

Carnegie Council
Deloitte Touche Tomatsu
Privatization Project

**Privatizing Eastern
Germany: A Report
from the Treuhand**



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No. 11

The Carnegie Council\Deloitte Touche Tomatsu Privatization Project has been made possible by a generous grant from Deloitte Touche Tomatsu.

Privatizing Eastern Germany: A Report from the Treuhand

June 26, 1992

Dr. Christoph Reimnitz

Treuhandanstalt is—as opposed to other privatization organizations in other countries—a very unique institution. I would like to begin today's presentation with a comment on our organization—how it was founded and how it was structured. Then I will talk about the privatization process: namely about the structure of our contracts, about what a Treuhand deal is, and how privatization is being handled through Treuhandanstalt. I will touch on the problems we have faced (and they have been numerous) and how we try to resolve these problems, the work of the New York office, United States investment in eastern Germany, and what successes we have to report.

Beginning with Treuhand and its organization, I'd like to make a few remarks concerning German history. Although I think most of you are quite familiar with what happened in the fall of 1989 and 1990, I would just like to run through the timetable and remind you of the incredible pace at which reunification took place and Treuhand's achievements during the past twenty-four months. First, on November 9, 1989 the Wall came down and only seven months later monetary union took place. Monetary union introduced the West German Deutsche mark to all of Germany, making it one country with one currency.

Next, on October 3, 1990 reunification was celebrated—it now is a national holiday—and then finally, in December of 1990, we had our first German elections. So you can see that within only thirteen months this political process occurred; economically it did not take place in that short a period of time, but many things have since happened.

The Treuhandanstalt was founded in March of 1990 by the then East German government and initially it employed only East Germans. That is not known by many people. The first West German to work at Treuhandanstalt came in June of 1990, even before monetary union, and our first president at Treuhand only lasted for two weeks. He was succeeded by Detlev Carsten Rohwedder who was assassinated last year at Easter and who was succeeded by Birgit Breuel, who officially opened the New York office in November of 1991.

How do you set up a structure to privatize thousands of

enterprises and how do you privatize 7,122 of them (as of last Monday—June 22, 1992)? Of course, there were no textbook examples, and there were no studies made in advance; it just happened by learning as we went along. I think a remark from Mrs. Breuel on how privatization started and what her personal introduction to Treuhand was, is quite representative and I would like to paraphrase what she said when she was in the United States. She said she was asked by her friend, Mr. Rohwedder, as one of the members of the Board of Managing Directors, to head the division to privatize small businesses. When she accepted she was entrusted with the work of privatizing roughly 4,000 companies for which no data was known, not even the names of employees. She was asked to create her own staff, to hire people (there were no people to

work with her at that point), to find her own offices in a building that was cleared for Treuhand, and to begin the process of privatization. With these structures developing step by step (this was in September of 1990) you can imagine that you stumble onto a lot of problems and that many issues just arise—mostly through the press—as you go through the process of privatization. Treuhand now has a very solid structure, which has been in place for

“When we set up contracts to sell our businesses we not only look at the sale price but we also ask for commitments toward the work force. Just guaranteeing jobs, however, would be meaningless, so we attach penalty clauses, which may range from 10,000 Deutsche marks per job to as much as 150,000 Deutsche marks”

over a year, and it has been continuously privatizing at the steady pace of 20–25 companies a day, which is quite impressive.

How does it work? We have the head office in Berlin which is in charge of privatizing large companies, meaning companies that initially used to employ more than 1,500 employees. Basically these were the conglomerates: the big East German holding companies that had very deep vertical production, meaning that a machine producer also had its own foundry, its own construction unit, and maybe even its own textile manufacturer to make clothing for the employee uniforms. Treuhand was entrusted with 127 such conglomerates and these have been handled through our main office in Berlin. We also have fifteen regional branch offices, which are divided up by the former East German districts and they are taking care of the privatization of smaller businesses—those with 1,500 or less employees.

