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The Energy Community of Southeast Europe: A neo-functional project of regional integration

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Abstract

This paper explains the emergence of the Energy Community of Southeast Europe with (1) the European Union's external energy policy, (2) the specific regional approach of the EU at the Western Balkans and (3) the neo-functional ideas of those European Commission officials that were crucially involved in the process. The guiding ideas of the Commission officials involved were directly drawn from a "popular version" of neo-functionalism: the idea that peace can be established with integration starting in a highly technical area and with creating the institutional capacity for a possible spill-over into other areas. Through this export of the EU's rules and institutions in the energy sector the Energy Community represents an innovative new mode of governance in Southeast Europe.

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1. Introduction [↑]

In Southeast Europe (SEE) the European Union recently initiated a process that ideologically dates back to the very foundation of the Union in the 1950s but which represents a radically new approach for the region. In October 2005 the European Community and nine states or territories in SEE – Croatia, Bosnia and Herzegovina, Serbia, Montenegro, the Former Yugoslav Republic of Macedonia, Albania, Romania, Bulgaria and the United Nations Mission (UNMIK) on behalf of Kosovo – signed a multilateral treaty to establish an Energy Community. This treaty was the first legally-binding treaty between these countries after the wars of the 1990s and was the result of the so-called Athens process that began in 2001. The signatory states committed themselves to establish the legal framework for an integrated and liberalized energy market in their countries and to adopt the relevant EU *acquis communautaire* on energy, environment, renewables and competition (European Commission 2005c).

The guiding idea for the development of the Energy Community was based on neo-functional thinking among those European Commission officials that initiated the Athens process. Neo-functionalism assumes a logic of integration that starts in a highly technical policy field and creates a dynamic that eventually spills over to other policy fields. A “popular version” of the neo-functionalist approach was prevalent within the responsible officials of Directorate-General for Energy and Transport (DG TREN). This ideational position coincided with the European Union’s external energy policy and its strategy for Southeast Europe and resulted in the transfer of EU rules and institutions. “The Energy Community Treaty is consciously modeled on the European Coal and Steel Community that was the genesis for the European Union”, the Commission argues (2005c).

This paper’s goals are threefold. First it introduces the EU’s strategy to export its liberalised regulatory regime in the energy sector to non-member states. The EU’s strategic goal is create a pan-European market based on common rules and institutions. Secondly, it traces the two-fold approach of the Union in Southeast Europe that includes both the option of EU-membership and the request for regional integration. Membership is the long-term goal; regional integration, however, serves as an intermediate step. Thirdly and finally it presents the Energy Community as a new mode of governance for SEE, from the Athens process to the signature of the Treaty. The emergence of the

Energy Community in its present form is the result of the EU's strategy to integrate non-member states into its energy regime and a consequence of neo-functional ideas within the European Commission.

The empirical data of this paper was drawn from 42 non-structured expert interviews that were conducted between April 2005 and September 2006 with members of the European Commission, the Energy Community Secretariat, EC delegations, interest groups, energy regulators, international financial institutions, national ministerial officials and members of the scientific community. (1)

2. External governance in energy policy – Exporting EU-rules and institutions [↑]

The current fuel mix of the EU is dominated by oil, gas and solids which represent about 80% of primary energy demand. Under baseline conditions of the European Commission's PRIMES-Scenario the EU's total energy consumption in 2020 rises between 5% and 9% depending on the oil price (European Commission 2008, 13). In the reference scenario of the International Energy Agency (IEA) the European demand for natural gas will rise from presently 540 billion cubic meters (bcm) to around 700 bcm in 2030. Oil demand will remain at a level of around 14 million barrels per day (mbd) (IEA 2008a). Fuel needed for the transport sector remains the main driver with a projected rise in consumption of between 17% and 21% by 2020.

