Directorate of Intelligence

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European Review

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17 January 1986

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European Review [redacted] 25X1

17 January 1986

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Prototype development of a new attack helicopter by the Franco–West German Eurocopter consortium is under way. Mass production—scheduled for the early 1990s—will feature three versions, each designed to meet specific French and West German military requirements and compete with US helicopters in the export market. Despite its high cost, West Germany has been eager to proceed with the program to demonstrate Franco-German cooperation [redacted] Agreement has been reached on configuration of the new helicopter and on work-sharing, but the program still could falter over financing. [redacted] 25X6 25X6 25X1 [redacted] 25X1

[redacted] 25X1

Some articles are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the views of a single analyst; these items will be designated as uncoordinated views. Comments may be directed to the authors, [redacted] 25X1

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East Germany–China

High-Level Visitor to Beijing [redacted] 25X1

Steadily improving relations between East Germany and the PRC got another boost recently when the GDR sent the highest-ranking official to visit China in more than a quarter century. Horst Sindermann—number three in the Politburo, deputy head of state, and president of the legislature—had talks with numerous senior Chinese officials, including party leader Hu Yaobang, during his visit on 14-20 December. Sindermann's visit at the head of a parliamentary delegation was in return for a similar one made to East Berlin last June by deputy parliamentary leader Wang Renzhong and other representatives of the PRC's National People's Congress. Wang's visit marked the resumption of parliamentary ties after a 20-year hiatus dating back to the Sino-Soviet rift. [redacted] 25X1

Party ties still remain under Soviet proscription, but Hu's reception of Sindermann (reciprocating Honecker's earlier meeting with Wang) shows a desire by both sides to improve relations. In the official media, Hu fondly recalled his "close" association with Honecker years ago in the international youth movement—immediately provoking speculation among Western journalists in Beijing and East Berlin that Honecker would visit China in 1986. An East German Embassy official in Beijing told a US diplomat that, while a Honecker visit was agreed to in principle, no date has been set. Such a visit, in our view, could take place only with Soviet concurrence and only then if it serves Moscow's interests. An East European source of the US Embassy in Beijing claims that Honecker has the green light to be the first East European Warsaw Pact leader to visit the PRC. [redacted] 25X1

While closely coordinating its China moves with the Soviets and serving wider Warsaw Pact interests, the GDR is also pursuing its own economic and political goals as part of a more general effort to diversify trade and raise its profile on the international scene. At the same time, the East Germans are leery of being used as a wedge against the Soviets by the Chinese, who featured the visit prominently in their Russian-language radiobroadcasts. Sindermann dutifully stopped off in Moscow on his way to and from Beijing. [redacted] 25X1

Poland

Party Personnel Changes [redacted] 25X1

General Jaruzelski's recent appointment of an army officer to the Central Committee Secretariat and replacement of four Central Committee department heads are part of an ongoing effort to put more trusted collaborators in sensitive policy areas. Jaruzelski has changed 12 of the 16 department heads at least once since taking over the party leadership in October 1981. [redacted] 25X1

Gen. Jozef Baryla, the new Central Committee Secretary, is a Jaruzelski loyalist, [redacted] who will likely assume responsibility for security 25X1 matters in place of deposed hardliner Miroslaw Milewski. Baryla is a career military officer whose appointment may perpetuate reported resentment of military meddling within the Interior Ministry but should help Jaruzelski bring the security apparatus under better control. Two of the replaced department heads supervised the education and propaganda bureaucracies, where purges have been under way. Jaruzelski may want people beholden to him to ensure that any continued purges closely reflect his wishes. The other two department heads have moved to more important posts. The chief of the foreign department has been assigned as ambassador to Moscow in place of a hardliner who reportedly had been making trouble, and the head of the sociolegal department has been named first secretary of the important Warsaw party organization. 25X1

Jaruzelski may hope that the changes, coming in the wake of the ouster of his archrival Stefan Olszowski, will signal to lower-level party bureaucrats that he has the determination and political muscle to get rid of uncooperative people before the party congress. Some apparatchiks have held Jaruzelski responsible for the party's ill fortunes and reportedly have tried to frustrate the implementation of those policies they believe would erode their authority. 25X1