Let me briefly run through the different methods we employ to dispose of or sell our companies. First, there is the stock and the share deal where you sell the entire company with all its assets and liabilities—and here is the first thing which puzzles many Americans I've talked to: everything is negotiable. So if you were to buy a company from Treuhand on the basis of a stock deal, you could actually negotiate positions on the balance sheet. Next we have the asset deal, which we were initially reluctant about, but as privatization continues and the need to privatize whatever is left becomes more urgent, we give investors the chance to pick the kind of assets they are interested in. I will talk later about some of the conditions we asked investors to accept.

Next, we have been quite successful in the past implementing Management Buy-Out programs (MBOs). We have sold roughly 1,200 companies through MBOs, trying to create what is the stronghold of West German industry and economy—Mittelstand or midsized family-run businesses. Of course, former East German management taking over their former companies need capital, and here various programs such as loan programs are made available to help them. The success of these MBOs remains to be seen, but we are very optimistic and we have seen that with a clear designation of the ownership of these companies and with new management in place, business is easier.

We have also tried other forms of privatization. For example, through big international auctioning processes, advertised worldwide in newspapers (I'm sure you have seen such advertisements in *The Wall Street Journal* or *The Financial Times*), we have been auctioning off companies industry by industry in what we call a tender offer practice. This tender offering is not completely compatible with the typical American tender offer but what we try to do is set deadlines and sell companies in the given time frame. A new program will be started this summer—selling by catalog roughly 200 smaller businesses with fifty or less employees, and for the first time we will offer these companies at a set price.

Another instrument we've chosen is the Management Buy-In (MBI). Through advertisements in Germany we have been looking for West German or Western management to buy into East German companies and the first MBIs are underway. Finally, Treuhand has taken administrative and other measures to ensure the restructuring of its businesses. We have created Management KGs which refer to a German legal structure of a company. What we are trying to do is give direct control to one CEO who will oversee a block of ten companies, who will be responsible for managing them, and who will participate in the profit shares that he generates once these companies are sold. This is intended to help these companies restructure faster, and it works well in those cases where Treuhand does not have the time to do those things.

Something that has been introduced through Treuhand that is unique and that has been widely criticized is the commitment Treuhand asks from its investors regarding job guarantees and investment pledges. When we set up contracts to sell our businesses we not only look at the sale price but we also ask for commitments to the work force. Treuhand, as a government agency, has to act within a political environment and we are often made the scapegoat—if you read the German press—and one of the obligations we have is to ensure the future employment of the labor force. What we are trying to do is to get commitments for the next two to three years in our contracts with our investors. We had one American company sign a contract last November; they took over 1,000 employees on the date the transaction was concluded, but actually only guaranteed 500 jobs.

Just guaranteeing jobs, however, would be meaningless, so we attach penalty clauses, which are subject to negotiation. A penalty clause might range from 10,000 Deutsche marks per job to as much as 150,000 Deutsche marks. As you can see, there is a wide variety, which is reflected in the sale price. We are also looking for investment pledges to see that the investor is serious about his commitment. We like him to commit himself to investing money in the company for the next two or three years, and we note in the contract which divisions or which production lines he will invest in and by what time. And here again, the penalty clause will typically show that the investor is obligated to pay Treuhand perhaps eighty or 100 percent of the contracted amount if he doesn't make the investment in the company.

The Treuhandanstalt here in New York has been officially active since last November and our task is to attract American investors to buy into eastern Germany. When we opened the office there were only seventeen American companies that had invested in eastern Germany; we currently have thirty-six. Of course the big companies were there in the very beginning: Coca-Cola, Procter & Gamble, Phillip Morris. What we have been able to do is convince midsized U.S. companies with as little as \$50 million in annual sales

“When Treuhand took over all of its businesses, we employed 4.1 million people. Today, that number has declined to 0.9 million. Of course, some of them went into new businesses and were taken over by investors, but a large number also went into unemployment.”

to take a close look or even to close deals with Treuhandanstalt. What are their objectives? We've seen different strategies. Some of these companies are very interested in going global but haven't found the kind of businesses they are looking for in West Germany because corporate Germany is not open to acquisitions. And here suddenly we present them with our inventory of 11,600 companies, representing a huge variety of industries. So, we have the global players that are looking



Dr. Reimnitz speaking at a Privatization Project breakfast.

at business opportunities and have now found them, and their interest is to acquire businesses at a reasonable price, with low up-front investment. Maybe they are even considering eastern Germany as a testing ground where they can learn something or from where they can open the door to eastern European markets. We have others that have been exporting heavily into Europe, are looking for production sites, and here suddenly they have found the opportunity to invest. And finally, of course, the fear of a closed Common Market in the EC pushed some investors to look closer at the opportunities we have to offer in eastern Germany.