Europe has always relied on external supply of energy sources to meet its demand. However, in the coming decades the dependency on external energy supply of the European Union is expected to increase up to 56% in 2020. While with current trends and policies the oil and gas share in primary energy consumption is expected to remain stable in 2020, under each scenario, the EU's indigenous energy production declines sharply. Domestic energy production, such as in the North Sea, has peaked and is expected to contribute less to Europe's energy supply in the years to come. As a consequence, the share of imports in the total final energy consumption of the EU is increasing: reliance on imports of gas is, according to European Commission estimates (2008), expected to increase from 57% to 77% by 2020, of oil from presently 82% to as much as 93% in 2020 and of solid fuel supplies from just under 40% today to between 57% and 59% in 2020.

While oil is traded globally, natural gas is – if we exclude liquified natural gas (LNG) – dependent on pipeline infrastructure. This explains the importance of the EU's neighbourhood for the transportation of natural gas (Mavrakakis et al. 2005). In a situation of increasing energy dependence the European Commission demands that “energy must become a central part of all external EU relations”. The goal of the Union's energy policy should be, according to the European Commission (2007), to “build up a wide network of countries around the EU, acting on the basis of shared rules or principles derived from the EU energy policy”. In other words, the export of its own regulatory rules in energy is an explicit external strategy of the European Union.

The EU as an actor in the global energy game advocates stable and transparent regulatory rules for the production and trade of energy (Hofer 2008). The Commission argues that the spread of liberalized regulatory rules in the energy sector would create a pan-European energy market where energy can be exchanged on the basis of demand and supply rather than on national interests and geopolitical considerations. That in turn would increase the security of energy supplies in the EU (Gault 2004, 177). In the two storylines along which the future of global energy relations may take shape, namely *Market and Institutions* and *Regions and Empires* (CIEP 2004), the European Union unerringly favours the former. This is not only due to the fact that EU member states are predominantly energy importers, it is also because of the limited competences of the Community institutions in the field of energy. Despite the fact that two of the founding treaties of the European Communities were concerned with energy, EU activity in energy policy is a relative novelty and essentially only started with the paradigmatic shift of energy regulation in Europe and the start of the

liberalisation process in the 1990s (Eising 2002; Schmidt 1998; Matl ary 1997). However, although the European Union does not yet speak with “one voice”, it has a common corpus of legislation for energy efficiency, renewables, competition and liberalisation.

The realisation of the internal energy market and the liberalisation of network-dependent forms of energy is a cornerstone of the EU’s energy policy and part of the *acquis communautaire* (Serrall s 2004; Ellis et al. 2000). Two crucial directives on common internal market rules laid the foundation for the reorganisation of the production, transmission, supply and distribution of electricity and natural gas in the European Union (2). Although far from being fully implemented, they establish the principles of a common European market in network-based energy. The “spirit of the directives” demands

1. the provision of non-discriminatory access to networks for all energy producers (*Third-Party Access*),
2. the transparent separation of infrastructure management from the provision of services (*unbundling*),
3. the effective management of infrastructure by independent transmission and distribution system operators (TSOs, DSOs),
4. the introduction of a regulator that is independent from the interests of the industry, and
5. the gradual opening of the market, allowing consumers to choose between energy suppliers (Pollitt 2008; de Jong 2004).

According to an early European Commission Green Paper on energy supply security, the liberalization of the energy sector and the development of a single market curbs the influence of energy exporting countries, “as liberalization and increasing trading encourage competition between exporting companies, particularly where natural gas is concerned” (European Commission 2000, 29). Under conditions of interdependence, the export of EU rules in the energy sector and the creation of functioning markets and institutions are considered as essential means in ensuring stability and prosperity within and beyond the EU’s borders. “The dependency is not a problem in itself,” the European Commission argues (2008, 23). “However, it requires an active energy security policy, building up internal strengths through a well-functioning internal energy [market] with good interconnections, diversity in the types of energy used, clear regulation for security of supply and mechanisms for cooperation to deal with crisis.”

The European Union is a rule exporter, not only in energy policy. The “extra-territorialisation” of European policies and the extension of internal rules beyond the EU’s borders as a mode of external governance of the Union has enjoyed increasing interest in academic debates in recent years (see e.g. Hofer 2007; Bicchi 2006; Lavenex/Wichmann 2006; Kohler-Koch/Rittberger 2006; Schimmelfennig/Sedelmeier 2004; Lavenex 2004; Olsen 2002). External governance is hereby defined as the ability of an actor to influence the rules that govern social entities beyond its borders. The European version, which is to say the spread of EU rules, political organisation and modes of governance beyond its territory and “a process of change in national institutional and policy practices that can be attributed to European integration”, is called “Europeanisation” (Hix/Goetz 2000, 27; Olsen 2002, 937) (3).