Yugoslavia

Unorthodox Job Creation in Bosnia 25X1

Faced with a chronic unemployment problem—20 percent of the work force are jobless, as against a national average of 14 percent—leaders in the northern republic of Bosnia-Hercegovina have designed a scheme to create between 100,000 and 400,000 jobs over the next five years. The republic government late last year floated a low-interest bond issue to be purchased by workers and whose proceeds would be used to fund job creation, particularly in small-scale enterprises in both the public and private sectors. Western press reports say officials are using heavy-handed pressure to encourage the "voluntary" purchases, causing some resentment. The republic interior ministry reportedly has branded as politically hostile those opposed to the loan program. 25X1

Though not yet tested, the Bosnian scheme has already sparked interest in other regions of the country. As of late December, media reports indicated that Serbia, Macedonia, and Kosovo—the latter two southern regions suffering above-average unemployment rates—were considering similar bond issues. 25X1

Bosnian leaders are probably trying to show the population that they are serious about increasing employment but probably also believe the bond plan will succeed. Officials have told US diplomats that they are particularly unhappy with stabilization measures that would increase unemployment in the short run—such as closing unprofitable firms—and have refused to implement them. Over the past few decades, the Bosnian regime has successfully overcome many other economic problems through a combination of strong republic-level oversight and a willingness to experiment. 25X1

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France–West Germany: Outlook for the Eurocopter Program [redacted]

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After several years of negotiation, the defense ministers of France and West Germany signed a memorandum of understanding in May 1984 establishing the Eurocopter consortium for development of a new attack helicopter. Prototype development is under way, and mass production, scheduled for the early 1990s, will feature three versions, each designed to meet specific French and West German military requirements and compete with US helicopters in the export market. Bonn estimates the joint program will cost between $175 million and $630 million more than an existing model, such as the US Apache AH-64, and will delay replacement of its current helicopters by at least three years. West Germany has been eager to proceed with the program to demonstrate Franco-German cooperation and Bonn's frustration with previous failed attempts at US-German cooperation. Despite agreement on the configuration of the new helicopter and on work-sharing, the program still could falter over financing. [redacted]

Specifications

	West German PAH 2	French HAP	French HAC/3G
Mission	Antitank	Air-to-air combat	Antitank
Initial operational capability	Beginning in late 1992	Beginning in 1992	Beginning in early 1996
Production run	212 days	75 days	140 days
Maximum speed	250 km per hour	280 km per hour	280 km per hour
Weapon system	Eight HOTs before 1995 (ATGW-3s after 1995)	30-mm gun, four Mistral air-to-air missiles	Eight ATGW-3s
Configuration	Copilot/ gunner in front	Pilot in front	Pilot in front

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[redacted] 25X1

Differences in Mission Concepts

Resolution of differing French and West German requirements for advanced helicopters—through the decision to develop three models—has been key to the agreement to proceed with the new program. According to US military officials, the French originally were seeking both a second-generation attack helicopter optimized for air-to-air combat in support of France's new airmobile division and an advanced antiarmor model equipped with third-generation antitank guided missiles. They also were interested in potential export sales, particularly in the Third World. [redacted]

The West Germans, on the other hand, were primarily interested in an all-weather antiarmor model initially equipped with current-generation HOT antitank missiles. Because of the need to replace its inventory of the much less capable PAH 1 helicopters,[1] Bonn wanted a new model that could be developed and fielded relatively quickly and then retrofitted with new-generation ATGMs at a later date. [redacted] 25X1

Three Versions

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The Eurocopter consortium evolved from longstanding cooperation on helicopter development between West Germany's Messerschmitt-Bolkow-Blohm (MBB), the prime contractor, and France's Aerospatiale, the associate contractor. The consortium has agreed on a common design for the basic airframe, rotor, and engine combination, but avionics and weapons for each of the three helicopter versions will vary depending on the aircraft's mission.

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[1] The PAH 1, intended as an interim solution to the Bundeswehr's attack helicopter requirement, has only a daylight good-weather capability and is armed only with six antitank missiles. It is relatively small, underpowered, and considered highly vulnerable to ground fire. [redacted] 25X1

The helicopter's engine will be developed by Motorenund Turbinen-Union (MTU) of West Germany and Turbomeca of France. MTU will be responsible for the "hot" section of the engine, including the combustion chamber and two high-pressure turbines; Turbomeca will provide the "cold" section and the engine's digital control system. [redacted]

All three versions will have a tandem crew configuration, with the pilot seated in either the forward or rearward cockpit. The German decision to fit their model with a US-made target acquisition and sensor system requires that the forward position be occupied by the copilot/gunner, with the pilot in the rear. The French, however, prefer the pilot in the front cockpit, opting for the advantages in operational efficiency and safety afforded by this configuration. [redacted]