What we've been doing from our New York office is to take a hands-on approach. We have been trying to assist as much as we can. Initially we provide company profiles, which, we admit, have little information—little more than the number of people in the work force and a division of the products that they are producing—but it is often enough just to skim through these company profiles to get a first impression and to filter out those kinds of companies that might be of interest. As a next step, we collect more detailed information if there is interest on the American side. We submit financial information to the interested party: an opening balance sheet; the last balance sheet as of December 31, 1991; a quarterly report; profit and loss accounts; a more detailed description of the products, if available; colorful prospectuses; and the size of the real estate, the buildings and their condition. With this information we usually ask the American investor to go ahead and take a look at the companies. We keep track of the number of investors that have actually traveled to eastern Germany, and we have had fifty to sixty so far. Out of those, eighty percent are very interested and are pursuing their offerings or their due diligence. We also provide Americans with contacts, if desired, such as law firms—German and American; accounting firms; and all the intermediaries that might be needed in such a transaction, and we have found that al-

though as the Treuhandanstalt we are the seller, we have been able to assist with a lot of sideline information to American investors. The midsized and smaller companies especially are afraid that once they step on an airplane they are left on their own, but we have a backup office in Berlin to assure that they receive the right treatment, that the introductions are made, and that they are being guided through the facilities they are considering. We're quite proud to say that in the past six weeks we have been involved in four U.S. acquisitions in eastern Germany. Interestingly enough, two of those come from the environmental sector. Both are California-based



President Christian Rindfleisch (left), Deloitte Touche Tomatsu, with Christoph Reimnitz.

companies; one is a water treatment facility, and the other is a company that is involved now in the scrapping of ammunition. It used to be in the field of producing ammunition and they quickly saw their opportunity to alter directions and switch their business.

We hope that these successes will continue over the coming months.

I would like to conclude with some statistics on Treuhand. Our inventory is now up to 11,660 companies. This is due to the fact that we broke up the conglomerates into sellable and manageable business entities. We have sold 7,122 companies, ranging from the big InterHotel chain to garage sales, if I may call them so, where we have sold smaller companies to two or three of the employees. We have generated revenues of US\$17.5 billion and we have investment pledges of an-

“In the very beginning we put a lot of emphasis on privatizing quickly and thus not allowing private enterprises to compete with the former state-run companies. This has clearly given us an edge over a country like Hungary where it is actually the private companies that are prospering and are taking away business from the big government companies.”

other US\$80 billion over the next two to three years. The foreign acquisitions among these stand at 390 sales. Currently, in terms of investment pledges, Americans rank number three

and in terms of deals concluded they rank number five. We hope we are able to increase that number over the next several months and maybe slide up one notch or two. ■

Questions and Answers

Q How do you dispel the general feeling that it's mostly a German-German affair and, also, can you share some success stories or major failures which could be of interest to investors?

A I think your first question as to why there were initially German investors as opposed to foreign investors has a very logical explanation. Treuhand was busy setting up its own structure and starting to gain control over the companies in eastern Germany and was unable to focus on marketing. Basically, those Germans that acquired businesses in the early stages did so because of persistence. They were always there on the doorstep and they made sure that they acquired the business they were interested in and it was just by being obnoxious that some of those deals were closed. Last July, when I was sent over to the United States, the portion of foreign investment in eastern Germany stood at five percent. Now it stands at ten percent, so there has already been a substantial increase and the goal is to achieve the same portion of foreign investment as exists in western Germany, which is fifteen percent. In addition, Treuhand has opened an office in Tokyo and we have what we call "ambassadors" in most European countries (such as Great Britain, France, Spain, Italy) who are nationals of their countries and have good contacts and have been able to promote the Treuhand idea.

