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## THE POSITIVE AND NEGATIVE EFFECTS OF ACCESSION TO THE EU - LESSONS FOR SERBIA-

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***Abstract:** The Europe witnessed spectacular changes in its economic, social and political landscape during the last decade. Equally remarkable are the forthcoming changes over the new decade. The past and the forthcoming changes in Europe manifest themselves, among other things, by dramatic reshaping in the positions of the countries, of their economic systems; of the economic, social, professional, generational, regional and other interests. The Eastern enlargement of the EU is a strategic undertaking, aiming at economic, social and political wellbeing for all European countries and their people.*

***Key word:** EU, Accession Strategy, Costs and Benefits of Integration*

Even in the most thoroughly designed social projects, however there is no guarantee that everybody will get equal gains at the same time. The overall aggregate outcome may be positive, but it may not be equally beneficial for all participants in the integration process. Economic theory provides no assurances that all economic agents benefit from the integration. Behind the positive total outcome of the expanded EU, there will inevitably be partial misbalances, which occur as loosing (though temporarily) countries, regions or groups of the population. The positive and the negative effects will not be shared evenly. Some countries, regions and sectors may get net positive effects at the beginning, and later on may transform into losers. Some may get direct positive and negative effects, while others get them indirectly.

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The positive and negative effects are dynamic. Current positive effects may evolve into negative ones after a while, and vice versa, if in the balance of measurable effects one adds the immeasurable economic and non-economic effects, such as national and personal security, stability; political, psychological, ethnical, religious and other considerations. The quantitative assessment of the overall effects proves more difficult, even impossible. As stated above, the horizon of this study is confined to the likely 10-year long pre-accession period for Serbia. This is a long enough period, full of uncertainty, making nearly impossible the measurement of the net positive and/or negative effects of the preparation for accession, because: One does not know whether the pre-accession period will be ten years or longer; one cannot foresee the institutional reforms within the EU during this period. The controversial outcome of the Nice Conference (December 2000) strengthens the uncertainty. Hardly anybody would venture to forecast the outcome of the next Intergovernmental Conference, scheduled for 2004; Even more difficult to foresee are the future reforms of the Common Agricultural Policy (CAP), the structural and social policies, the intensity and the implications of the Eastern enlargement; Negative global shocks are possible (energy prices, ecological factors, fluctuations in the world financial system, etc.) as well as positive ones (consequences of the information technologies, of the genetic engineering, of the "New Economy", etc). They will affect the functioning of the EU and its relationships with other powerful regional communities and centers.

Important changes in the multilateral rules of global trade within the framework of the WTO are also forthcoming. They will certainly affect the internal economic, social and other policies of the EU. There are still uncertainties about the future development of the EMU and of the common currency. The same is true, concerning the development of the EU itself - will it develop into an organization of the present type, a Federation of European States, a Union of States, integrating politically, economically, socially, and moving ahead by several speeds. It is difficult to foresee the development of the CEECs before and after accession. Although Serbia is a small country, it could also offer unexpected developments over the next ten years and later. The western part of the Balkans is even less predictable. So far there is no comprehensive broadly based quantitative assessment of the effects of the European integration – for the Community as a whole, for the applicant countries, and for the member countries. The attempts for a quantitative measurement on macro- and sectoral level contain so many uncertainties and simplifying assumptions that their authors even call for caution.

