysis will lead us into a consideration, as well, of various "bargaining power" and "consumer protection" issues.

Although the exploitation theories play a large role in socialist thought as central to socialists' critique of capitalism, the discussion necessarily centers on capitalism rather than on socialism.

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[1] This paper expands upon the theme first examined by the author in *Socialist Thought* (Washington: University Press of America, 1983).

[2] The statement by the British Socialist Union is quoted by Norman Thomas in his *Socialism Re-examined* (New York: W. W. Norton & Company, Inc., 1963), p. 27.