Now to a success story, let me be brief, even though I could name several of them. One of the successes we've been dealing with—and it hasn't been concluded yet—is a smaller company, a luggage company that came to the New York office last year in September and was looking at luggage manufacturers in eastern Germany. I showed them eight company profiles, they looked through them, and asked for more detailed information on three of them. Here's where it gets interesting: of those three companies there was one "ugly duckling" that was not profitable, looked in terrible distress, and was to go into liquidation. The other two were doing fairly fine, one of them was manufacturing for a German luxury luggage company. The interested buyers received detailed information on all three companies, and they decided they wanted to look at two: the luxury manufacturer and the "ugly duckling." We went to Germany in January, looked at the non-profitable company on the first day, and the potential buyers did not even want to see the other company. Immediately they were thrilled by what they had seen, not because everything was modern or the products were something to add to their line, but their imagination started to work

and they saw the possibilities that this company could offer. They had to stop manufacturing in the United States in the 1980s because of the competition in the Far East, and they are now very interested in going back into manufacturing. What they've done is they have gone through different stages. They initially wanted to go through an asset deal, acquiring only parts of the business, then they decided to get their imports from the Far East through this company, and now they're working on a stock deal, planning to acquire the whole business. They were very enthusiastic about management and about their technical know-how and skills. They learned why the company was set up in such an irrational way: why they had parts of the production line in one building and about 500 feet away they had another production unit, and why the shipping had to work by a pull cart. They were thrilled by the possibilities of just molding this company to their needs and they very early realized that the management was willing and enthusiastic to go along and I think this will be the driving force that will conclude this transaction within the next three weeks.

We had another American company (and I will stick with the Americans here) where things haven't worked out as well. It's a company that has been very aggressively involved with us over the past sixteen months, and Treuhand offered a combination of a Management Buy-Out and American investment. The Americans' only interest was to bring in capital. They entered negotiations with management to structure the company contract but the East German management was not willing to give the majority to the Americans and the Americans obviously argued that if they were putting up the capital they wanted to make sure they had control. Treuhand did something that is very unusual and it shows the wide variety of Treuhand deals and how many different strategies sometimes are being followed in such a big organization. Treuhand said we're very interested, we'd like to make this a model MBO and we're going to give the management full support—to the big disappointment of the American company, because they had thought that Treuhand was interested in selling companies, not supporting companies. That is something that has been difficult for us here in the New York office to understand as well, but we learned that politics were involved; that the federal government of Saxony, which was involved in this case, was willing to provide capital or financial assistance.

So when we're looking at all the different cases, something like this can happen as well. I would not call it a model case, however; it's been one exception in a number of cases where we think we were able to achieve something.

Q I'm wondering what you are going to do with the world famous cases like the Meissen plant or the Jena glass works—the plums in your case. And secondly, what percentage of the top management is from the east?

A First of all, to answer the question about Meissen and Jena, Meissen will not be privatized. I think we could easily have found 500 buyers—most of them from Japan. This is a traditional German manufacturer and that is, of course, why the government has decided to take on this company and keep control over it. The case with Jena is in a way similar. We have privatized it, but we privatized it to a state, the state of Thuringia. I would not consider Jena a plum because looking at the problems they're having and the financing they need, they are in distress, and the government has taken on a big obligation that a private investor would not have. So politics are heavily involved in this case. There have been other big companies that have been privatized successfully: the InterHotel chain, which was operating more or less at western standards, was successfully privatized this spring with the assistance of a British investment bank. And also a cherry or plum is the chain of gas stations, the Minol, A.G., that was neatly packaged with one of the petrochemical refineries and was sold to a consortium led by Elf Aquitaine, the French gasoline manufacturer.

To your second question, of course Treuhand, focusing on privatization, was not always able to focus or restructure companies as we should have. We laid off quite a lot of former managers from East German companies because of their political involvement. If I were to give a number, I would say that on the acquisition date or the date transactions take place, about 65-70 percent of management is still East German management.