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### **Assessment of the Short- and Medium-term Effects**

Major features of the European integration during the last ten years were the short-term actions and capturing of short-term benefits. The EU companies benefited from the liberalization of trade and capital flows. They increased exports to Serbia and other CEECs on readily available markets, doing almost nothing for their development. Moreover, their trade surpluses kept growing. The West European companies were major beneficiaries through exports of modern capital goods for structural and technological modernization of the CEE economies. The size of these exports will be much larger over the coming years within the context of their preparation for EU accession. The large negative trade saldo of the CEE countries should be treated as their costs over the past decade. This is likely to go on for the new decade. Trade liberalization was more beneficial for the EU countries as they were better prepared than the CEECs. Although unprepared, the CEECs were compelled to open their markets for goods and services from the EU bearing heavy economic and social consequences, being unable to benefit from "jocks" (accesses to EU structural and social funds), or "vents" (emigration of a redundant man power, generated by import competition). As stated earlier in section 4.2 and 4.4 Greece, Portugal and Spain were treated more fairly in this respect. They have got and continue to receive 40-60 times more net EU transfers per capita than the CEECs. The same is true for the liberalization of capital flows, although the benefits were shared less unevenly between the partners.

The net benefit in favour of the EU was (and is) most pronounced in sharing benefits from labour migration. The EU countries have nearly blocked the migration flows. This is good for them, but heightens the tension on the CEECs labour markets at a time of drastic structural adjustments to prepare for accession. The net positive effects of the EU countries are even larger and these of the CEECs –smaller from the EU governments' policies to attract highly skilled experts from the East. This affects the CEECs negatively and will go on increasing over the coming years and decades. The analysis confirms an obvious asymmetry in sharing of net effects from liberalization (or lack of liberalization) so far between the EU and the CEE along the major integration flows. The EU companies have already captured a large proportion of the positive effects from these flows. The CEECs sustained so far predominantly negative effects (costs for accession preparation, losses from import competition, accumulated trade deficits, losses from skilled labour emigration) and got only meager positive effects. The short- and medium term overall net effects for the EU countries were

obviously positive, while for the CEECs – clearly negative. The same holds true for Serbia.

Large multinationals from the EU, USA and others benefit from the low labour, energy, land and other input costs in the CEECs by establishing new production capacities, aimed at the CEE market as well as for current and future exports to the EU. This is beneficial for both sides, but more for the foreign investors. The past decade was marked by large costs of the CEECs for transition and accession preparation. As stated in sections 1. and 2. the two are complementary. With or without accession, transformation serves economic and social development of the CEECs. What matters in this case is, that past years, and for Serbia – the next ten years will witness large imbalance between positive and negative effects. Serbia has spent and will continue to invest even more for accession preparation, without receiving even partial commensurable benefits. Positive net benefits are expected to emerge only a few years after accession.

The composition of accession preparation costs also deserves attention. One can see and Fig. No 1. those EU pre-accession transfers will be around 5% of the overall investment during 2000-2005, and 10% for the second half of the decade. The EU transfers are expected to cover up to 15% of the investments directly related to accession preparation. As stated above, Serbia must provide the bulk from domestic saving, FDI, and external loans. This will burden the budget with infrastructure investment and public debt servicing, while revenues from import tariffs will be on decline, due to trade liberalization. As a result, the external debt servicing will be even more difficult. This will necessitate greater economic and social mobilization, in spite of accumulated social fatigue from transition and high expectations for better incomes and consumption. The burden of accession preparation costs will grow year after year during the pre-accession period and also after accession. Particularly over the 4-5 years after accession, if the present pattern of gradual switching in to EU funds is to be applied for the second wave of new members.

One could argue that the constructive external pressure for faster compliance with the Acquis and related standards would accelerate modernization of CEECs. This may be true if such pressure was exercised over countries with financial and other capacities for modernization. For some of the CEECs, and particularly for Serbia, this is not the case. For the more backward CEECs still in transition recession, the external pressure would be constructive if supplemented by financial assistance. In the absence of such support it would not lead to anything beneficial. One should also bear in mind that these standards were designed for advanced European

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countries, and developed over many decades with huge resources. The CEECs are not in a position to meet these standards within much shorter time, much smaller resources and less favourable environment. In addition to time and resources needed, compliance with technological, ecological, social and other standards of the EU by CEE companies will be damaging to their cost competitiveness, at least in short- and medium term. This would crowd them out from traditional markets for a long time.