Each of the versions also will be equipped with comprehensive electronic countermeasure systems, notably warning detectors for radar and laser illumination and dispensers for both chaff and infrared flares. The pilot and copilot/gunner will have the same control and display units and engine-management systems in each version. Only the distribution of electronic displays between pilot and gunner will vary, since these are associated with the two different types of visual electronics that will be in use. [redacted]

The Bonn government has decided to equip its prototypes with the US-made Martin Marietta target acquisition designation sight and pilot night-vision sensor systems (TADS/PNVS). The TADS system allows the gunner to search for, detect, and identify targets using three viewing channels—television, optical, and forward-looking, infrared radar (FLIR). It also includes laser-ranging and target designation facilities. PNVS is a separate thermal imaging system that enables the pilot to fly at night at very low altitude. [redacted]

Prototypes

[redacted]

[redacted]

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Prospects

The economic incentive of arms sales has emerged as an increasingly important factor in this and other Franco-German weapons ventures. West Germany maintains one of the most stringent arms export control policies in the West. France, on the other hand, has explicitly identified exports as an important prerequisite for any weapons program and pursues arms sales with countries in areas of tension with virtual impunity. [redacted] Bonn probably will not seek a veto over foreign sales of the Franco-German helicopter, welcoming the opportunity to receive the economic benefits, as it has with the Roland air defense missile program and Tornado aircraft. [redacted]

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Although Paris and Bonn have agreed on the basic configuration of the helicopter, work-sharing for the production of common components, and the division of responsibility for prototype development, the program still could falter if either country runs into financing problems. [redacted]

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While we do not believe the program would be cancelled outright, in the face of funding problems, deliveries could well be stretched out or scaled back.

Key Features

***PAH 2** (see photo)*
The West German model, designated Panzerabwehrhubschrauber (PAH 2), will replace existing PAH 1 helicopters. Designed primarily for antitank missions and equipped with night-vision capabilities, the PAH-2 initially will be armed with the HOT antitank guided missile but will be upgraded later with a third-generation system—the antitank guided weapon (ATGW-3)—as it becomes available. The PAH 2 will not carry an onboard gun system since the West Germans will rely on Alpha Jet aircraft to provide air cover.

***HAC/3G** (see photo)*
France's antitank version, the Helicoptere Anti-char (HAC), also will be equipped with day/night capability but will be armed with the third-generation TRIGAT antitank missile system, which will enter service in about 1995. This model also will be equipped with French-built target acquisition and sensor systems. The French acknowledge the quality of the US TADS/PNVS systems and their ability to meet the mission requirements of the German helicopter armed with HOT antitank missiles. They believe, however, that the US system would have to be modified to accommodate the TRIGAT missiles, which could cause setbacks in the French program.

HAP
The second French model, designated the Helicoptere d'appui-protection (HAP), will serve in an air-to-air role in general support of airmobile forces. It will be armed with air-to-air missiles as well as with the 30-mm, single-barrel CASSIOPE gun system. The gun will be used against targets appearing suddenly at short range and the missiles against distant targets.


PAH 2 helicopter Heracles © 25X1

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HAC/3G helicopter Heracles © 25X1

Both Paris and Bonn, however, are eager for this joint project to succeed. German industry needs the spinoff technology and the opportunity to improve its skill in developing new technology. In addition, the German work force will benefit from the associated jobs. 25X1

While French companies involved in the project are prepared to go it alone, they recognize that the high cost to both countries of so large a program makes joint development attractive. The program, moreover, will contribute substantially to maintenance of the European aircraft industry by strengthening European competitiveness on the world market and promoting standardization of weapons. 25X1 25X1 25X1

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West Germany: Modernizing the Artillery Forces

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The West German Army is streamlining its artillery forces as a hedge against future manpower shortages while increasing firepower and flexibility of the forces by shifting fire units forward, introducing new weapons, and establishing computer links between command and field elements.

Strengthening the Divisions

Under the reorganization, artillery firepower will be concentrated at division rather than corps level to improve accuracy and response time. The divisional artillery batteries will remain at six, but the total number of tubes and rocket launchers will increase from 40 to 52. The additional manpower requirements of the divisions will be offset by substantial reductions at the corps level. Each of the Army's three corps will keep its Lance missiles, but all the corps' 203-mm self-propelled (SP) howitzers will be transferred to 10 divisions. The divisions' three 155-mm SP howitzer batteries also will be reorganized into two units with nine guns each to consolidate personnel and firepower. By 1988, the division's light artillery rocket systems (LARS) will be complemented by 16 additional medium artillery rocket systems (MARS). At the brigade level, restructuring will reduce the number of batteries by one while maintaining the same number of artillery tubes.