Q There is something very distinctive about the East German experience, yet there's been an awful lot of talk about how do we begin to take the lessons learned out of Central Europe, East Germany, Poland, and Czechoslovakia, and apply them to countries in the CIS and other parts of the world that are just beginning this experience. Which aspects of the Treuhand experience do you think are genuinely exportable to these new privatization experiments and which ones are quite unique to East Germany?

A One of the clear assets of privatization in eastern Germany is that we have been moving along very quickly

and that our law-making body, the parliament, has implemented legal structures needed for this process. In the CIS, for instance, I hear that they are at a much earlier stage; they are considering creating the respective laws, such as the corporate laws and the accounting laws needed, just as a requisite for the process of privatization. Another thing that is unique to Germany is, of course, the incredible funding that is available from the western part of the country.

I think it is very important to get outside assistance and advisers involved, people that have been dealing with capitalist structures or corporate structures all their lives. One piece of advice would be to go ahead as quickly as possible in these countries, privatizing smaller companies as much as possible with their own people while larger businesses need foreign participation. Of course, that needs a lot of financial backing and funding and I think the international organizations are the only ones that are capable of doing that.

Q How does Treuhand handle restitution claims, and does Treuhand offer assistance to East European countries that are privatizing and could learn from your experience?

A Regarding restitution claims, we have been assisted by the Parliament and the legislative body and a clause was introduced as early as September of 1990 giving the investor the opportunity to obtain a waiver from restitution claims, and leaving Treuhand with the restitution costs. There is one principle in the reunification treaty, "restitution before redemption," that is sometimes waived in the case of serious investment plans for properties. The possibility of obtaining a waiver was revised once in the spring of 1991 and is currently being revised again to cut red tape and to hasten the process.

Regarding your other question as to what Treuhand is doing in terms of support for other East European countries: we convened a conference last March and invited Eastern European governments to inform them about our experiences; and we are currently organizing a Treuhand-East Europe Consulting Agency that is a fully-owned subsidiary of Treuhandanstalt. It will take former Treuhand employees and send them to Eastern European countries to help give them advice.

Q What is the policy concerning the financial obligations of potential buyers to clean up the environment?

A This falls under the category of "widely negotiable." There are two aspects to environmental issues. One is to include the clean-up costs in the contract and we've started to negotiate with investors the repartition

of the clean-up costs, starting with sixty percent of costs for Treuhand and forty percent for the investor, but we have accepted up to ninety percent of these clean-up costs. In most cases environmental appraisals are part of the negotiations, and they are included in the contracts. There was, until the end of March, the possibility of getting a waiver from the federal state in terms of civil liabilities. (The issue of environmental liabilities is not as big an issue as it is in the United States, especially in terms of liabilities toward neighbors and the work force.) This led to 2,200 filings for such a waiver, and Parliament is currently discussing and negotiating whether it will be extended. The waiver is more or less something to comfort the investor, giving him the possibility of being totally cleared of environmental liabilities.

Q Notwithstanding your political obligation to protect your worker base, could you tell us a little bit about programs that are available either through the government or privately for worker retraining and to what extent has employee dislocation been experienced in the privatizations that have taken place?

A There have been quite a lot of government programs that were necessary and related to the shedding of labor in all areas. One statistical figure, to put that into perspective is: when Treuhand took over all of its businesses, we employed 4.1 million people. Today, that number has declined to 0.9 million. Of course, some of them went into new businesses and were taken over by investors, but a large number also went into unemployment. The German government has created different systems. First of all, there is short-time labor which does not lead to unemployment and continues to pay workers at the previous or at a reduced rate. We have created labor organizations that are state-run and are assisted by companies in eastern Germany involved in social work or in work that is government-funded, such as building new roads, cleaning up cities, or tearing down buildings. Something new that is currently being discussed but has not yet been decided is whether retraining will be funded. Due to the federal structure of Germany, on different levels there are different programs and if a business were to relocate in one of these regions, I'm sure it would get local assistance in retraining. These are not clearly defined programs but there is some freedom for local government entities to help and assist in such retraining.