Serbia and other CEECs countries are burdened excessively due to overlapping of the transition and preparation for accession. It is well known that transition necessitates large costs for restructuring of the real and financial sectors, development of technical and institutional infrastructure and many other components of the functioning market economy. And this must be done by weak exhausted economies due to the deep recession and radical transformation of the economic systems. The private sector is expected by definition to perform better and be helpful to the state and society. In the short term (in Serbia - in the medium term) the poor quality private sector will not be loyal to society. Of course, this does not apply to the entire private sector, but only to the portion, which is in the grey area between law and crime. As a matter of fact, much of this private sector was initiated in semi-criminal environment. It is very active and inventive in tax, customs and social security payments evasion, violation of labour code, etc. As a result, for several years after privatization, the economy is in a poorer shape than before privatization. The post-privatization ailing may last longer in Serbia. Serbia and other transition countries are burdened by additional costs for compliance with the EU standards in this complex environment. The CE countries, more advanced in transition, are better prepared for accession and can afford more easily the related costs. The countries, which have not yet solved the most acute transition problems (such as Serbia) must carry on the two at the same time – market transformation and preparation for accession, and burden themselves with two types of costs. It is true that the two processes are complementary, but their sequential implementation is less painful than the simultaneous one.

It is logical to expect that the progress of transition and preparation for accession accumulates a potential for higher growth, productivity, competitiveness, employment and incomes and not only costs. This will produce economic and social relief for the population. It is logical indeed for most of the CE countries, but not for Serbia – backward both in transition and in preparation for accession. The Serbian economy is and will be in the foreseeable future at a stage of development of economic, institutional, social and other prerequisites for both - transition and preparation for

accession. This means - at a phase of investing. It has not yet reached the indispensable minimum of economic maturity to "harvest the fruits" of these investments. With appropriate economic policy and enhanced preparation for accession the more favourable stages of development and maturation may start surfacing after 6–7 years, at the earliest. More visible results are to be expected later on. From the above it follows that the EU countries first capture the benefits from integration (liberalized trade and capital flows, large exports of capital goods to transition countries, large trade surpluses, participation in speeded up privatization, blocking of migration flows for low-skilled labour, and draining the most skilled experts). Only later on they will make expenditures (potential transfers, opening labour markets) for aiding the CEECs. Only a comparison of accumulated trade surpluses with transfers made so far and promised for the future proves that short- and medium term net effect is positive for the EU and negative for the CEECs. This is true for Serbia as well.

The longer this asymmetry lasts, not only in the size of the positive and negative effects, but also in their sequencing in time, the larger the positive effects for the EU and the negative ones for the CEE. Other researchers of the effects of integration of CEECs into the EU draw similar conclusions. The applicant countries in the Eastern enlargement are placed from this point of view in less favourable position than were the applicants for the Southern enlargement in the 80s. It is well known that from an economic point of view one cannot commensure nominal figures occurring at different time. One \$ worth of profit today is much more valuable than \$ 1 five years from now, and even more so, than 10 years from today. The opposite is true for costs. The sequencing of the effects of CEECs integration so far, and the expected one for the new decade, taking into account the "time factor", leads to the following conclusion: The net present value of the overall positive effect for the EU is much larger, than the net present value of the overall positive effect for CEE. To be precise – in the short- and medium term there is no positive overall net effect for CEE, neither nominal, nor discounted. The net present value of negative effect for CEECs is more unfavourable than the net nominal negative effect as a sum of nominal annual numbers.