The European Union has a long tradition as a rule exporter. The EU’s very identity in the international system is characterised not least by the diffusion and “reproduction” of its own rules in its relations with third countries (Bretherton/Vogler 1999, 249). The EU uses its unique institutional characteristics to domesticate relations with non-Member States and to project internal solutions to its external relations (Lavenex 2004, 695). The European Commission’s motto is essentially “our size fits all” (Bicchi 2006), due to an inherent eurocentrism that is combined with a deeply engrained belief that the European model can be applied to solve policy problems elsewhere in the same manner as within the EU. During its four waves of enlargement, for example, the Union has expanded its regulatory framework to candidate countries and has undoubtedly contributed to the

democratic consolidation of new Member States (Pridham 1991). In the recent enlargement process in Central and Eastern Europe the EU successfully “europeanised” former centrally-planned economies and non-democratic political systems (Vachudova 2005; Schimmelfennig/Sedelmeier 2005).

In energy policy, the European Union makes a virtue out of necessity. It is a result of the institutional capacity that emerged in the five decades since the Treaties of Rome and Paris were signed. The Commission was not supposed to exercise the traditional capabilities of a nation-state; it had to develop its own instruments instead. Exporting its own rules and institutions is what it has been doing since it was founded. Moreover, the creation of a common European market based on liberal principles was the founding goal of the Economic Community. And while the competences of the Commission are strictly limited and the EU member states – despite their pledges and intentions – do not speak with one voice in their external energy relations, common regulatory rules for the energy sector *do* exist and provide guidelines for the international activities of the European Commission. Energy issues, for example, became an important aspect of the European Neighbourhood Policy. Energy policy is also the cornerstone of the EU’s relations with Russia (Goldthau 2008). Here again, the underlying idea has been to spread the EU’s legal norms and to export the liberal regulatory framework and its provisions on competition, environment and nuclear safety – albeit with limited success (Romanova 2005, 16). Finally, in Southeast Europe the European Commission supported the export of both the EU’s rules and institutions within a framework of regional integration. The export of rules and institutions became an important strategy in attempting to extend the European Union’s zone of governance to non-member states.

3. Regional integration in Southeast Europe [↑]

As a consequence of the conflicts of the 1990s, stability in the Balkans became the priority of EU policies. The EU’s intention was to demonstrate its ability to promote post-conflict stabilisation and rehabilitation. The Union is aware that “the credibility of [its] foreign policy depends on the consolidation of [their] achievements there” (ESS 2003, 9). In addition to the security aspect of the EU’s engagement in the region, energy has moved slowly but surely to the forefront of the Union’s interests. Southeast Europe is an important corridor for natural gas supply from the Caspian region and therefore the key to the diversification of the EU’s gas imports (Socor 2006; Mavrakis et al. 2005; Röhm-Malcotti 2005; Müller 2000). The EU member states are thus highly interested in having a stable and predictable political and regulatory environment in the region.

The European Union has, however, been in an external policy quandary towards the Western Balkans, oscillating between inclusion and exclusion. On the one hand, the EU understands that security, prosperity and stability in the Western Balkans depend to an important extent on offering these countries a European perspective. Additionally, according to Article 49 TEU, any European country can apply to become a member of the EU. Consequently, all countries have the status of potential or *de facto* “candidates” for eventual EU-membership. On the other hand, the EU is once again held back by an evident form of fatigue: this time it is the *fatigue de l’élargissement*. Several member states remain against the quick accession of more states, particularly the small yet rather unstable countries of the Western Balkans.