Q One of the prime complaints of some American chief executives is that most of the plum credits in the privatization offer have already been picked clean and there is nothing left for American investors. Could you respond to that?

A Today we are seeing a different approach from American investors. I would say that it is true that of course



Steven Davis (foreground), LeBoeuf, Lamb, Leiby & MacRae; and Masahiko Imazato, The Japan Development Bank.

those companies that represent a value in terms of special technical know-how or are profitable businesses have already been sold. By breaking up conglomerates, however, even today valuable new business opportunities are being created. But we are looking at different investors today who, for strategic reasons, are buying companies that have been trimmed down to a size that they are more interested in taking over. One of the clear examples is a West German construction company that had immediately established a relationship with an East German construction firm—advised them, provided them with material, with technical know-how—and of course was a prime bidder for that company. They bought the company at very favorable terms for Treuhandanstalt and afterward realized that sixty percent of the order backlog was from the Soviet Union and was not guaranteed and then the buyers tried to get out of the contract. So I think the question is somewhat relative and we have to put it into perspective. Those companies that approach us today do not expect to find cherries but they expect to find businesses with the main assets they are looking for, such as qualified labor, and businesses they can start operating tomorrow if they bring in new machines or if they upgrade the companies. So it is a different approach. The sort of gambler that comes in and is looking to find a jewel or a gem within our companies is not approaching us anymore.

Q I have been told anecdotally by friends who run operations in West Germany that the East German workers who have been hired have been shocked into numbness by how hard the West German workers work. Would you comment on the relative zeal of the East German workers as compared to those who've built such a success in West Germany?

A That information might be somewhat outdated. It definitely is true that for the first six months of reunification, East German laborers really expected heaven on earth without having to work hard. And today this is an important question I ask Americans when I'm writing up success stories and talking to them about their experiences. I hear there are some disappointments in terms of people not being able to face a forty-hour work week of constant work. But by and large the East German work ethics are just as high as the West German. Their work practice, however, used to be this: we work if we have material and if we run out of material then we just don't work and we wait until the new material arrives. This gave them very comfortable working days. So there has clearly been a change which one can see by just looking at the East Germans working incredibly hard at Treuhandanstalt.

We also see that Western investors, particularly American investors, have been reporting very favorably, saying that there is great devotion and commitment amongst the work force, now that it knows that there is a clear idea that the company will continue to exist in the future. This inspires them. This is, of course, a learning process, but some of the companies we've been talking to have shifted production from west to east because the percentage of absenteeism, for instance, is much lower. Here in the United States you have 11.5 percent absenteeism; in western Germany you have twelve percent; in eastern Germany you only have two percent. That's a considerable difference. Also, many of the productivity increases are reached through the introduction of new techniques; they are not always labor related. Otis Elevator, for instance, acquired five companies in eastern Germany and whereas the East German companies always needed two people on a maintenance crew in order to maintain their elevators now they

only need one person. This is a clear productivity increase.

Q If you look at the case of Hungary's privatization, a lot of specialists have come to the conclusion that their big companies are in such bad shape that you really won't be able to turn them around. You are going to have to depend on the small entrepreneurs to create wealth in Hungary. When you look at eastern Germany, what role are the large companies willing to take in creating wealth and what role will the midsize companies and entrepreneurs play?

A In Germany the case is somewhat different. In the very beginning we put a lot of emphasis on privatizing quickly and thus not allowing private enterprises to compete with the former state-run companies. This has clearly given us an edge over a country like Hungary where it is actually the private companies that are prospering and are taking business away from the big government companies. Having an organization like Treuhandanstalt is a clear advantage because you have a semi-governmental agency that can take on all the blame such as laying off a substantial percentage of the work force. If the Hungarian government were to do this, it would be out of power immediately.

I think that big businesses in eastern Germany will only continue to exist if they find the right industrial partner, which basically has to come from the West. We cannot report any Management Buy-Outs, of course, in what used to be the conglomerates, but we've seen that if big international corporations go in and start new manufacturing sites or upgrade existing facilities, they are providing the basis for future wealth just as much as the successfully privatized smaller businesses are. ■

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