The transfers from the pre-accession funds are useful and indispensable for Serbia and the other applicant countries. They are free and, therefore, provided under more favourable terms, than the softest official loans. However, one has to state that these transfers are not beneficence to Serbia and the other applicant countries, made despite the interests of the donors. The utilization of the transfers proves that they are at the same time a

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form of self-financing the economies, the budgets and the citizens of the donor countries. The transfers are used for consultants' fees from the donor countries, 30-50 folds higher than fees for local experts of comparable quality (and part of them goes to their budgets as income tax). The funds are used for engineering – designing services, provided predominantly from the donor countries' companies (and part of them contributes to their budgets as corporate and income taxes, and VAT). They are used for procurement of equipment, technologies, information, software, transport and insurance costs, and others, again by companies from the same countries (and part of them transforms into budget proceeds as taxes). A portion of these resources transfers into contributions to the social security systems of the EU countries. It would therefore be more appropriate to say that pre-accession transfers are free assistance to the applicant countries, which matches adequately the interests of the EU members.

### **Assessment of the Long-term Effects**

Serbia and the other CEECs face serious problems in estimating the long-term effects of integration into the EU for many reasons. One of them is the uncertainty about the standards that should be met before and after accession. The negotiations will produce agreements. The EU Acquis, however, is changing constantly. Standards become more demanding and require even larger costs to be met and upheld. Present members have decided the modifications, but they will be compulsory for the new ones who did not take part in the decision making process. This contributes to greater uncertainty for the candidates regarding their rights and responsibilities as future members in 5-10 years or later. Problems for prospective members arise due to difficulties in commensuring costs and benefits. It is easier to measure the cost, but it is not so with the benefits. If the objective is to increase the growth potential, productivity, competitiveness, the outcome is easier to measure. This is, however, not the case with the improvement of environment, working conditions, protection of consumers, nuclear safety, and protection of external borders. It is even more difficult for benefits, such as protection of national security, regional stability and so on. In those cases one cannot commensurate costs and benefits in the traditional sense. This, however, does not question the soundness of such costs and benefits. The assessment of long term effects of integration is impeded by the remaining uncertainties with the investment climate. Many potential investors are not yet convinced of the irreversibility of the integration between EU and CEE as far as some important details are concerned: preparedness of the applicant countries, readiness of the EU itself, the terms

and conditions of accession, nature, scope and number of transitional arrangements, etc. The configuration of these prerequisites determines the effects of the investment decisions. An unfavourable economic environment increases the risks for the investors. The memories of the East Asian and Russian crises are still fresh. The recollections of the dramatic events on the Balkans over the last 9 years and the fears of their re-emergence in a modified form are even stronger.

Though difficult to estimate, the long-term effects are the major inducement for the integration efforts of CEE and the EU. It is even more important for the CEECs as the short- and the medium-term effects are negative for them so far. The misgivings that future transfers from agricultural, structural, social and other funds to the new members will be thinner, than the present ones to the less developed members, inject additional mixed expectations. This notwithstanding, the new members, such as Serbia will get probably 2,5 – 3,5 % of their GDP after accession. In spite of the unfavourable short- and medium-term net effects, Serbia and the other CEECs may count on net positive long-term effects under normal conditions. The prospects are better for applicants who will accede by 2005 – three to five years after accession. For Serbia and the other applicants, who will accede by 2018-2020, the prospects are more distant – 3 to 5 years after accession. The estimates of S.Richter from the Vienna Institute are similar. The perspective is not attractive, but there is no sound alternative for the CEECs. The theoretical scenarios could be the following:

- Accession to another integration community;
- Independent foreign economic policy with closed economy;
- Independent open foreign economic policy, consistent with modern trends of globalization.
- Alternative integration community does not exist in Europe, neither it is likely to emerge. Isolationist foreign economic policy is a recipe for economic disaster. Only countries such as Switzerland and Norway could afford for some time to have fully open foreign economic policy of their own. This is, however, unthinkable for Serbia.