Weapon Upgrades

The overall capability of the artillery forces will be increased by procuring new equipment (such as joint West German, Canadian, and French reconnaissance drones) and updating older equipment (such as the M-109 SP howitzer). At corps and division levels the CL 289 reconnaissance drone will have improved although still limited real-time capabilities and be equipped to penetrate as far as 150 kilometers. The MARS—to be operational in the late 1980s—will have an onboard navigation and targeting system, computerized fire-control equipment, and an automatic loader. Additional equipment to be procured will include an updated 155-mm SP howitzer that can fire a standardized NATO projectile 24 kilometers and up to 30 kilometers with advanced projectiles. An important force multiplier will be the ADLER computer link between command and field components designed to consolidate and compress communications procedures and thus accelerate response times to field units needing artillery support. The system should improve accuracy and reduce ammunition consumption. 25X1

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Implications

The reorganization and modernization of the artillery forces, primarily motivated by the decline in draft-age manpower, are designed to improve artillery support without exacerbating projected manpower shortages. Reequipping and reorganizing artillery units will ease manning problems by reducing the need for associated support structures and streamlining existing chains of command. Survivability also will increase due to enhanced mobility and dispersal. 25X1

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Existing and Planned Distribution of Artillery Equipment

	Present Distribution		Planned Distribution	
	Number of tubes or missiles	Number of units	Number of tubes or rocket launchers	Number of batteries
Corps				
CL 289 drone	0	0	NA	NA
Lance	8	1	9	1
203-mm SP howitzer	36	2	0	0
Total	44	3	9	1
Division				
CL 389 drone	0	0	NA	NA
203-mm SP howitzer	6	1	18	2
155-mm SP howitzer	18	3	18	2
LARS	16	2	16	2
Total	40	6	52 [a]	6 [a]
Brigade				
155-mm SP howitzer	18	3	18	2

[a] Excluding the MARS, of which 16 will be deployed with each division in two batteries, starting in 1988.

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Poland: Dim Prospects for Increasing Hard Currency Earnings

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A major goal of the Polish Government is to increase hard currency earnings in the next five years to keep its foreign debt from rising. Poland, however, lacks effective export promotion policies. In particular, Warsaw has failed to stimulate firms to seek export opportunities or channel adequate investment to industries that are potential hard currency earners. The regime may tinker with its policies, but internal pressures to increase domestic consumption rather than exports and weak Western demand for Polish products are likely to thwart any major export campaign.

Poland: Key Elements of Export-Incentive Policies

Hard Currency Retention Fund
- *Permits firms to keep an average 20 percent of export earnings to fund imports.*
- *Restricts purchases to raw materials and equipment essential to export production.*
- *Is held by 40 percent of firms.*
- *Financed 15 percent of imports in 1984.*

Foreign Trade Rights for Firms 25X1
- *Allow firms to conduct trade directly without the aid of foreign trade enterprises.*
- *Have been granted to about 300 firms.*
- *Accounted for about 7 percent of exports in 1984.*

Foreign Exchange Export Credit System
- *Allow firms to obtain loans from Bank Handlowy to purchase the machinery and equipment necessary to develop hard currency exports.*
- *Funded 0.5 percent of imports in 1984, but probably about 2 percent in 1985.*

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Inadequate Export Incentives

The 3-percent decline in hard currency exports in the first nine months of 1985 compared to the same period in 1984 partly reflects an ineffective export policy. With domestic demand high, firms have little incentive to export or introduce quality products. In a recent survey, more than 40 percent of all firms expressed no interest in exporting. Easier and more profitable sales on the domestic market encourage firms to avoid the costlier marketing arrangements and lower prices for exports.