In order to ‘kill two birds with one stone’, that is to increase stability and predictability through maintaining a European perspective while postponing any eventual enlargement, the European Union pursues a strategy based on two pillars. First, it continues with the pre-accession strategy in a similar mode to that which it employed in the recent rounds of enlargement in Central and Eastern Europe. Here, however, the Union faces a fundamental commitment deficit: without a clear timeframe for a future EU-membership, the prospect of membership for the countries in the Western Balkans remains only an abstract possibility without palpable political implications. Secondly, and different from the recent enlargement process in Central and Eastern Europe, the EU not only offered EU-membership, but insisted on a regional rapprochement of the countries of the former Yugoslavia.

Resembling the history of European integration itself, the EU initiated an integration process with the goal of bringing former opponents back together.

As a result of the strategic interest in the region, the EU has introduced a pre-accession framework based on these two pillars. The regional approach was specified in Council conclusions in both April 1997 and in June 1999 in Cologne where the Stability Pact for South Eastern Europe was also adopted. The explicit prospect of EU-membership for the countries in SEE was then made at the European Council Summit in Feira in June 2000 and at the Southeast Europe Summit in Zagreb in November 2000. All countries in SEE became “potential members” of the EU. In June 2003 the European Council adopted the “Thessaloniki Agenda for the Western Balkans” and made regional cooperation an important condition for closer cooperation with the EU in the context of the Stabilization and Association Process (SAP).

The Stabilisation and Association Process is a bilateral affair between the EU and the applicant country. Macedonia was the first country to sign a Stabilisation and Association Agreement with the EU in April 2001, soon followed by Croatia in October 2001. Croatia subsequently proceeded more quickly, presenting its application for membership on 21 February 2003, starting accession negotiations in October 2005, and completing the screening process on 18 October 2006. The chapter on energy and transport was opened in April 2008. With the publication of the European Commission's annual progress report on Croatia's candidacy in November 2008 enlargement commissioner Olli Rehn indicated that Croatia could be a full member by 2011 at the latest – if not vetoed by Slovenia (which in December 2008 opposed the opening of nine out of ten negotiation chapters over a border dispute) or any other Member State. Macedonia, in turn, had to cope with the armed conflict between the Albanian minority and Macedonian majority in 2001. It took until March 2004 for Macedonia to apply officially for membership. In November 2005, the Commission (2005b) recommended to the Council the opening of accession negotiations. In December 2005, the European Council (2005) finally agreed to do so. However, it may take years before Macedonia will actually begin membership negotiations also due to the naming dispute with Greece.

The other countries – Albania, Serbia, Montenegro and Bosnia and Herzegovina – are even less advanced on their way to the EU. Albania signed the Stabilisation and Association Agreement with the EU on 12 June 2006. Serbia and Montenegro started the negotiations in April 2005 in a joint ‘twin-track’ approach (Council of the European Union 2004, 23) and continued separately after Montenegro’s independence. The talks with Serbia were deadlocked for a while due to insufficient cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). Only after the then UN chief prosecutor, Carla del Ponte, conceded that Serbia had improved its cooperation on the issue of delivering the demanded war crime suspects did the EU resume its Stabilisation and Association talks in June 2007. Despite enormous domestic controversies in the May 2008 parliamentary elections, in April 2008 the Serbian president Boris Tadic signed the agreement in Brussels and on 9 September 2008 the Serbian parliament ratified the agreement. Montenegro, in turn, started with separate negotiations in the wake of the country’s independence and successfully signed an agreement on 15 March 2007. With UN-administered Kosovo, the EU holds no formal contractual relations but has reinforced the European perspective after Kosovo declared its independence, appointed a special representative and launched the EULEX mission to assist the authorities in all areas related to the rule of law. The country lagging most behind is Bosnia and Herzegovina. It started negotiations in November 2005. Although the agreement was initialled after a police-reform was adopted, the conclusion and subsequent implementation of an agreement depends upon further progress on a number of priorities, most notably on full cooperation with the ICTY, police reform and broadcasting legislation (European Commission 2006).

In sum, all countries in the region have the prospect of becoming members of the European Union. However, as an intermediate step before full integration is administratively possible and politically desired, the Directorate-General for Transport and Energy (DG TREN) pushed forward a model of regional integration. It was in this context that the idea of an integrated regional energy market in

Southeast Europe was developed. We will see in the third part of this paper that this model is based on the narrative of European integration and neo-functional thinking.