Serbian accession to the EU has no viable alternative! There is no room for hesitation whether to join the EU or not. For a poor country such as Serbia the alternative "economic neutrality" is non-existent. The only question is when to accede and under what terms? Some people share the view: "the sooner, the better". This is hardly a wise decision! There are other alternatives, in our view – more promising. The analysis in previous sections provides the arguments. One should consider them and assess the pros and

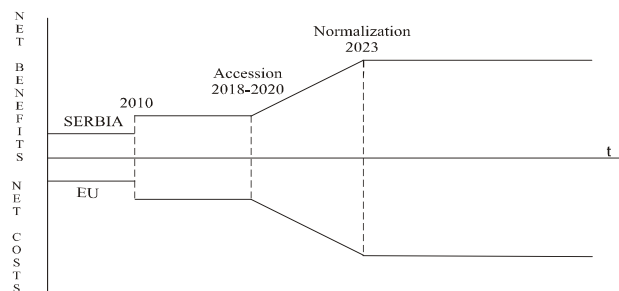


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the cons. The final political decision should be taken on the basis of overall net effects – measurable and immeasurable. The decision will be political, but based on solid economic, social, security and other arguments.

Under the present situation of on going accession negotiations the solution is a full mobilization of the national energy for the best possible preparation for accession at the most favourable terms feasible. It is easy to be said and very difficult to be implemented. As stated above, a comprehensive measurement of positive and negative effects of integration is not possible. The most one can estimate now is a tentative picture of the trends of these effects and their tentative sharing between the EU and the applicant countries. They can be presented in a graphical form. This is more a qualitative than a quantitative estimate. Any attempt even for such qualitative assessment contains a number of conditionalities. Such estimates should be interpreted cautiously and serve only as a starting point for reflection and further comprehensive investigation. On figure No. 1 one can see (qualitative) graphic assessment of the new revenues Serbia expects from EU transfers prior to and after accession:

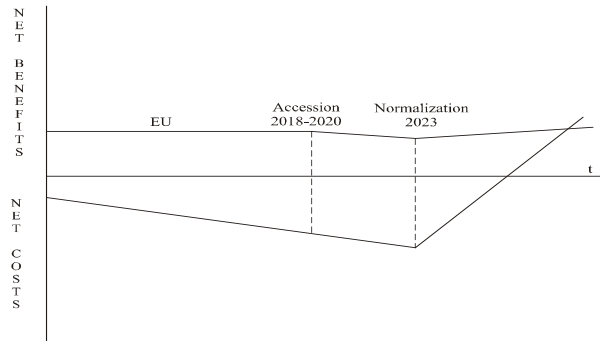
**Figure No.1 EU pre-and post accession transfers**



During the first half of the pre-accession period (2000–2005) Serbia expects annual gross budget transfers from EU around 260 mill. Euro. During the second half (2006–2010) – after the accession of the first group of applicants the transfers will probably double. One assumes that the pattern of gradual switching in to EU agricultural, structural and other funds, envisaged for the first group of new members will be applied to Serbia from 2018 to 2020. As it is impossible to forecast transfers beyond 2020 (which is assumed as a normal one) we expect they will remain at least at the same level over the following years. The assessment of these costs is more difficult than of budget transfers.

Serbia will gradually develop features of a medium level market economy over the next decades. The transfers from the EU would stabilize at a fairly high level. The great development efforts over the first two decades of the New Century would gradually bear fruits – sustained growth, higher productivity, competitiveness, incomes and consumption. One would still need high saving and investment rates, though slightly lower than the picks from 2010–2020. It is risky to use numbers for such a distant future, but if investment rates were 31–33% in 2010–2020 they might fall to 28–30 % over the third decade of the Century. One should not put the responsibility for this type of investment curve on the EU. These are investments of Serbia - for Serbia, by present generations – to the future ones. The relation with the EU is that investment rates are higher (say by at least 10 percentage points) than would have been otherwise, because the country must urgently prepare for an urgent accession. Figure No.2 presents a qualitative graphic assessment of the overall net (direct and indirect) effects from Serbian integration into the EU. It is hardly necessary to explain how difficult it is to venture an assessment for such a long period of time. The trends presented here for the net effects and their sharing between Serbia and the EU should be considered only as tentative. Any contribution, leading to precision is welcome.