The regime has not carried through on its economic reform policy, which—at least on paper—tied a firm's imports of Western raw materials and equipment to its export revenues. As a result, central allocations not tied to foreign earnings remain the most common method of financing imports:

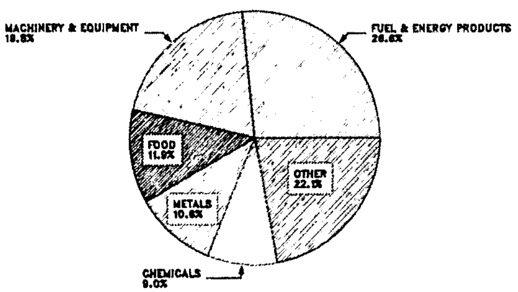
- The hard currency retention fund—eventually planned to finance over half of all hard currency imports—has encountered limited success because the share of hard currency earnings that may be retained is too small to encourage firms to accept the difficulties of becoming an exporter.

- The program to grant foreign trade rights to enterprises has not succeeded because most firms find it cheaper to deal with foreign trade organizations that possess the trading skill, trained personnel, and networks of established markets they lack. In addition, the Ministry of Foreign Trade excludes firms from entering markets in which foreign trade organizations already operate.

- The foreign-exchange export credit system receives little use by firms due to high interest rates on loans and the limited funds available. 25X1

Several other policies restrict a firm's incentive to export. The National Bank of Poland, for example, recently failed to authorize a promised reduction in the high taxes levied on hard currency earners. The regime also delayed implementation of a reform to tie wage hikes to increases in exports. 25X1

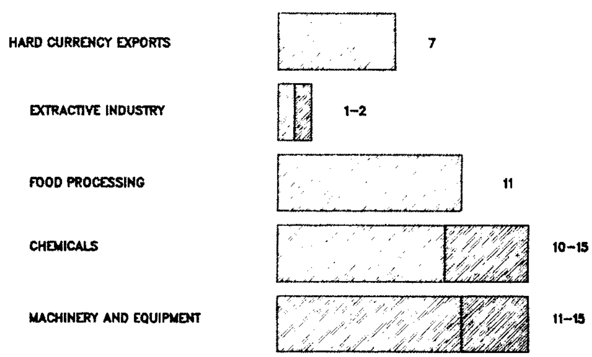
POLAND: HARD CURRENCY EXPORTS IN 1984



[redacted]

POLAND: PLANNED GROWTH OF HARD CURRENCY EXPORTS, 1986–1990

percentage average annual rate of growth



[redacted] 25X1

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Some Polish officials have opposed additional export incentives, especially further devaluations of the zloty. The value of the zloty has fallen from 80 to 159 zlotys per dollar in the last four years, but many Polish economists believe the rate should fall to 600 zlotys to bring domestic prices in line with world prices. The regime probably is reluctant to devalue, however, because of the major inflationary impact and concern that increased exports would reduce consumer supplies. Government actions at times have stopped potential exports; for example, a light bulb firm recently was ordered to cut foreign sales by 20 percent because of domestic needs. [redacted]

Lack of Export Options

Even with effective export policies, Poland is not well positioned in markets with high growth potential. About 70 percent of Polish hard currency in 1984 was earned through exports of coal, copper and other metals, machinery and parts, and processed food. Warsaw's plans to increase exports to the West by 7 percent annually in 1986-90 appear excessively optimistic, given prospects in its leading export markets. [redacted] 25X1

The Extractive Industry. Even the Poles see only marginal growth potential for this sector in the next five years. Output of coal, copper, and sulfur will stagnate, and production costs will escalate due to past inadequate investment. Moreover, many domestic consumers ignore pleas to conserve fuels and raw materials, leaving less available to export. Stagnant demand for many raw materials on the world market, competition from other suppliers, and possible protectionist measures by West Europeans also may constrain sales of these products. [redacted] 25X1

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The Food Processing Industry. Warsaw hopes to increase this industry's exports, especially meat, at rapid rates during 1986-90. Export growth hinges on increased production; reversal of past neglect of storage, packaging, and transport facilities; and the development of improved marketing strategies. Increasing meat exports carries political risks because many Polish consumers believe food exports drain away domestic supplies. Moreover, reliance on agricultural exports is risky because it depends on uncontrollable factors, such as weather and Western export restrictions. [redacted]

The Chemical Industry. Polish officials plan a rapid expansion of exports of specialty chemicals in the hope these products can command higher prices on the world market than bulk chemicals and will supply high-growth industries, namely electronics, pharmaceuticals, fertilizers, and pesticides. Investments required to increase output of these goods, however, currently are absent from the plan. [redacted]