4. Neo-functionalism and the emergence of the Energy Community[↑]

In a politically volatile situation at the end of the 1990s, even before the NATO-bombings on the former Yugoslavia and before the prospect of EU membership was given, a small number of Commission officials from DG TREN developed the idea of setting up a South East Europe Regional Energy Market (SEEREM) (Interview EU13, 12. April 2005, Brussels). With this initiative the Commission pursued a regional approach while preparing for an eventual accession process at a later stage. This was the beginning of what was later called the so-called Athens-process.

In their early efforts the Commission officials used the existing coordinating structures that were provided by the Stability Pact for South Eastern Europe (Interview EU13, 12. April 2005, Brussels) (4). Through a High-Level Steering Group of the Stability Pact, the European Commission and the World Bank started to coordinate the different donors that were active in the region. On Working Table II of the Stability Pact dealing with economic reconstruction, an Infrastructure Steering Group with the European Commission and Financial Institutions was launched to support the regional reconstruction and particularly to secure the sufficient energy supply to the region that was regarded as a prerequisite for economic recovery. Negotiations for a joint communication of all countries in Southeast Europe supporting a regional energy market began within the Athens process.

The guiding ideas for the Commission officials involved in designing the institutional set-up were explicitly taken from the early experiences of European integration and referred to the neo-functional model of regional integration. Just as between France and Germany after the Second World War, the idea was to bring together all those countries and territories that only some years previously had been at war with each other and begin a restructuring process. The Commission officials took this leading idea for European integration as a blue print for regional integration in Southeast Europe, started the initiative for an integration process in a technical sector, and provided for the institutional capacity for possible spill-over into other policy fields. As one Commission official involved argued: “We try to get everybody to agree on a common position and a common way forward. The aim is not necessarily to arrive at a station, but rather to get all on one train. Once we are on the train we can decide where we want to go” (Interview EU3, 12 April 2005, Brussels).

The European Commission, of course, is not a monolithic organisation. The identification with the ideas of neo-functionalism and the power of supranationalism vary between Commission officials. Lisbeth Hooghe (2002, 78), for example, shows that Commission officials are more or less evenly split on the question of dividing competences between the Community and the member states yet with a slight tendency towards the supranational pole. For some officials, however, the neo-functional idea and the so-called Monnet method as its practical application is still the guiding principle. As mentioned above, the regional initiative was started only by a small number of officials. They used the specific structure of the Commission that allows to start and push through new initiatives: “The Commission does not operate top-down or sideways or by policy. It operates by a few people being active and having a clear vision of what they want to do. (...) In technical policies like environment, energy, transport, one person with a good idea can push through change” (Interview EU3, 12 April 2005, Brussels).

Using the institutional freedoms within the Commission, the idea was to demand small concessions from the states in the region in one sector of the economy and create the institutional setting that would facilitate possible spill-over to other sectors. Hereby the Commission adapted the early experiences in the European integration process.

4.1. The emergence of the Coal and Steel Community [↑](#)

Since it is important for the main argument of this paper, just a few words are necessary on the early experience of European integration. On 9 May 1950 Jean Monnet, then head of the French *Commissariat du Plan* for the reconstruction of the French economy, and the French foreign minister, Robert Schuman, published a declaration calling for a new structure to control the resurgent heavy industries in France and Germany. The idea developed by Monnet and Schuman envisioned new institutions that should have a political life independent of the existing governments – at least for the range of powers which a capitalist state at that time exercised over its coal and steel industry. The Schuman Plan was not aloof of power politics, as observers at the time noted (Parker 1952). What they proposed, however, was not a conventional international organization, governed by committees of ministers. It was, as Jean Monnet noted in his *Mémoires*, after trying and failing to promote direct routes to eliminate the risk of war in Europe, the second-best indirect solution: the integration of two industrial sectors that would be necessary in the event of any future conflict (Schmitter 2005, 256-257).