Figure No.2 Overall net benefits and costs of Serbia's accession



This graphic is totally different from similar experiments of West European experts. Both numerically and graphically they present different sharing of integration effects between CEECs and the EU. They estimate positive net overall effects for the CEECs both before and after accession. The effects increase sharply after accession. Net effects for the EU are estimated as slightly positive, but smaller than the net positive effects for the CEECs before accession. They decline sharply after accession and stay negative for many years tending towards the zero in the distant future. Even

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then, they are expected to be much smaller than the overall net positive effects for the CEECs.

The above publication foresees leveling of the average representative CEE country-member of the Union in terms of income per capita with the one for the Community (i.e. over 75% of the average). This means discontinuation of the prevailing part of transfers. We do not share such an expectation for the next two-three decades (and much less for Serbia). All studies on European economic integration we are aware of confirm that convergence will take decades not just years. Our studies also prove that several decades will be needed for CEE as a whole to reach 75% of the EU-15 average. We, therefore, do not envisage discontinuation of transfers from the EU structural funds.

Figure No.2 provides a general (qualitative) graphic expression of what has been said so far concerning the short-, medium- and long-term effects. The net effects for Serbia will stay negative during the pre-accession period (by 2020) and afterwards until normalization of its status as EU member (tentatively by 2023). Their negative size will grow up to accession. It will go on increasing, though at a lower pace, by 2025 (tentatively) because of:

1. low level of economic and social development – the lowest among the applicant countries;
2. too short preparatory period, particularly taking into account the backwardness of the country;
3. huge investments needed for convergence with the EU standards within a short period of time and limited transition periods;
4. modest transfers from the EU pre-accession funds;
5. gradual switching in to agrarian, structural and other funds after accession;
6. expected curtailment of agrarian, structural and other transfers to new EU members, compared to their levels up to 2000;

A major reason for the negative overall effect is that Serbia and the other applicant countries have been left alone to bear the bulk of the costs for preparation. They will have to be financed from domestic saving by an economy which is in a deep recession; additional external borrowing at already high external indebtedness; attracting FDI at unfavourable investment environment. On top of that, efficiency of economic activity in this country is low, and will remain such for many years to come. The main reasons for this are domestic. If one looks for external reasons, they are in the EU, which is not willing, or able to provide larger transfers prior to and after accession, symmetric to the short pre-accession period and the limited

transitional arrangements. Here, too, caution is needed in the assessment, as the EU member countries have their own problems, constraints and interests. If we were they, we certainly would have given preference to our national interests and would have behaved in the same way!

Moreover, the EU countries have sufficient ground for reservations with regard to Serbia. It would be difficult to persuade their politicians and the public opinion for more transfers to Serbia, owing to the large-scale macro- and microeconomic irresponsibility and ownerlessness, criminality and corruption, more than 25% abeyant fertile lands, etc. Who would guarantee that EU transfers would be used properly in Serbia, if the authorities were helpless with regard to corruption and crime for ten years already!

After the normalization of the status of Serbia as EU member by, say 2023-2025 one may expect an augmentation of the overall net effects. The negative components would decline and the positive ones would increase, until the net volume would have reached zero and entered the positive area, improving further.

To summarize: over the next 10–15 years the overall net effects from the Serbian integration will be negative, or close to zero. Only the distant long-term net effects would be positive. This is not surprising! It may be normal for the development of a poor country towards economic maturity. Many other countries have done it. Serbia too must make it predominantly on its own. Nobody offers such gifts! If the overall pre- and post-accession investments were reduced by  $\frac{2}{3}$ , the directly related accession costs will be smaller, the net overall effects will remain negative for a bit shorter period, but the general trend would be the same. As seen from Figure 2 the net overall effects for the EU from the integration relations with Serbia and the other CEE countries are positive throughout the pre- and post-accession years. They may fall slightly after accession due to higher transfers, but would grow again later on, and in the distant future would equalize with the positive net effects of Serbia and of the other CEECs, while the two curves stay positive. The distant positive effects of Serbia may grow faster due to large investment, human, institutional and other efforts during preceding decades.