The Machinery Sector. Exports of machinery and spare parts also are slated to grow rapidly in the next five years. Similar plans have proved unrealistic in the past: in the first nine months of 1985, exports of machinery to the West were only 50 percent of plan. Warsaw still has difficulty in competing in Western markets with the newly industrialized countries (NICs). The NICs, having better quality control and marketing channels than Poland, sell the same low-technology machinery, such as steam boilers, internal combustion engines, tractors, and food processing machinery. Demand for this type of machinery is not high; many industries in developed countries have phased out these items in favor of more sophisticated products. [redacted]

Quality problems and a poor reputation among buyers will hamper Polish machinery exports. Polish officials estimate that the machinery sector accounts for much of the $1 billion lost last year due to rejected items, cancelled contracts, the cost of repairs, and freight charges to return defective goods back to Poland. In addition, the obsolescence of Polish machinery exports has required lowering foreign trade prices even though production costs have not fallen. Because of Poland's failure to develop new products, import new industrial components on a large scale, and buy production licenses from Western firms, a widening technology lag will cause these exports to become even less competitive on world markets. [redacted]

Other Sources of Earnings. Tourism and the sale of construction, transportation, and technical services offer little potential for expanding hard currency earnings. Warsaw earned about $400 million on its transfer and service account in 1984, and hopes for substantial future growth, but considerable investment in hotels and services is required to 25X1
increase tourism. Most tourist agencies agree that Polish prices are high compared to other East European countries, and accommodations and services fall below Western standards. [redacted] 25X1

An increase of construction services abroad has some potential for increasing earnings with a healthy world economy. Warsaw, however, must adapt better to world demand and develop an area of expertise. Poland's central European location creates potential for increasing transit services but investment and 25X1
marketing are required to develop the service. The outlook for the export of technical expertise, however, is not promising. A minuscule share of Polish hard currency earnings is derived from the sale of licenses and other scientific and technical expertise. Poland's outdated technology base means it has few patents licensed on a world basis. For example, less than 2 percent of all Polish inventions have foreign patents compared to 10 percent of East German and 60 percent of Dutch inventions. [redacted] 25X1

Outlook

Poland faces major problems in expanding hard currency earnings, barring major changes in investment policy and export incentives. The regime needs to invest in industries with the most hard 25X1
currency export earning potential, instead of the outdated investment projects now funded. Moreover, the regime must stimulate exports by increasing their profitability to firms and to employees. Devaluing the zloty to create a more realistic exchange rate would enhance Poland's competitiveness, but the regime fears a negative public reaction resulting from large increases in domestic prices. [redacted] 25X1

The regime suggested ways to increase export incentives, but none seem far-reaching enough to bring major improvement. For example, Warsaw

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plans to establish a Foreign Trade Development Bank to give firms credit for developing potential exports, to raise the quotas on the hard currency retention fund, and to grant tax and tariff concessions. The Poles also are encouraging joint ventures with the West, especially in the metals and machinery sectors, but Western firms appear reluctant to participate due to past problems and government policies. Prospects for renewing old contracts, which nearly all expire by 1987, are gloomy because of Western companies' phasing out the older products now made in cooperation with Poland. 25X1

Another major impediment to export growth is domestic pressure to increase consumption more than exports to either the West or East. Based on the past, the regime probably will yield to consumer demands to increase consumption more than the 2 percent now planned annually over the next five years. Such concessions would leave even less export revenue to repay the debt. Despite creditor demands to increase export revenues, their lack of leverage over Poland means the regime most likely will ignore the protests.

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Yugoslavia: Economic Stagnation and Social Instability in Kosovo 25X1

Four years after major rioting among ethnic Albanians in the southern province of Kosovo, Belgrade still is unable to ease tight security and has not adequately addressed the region's economic grievances. Rapid population growth is eroding per capita wealth and contributing to Kosovo's continuing relative economic backwardness within the Yugoslav federation. The government's large investment in capital-intensive industries has failed to exploit a growing labor surplus, and an already serious unemployment problem is likely to worsen over the next few years.

Sociopolitical Unrest

Friction between ethnic Albanians and neighboring slavic groups remains Yugoslavia's most inflamed nationality problem. On 7 December, Belgrade announced one of the biggest roundups of ethnic Albanian nationalists since the 1981 disorders. The Interior Ministry said 50 Albanians from several regions would be put on trial for organized antiregime activities and links to foreign (read Albanian) intelligence services. It reported that one security official was injured in a shootout and that several of those arrested had previous records.