In the cost component of the overall net effects for the EU the budget transfers to Serbia and the other CEECs will prevail. The benefits component will comprise benefits from liberalization of goods and capital flows; surpluses in trade with CEECs, huge deliveries of hard and soft capital goods for modernization of the CEECs for decades; attraction of the most skillful brains from these countries for the coming decades. There is an

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important issue for clarification here. At first glance the attraction of the most skilled experts from Serbia and the other CEECs by the EU may seem harmful to the East and beneficial to the West. This is, however, only at first glimpse. If the talented young people stayed in Serbia, they would have contributed to her development, but the innovative potential of these talents would not have been displayed in its full strength. The CEE countries cannot provide the indispensable informational, technological, financial, institutional, experimental, and other prerequisites. A comprehensive full-scale development of their intellectual potential is possible only in the advanced countries. And they will, of course, extract large benefits. The burning issue is not the "brain drain" from the poor to the affluent countries. The real issue is the rational (and fair) sharing of the benefits between the sending and receiving countries.

One of the most important challenges before the EU and the CEE countries within the context of the long-term effects of integration is to identify a rational compromise between timing of accession, size of transfers, and scale of transitional arrangements. This is of crucial importance in order not to destabilize the Single Market and not to threaten the economic and social cohesion of the Union. In this sense the EU and the applicant countries face a complex dilemma: If the EU makes small transfers to the candidate countries, their preparation will be poor and accession postponed. If accession, nevertheless, takes place, it would be risky and should be supplemented by a number of transitional arrangements, which in turn will bewilder the normal functioning of the Single Market. The "price" of such disturbance may prove higher than "savings" from pre-accession transfers.

If the EU increased the transfers the applicants would prepare better, accession would take place in time, with less transitional arrangements and fewer risks. This may enable the new members to become equal (or nearly equal) participants in the Single Market from the outset. It may accelerate the integration process in Europe and shorten the time between exertion of efforts and obtaining of benefits by the CEECs. All that would contribute to smoother functioning of the Internal Market and boost the global confidence to the EU and its common currency. The second approach seems to be sounder. The larger pre-accession transfers to Serbia and the other applicant countries during the next ten years would produce earlier and larger net positive effects, greater stability and security for the expanded Union.

The enlargement must be fair and the people should be able to feel it. Temporary deviations in the sharing of the net effects among countries, regions and social groups are possible, but they should not last for a long

time. If people feel that year after year the benefits go to some of the countries while the others bear the costs, misgivings and tension may emerge. The past ten years have witnessed asymmetry in the sharing of positive and negative effects by the EU and the CEECs. Further tolerance, keeping silent and postponement of appropriate decisions benefit nobody. As already stated, Serbia and the other CEECs have no viable alternative to accession. It is, however, of fundamental importance not to allow shortsightedness to discredit this brilliant gigantic undertaking!

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## POZITIVNI I NEGATIVNI EFEKTI PRISTUPANJA EU – POUKE ZA SRBIJU

**Rezime:** Evropa je tokom poslednje decenije suočena sa spektakularnim promenama u ekonomiji, socijalnoj i političkoj sferi. Naročito će biti interesantne promene u deceniji koja sledi, i to za zemlje koje teže da uđu u EU. Proširenje EU zemljama istočne Evrope je bio strateški potez, koji je u mnogome odredio ekonomsku, političku i socijalnu budućnost ovih zemalja i njihovih naroda.

**Ključne reči:** EU, Strategija pristupanja, troškovi i koristi integracije