The sociopolitical problem clearly persists. Last year, a Kosovo official revealed that 668 Albanian nationalists had been sentenced since 1981, of whom 442 were still in prison. The problem of repeat offenders is likely to grow as more nationalists arrested in 1981 are freed. The regime continues to rule out granting nationalist demands for a separate Albanian republic, opting instead for an uncertain policy combining a heavy security presence with economic aid.

Poverty and Stagnation

One of the factors that has fueled unrest in Kosovo is the region's continuing poverty compared to the rest of Yugoslavia. Kosovo is one of the country's richest regions in farmland and natural resources, but it has more in common with the Third World than Europe. In 1984, Kosovo's per capita gross social product (similar to GNP) of $414 was roughly one-third of that for Yugoslavia as a whole and one-sixth of that of the country's wealthiest republic, Slovenia. Unemployment in the region—about 35 percent of the labor force—is 2.5 times the national rate, with little prospect for improvement. 25X1

Belgrade's economic aid to Kosovo—$95 million in 1985 at current exchange rates—has contributed to improvements in some sectors of its economy but has been unable to keep pace with rapid population growth. At 3.5 times the national rate, Kosovo's population growth has kept per capita wealth below the rest of Yugoslavia, and the gap has widened in recent years. Rapid population growth has been accompanied by a demographic shift toward the city and growth of a large educated class with few job prospects. Kosovo's development also has been depressed by low rates of work force participation, slack labor demand, and poor worker productivity. The Kosovar worker is only 74 percent as productive as the average Yugoslav and must support more than twice as many nonworkers. 25X1

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Investment Policies 25X1

Investment in Kosovo has been concentrated on capital-intensive heavy industry to exploit the province's considerable natural resources. Local authorities have promoted development of two large enterprises to extract lead, zinc, and nickel deposits, but these projects are heavily in debt. While one operates below its processing capacity and faces exhaustion of its ores, the other is producing for a weak world market. 25X1

Kosovo has rich reserves of lignite coal and presently sells 60 percent of the electricity it generates to other parts of Yugoslavia. Local officials are currently trying to secure outside financing to expand generating capacity. Electricity sales, however, do not 25X1

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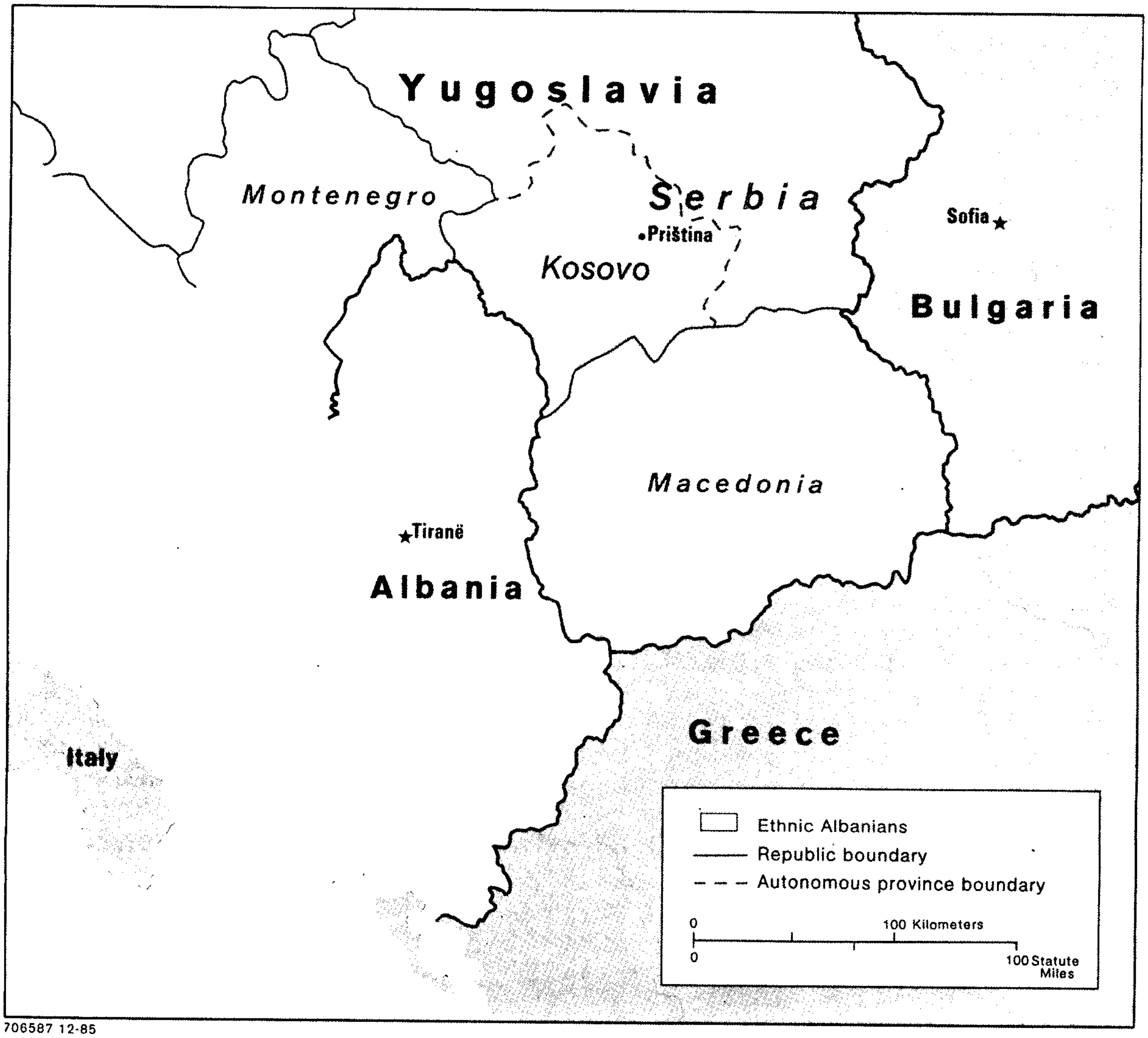
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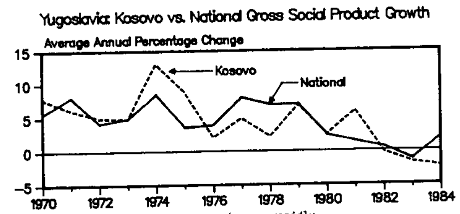
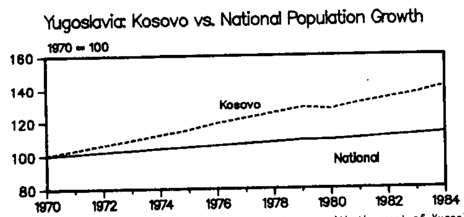
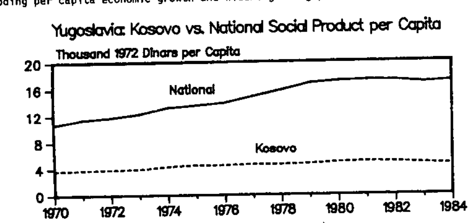
While the Kosovar economy has grown at rates comparable to those for Yugoslavia as a whole ...



...the population of Kosovo has grown much more rapidly...



eroding per capita economic growth and widening the gap with the rest of Yugoslavia.



earn revenue for the province because the Belgrade government has set the price below cost.

Little investment has been channeled into labor-intensive projects to exploit the province's large labor surplus. A few labor-intensive projects in agriculture have been successful, and, according to the US Embassy, the Chamber of Economy of Kosovo wants more such investment in the 1986-90 planning period. Most investment funds, however, are already committed to capital-intensive projects. 25X1

Declining Subsidies

The external funding that Kosovar planners have come to depend on is likely to become scarcer over the next few years. Such funding comes from heavily subsidized loans and direct transfers from the federal government as well as from legally mandated direct investment from other provinces. The Yugoslav Federal Executive Council recently suggested that repayments of loans made to Kosovo during 1982-85 be postponed until 1990 since the province does not currently have the resources to meet these obligations. 25X1

The developed republics of the north—mainly Slovenia and Croatia—continue to resist providing federal grants for Kosovo, an area they see as a black hole. The northern republics are dragging their feet on compulsory contributions to the Federal Fund for Underdeveloped Areas that are earmarked for Kosovo. The Slovene Executive Council has stated that it wants a limit on contributions, and Serbia has actually obstructed Fund legislation in an attempt to change the way its contributions are handled. 25X1

Outlook

Economic prospects for Kosovo are not bright, and Belgrade's options there will continue to be limited for the next several years. Rapid population growth probably will not slow through the end of this century, leading to the persistence of poverty, high unemployment, and the potential for social instability. The provincial leadership will have little room to maneuver in modifying past investment errors, and uncertainty about federal funding will reduce the chances for needed labor-intensive investment in the future. The province's relative economic position within the Yugoslav federation can be expected to decline further as northern areas continue to move ahead. 25X1

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