The three Benelux countries together with Italy in addition to France and Germany – but with Great Britain remaining on the sidelines – negotiated for eleven months and concluded by signing the Treaty of Paris on 18 April 1951, thereby establishing the European Coal and Steel Community (ECSC) (Pinder 1998, 5-7). The founding states surrendered some of their traditional powers to the supranational institution. However, this surrender of the control over coal and steel production and trade was sharply circumscribed. The six countries, for example, gave up the right to impose tariffs and quotas on the imports and exports of coal and steel from and to each other, the right to grant subsidies, to set up a system of favouring consumers in their own countries over consumers in any of the other five countries, et cetera. Moreover, with the treaty the six countries granted the free movement of workers. They no longer retained the power to fix prices, to allocate coal and steel products, or to control production of coal and steel. Unlike with each other, however, the countries tried systematically to retain all their sovereign powers over their trade with outside countries in coal and steel (Vernon 1953, 190).

Although the strategic importance of European coal and steel in the 1950s turned out to be diminishing, the founding of the ECSC nevertheless was the first step towards Franco-German reconciliation. The novel feature of the ECSC was that control of a sector would no longer be exercised at the national level but by a so-called High Authority. The German mines and factories would pass from an Allied regulatory regime to the oversight of a new Authority. The High Authority, in turn, was granted the right to consult not only governments but also, according to the ECSC-Treaty, “the various interesting parties (enterprises, workers, consumers, and dealers)”. Moreover, some of the powers it was granted by the treaty recall the mechanisms of a *dirigiste* state: in case of a decline in demand or a serious shortage of coal or steel products, for example, the Community gained the right to impose a system of coal or steel allocations (Vernon 1953, 198).

However, it was not so much the economic impact of the ECSC that was important at that time, since tariffs did not exist in coal, were low in steel, and other trade arrangements such as the General Agreement on Tariffs and Trade (GATT) and the Organisation for European Economic Cooperation (OEEC) were already in place. It was rather the public relations impact of the opening of the two markets and the accomplishments and growing autonomy of the High Authority. Despite the rather dismal performance of the coal-steel pool, the success of the ECSC was the transfer of sovereign power to an international body and the triumph of the supranational principle. The Messina Conference in June 1955, in the reports of which the six governments jointly and unanimously proposed to start drafting a treaty to establish a common market and an atomic energy community (EURATOM) and, finally, the Treaty of Rome, are consequences of this integration in coal and steel (Gillingham 2003, 22-27; Bertrand 1956, 559). In theoretical terms, functionalism and the sectoral approach to integration grew out of this political development.

4.2. The theoretical reflection: neo-functionalism

Integration in functionalist terms is a depoliticised and continuous broadening of cooperation in technical policy fields. The central idea is that common problems may only be solved with transnational solutions. Integration may start at the least common denominator in any sector. Yet as a consequence of the successful cooperation or the technical necessity, the member states see the need to tackle common problems in other policy areas as well and thus expand their cooperation (Mitrany 1943, 33).

The pioneer of neo-functionalism, Ernst B. Haas (1958), developed his ideas in a critical encounter with the functionalism of David Mitrany (1943) synthesised with Jean Monnet's pragmatic strategy for running the ECSC. Haas transformed the technocratic vision of Mitrany into a political conception of how cooperation was possible on the basis of competing and colluding sub-national and non-state interests. He argued that integration by liberalising flows of trade, investments and persons across previously well-protected borders may have a stabilising potential in a region. Integration in neo-functional terms was defined as the instrumentally driven process that proceeds through the interaction of stakeholders whose perception, cognition, values and loyalties might change in the course of that interaction (Schmitter 2005, 256; Rosamond 2005, 247).

Without fully exposing all of neo-functionalism's distinct features, which are readily available in the introductory chapters of Haas's *Beyond the Nation-State* (Haas 1964), let us mention two ideas that are highly relevant for this case study. First, neo-functionalism concentrates on the role of the "secretariat" of a regional organization that provides political and administrative leadership and thus comes up with a supply side of integration. Through an increased level of interaction, social interests and loyalties that hitherto have been directed to national authorities shift to the supranational authority. In this interaction national political elites re-evaluate their set of preferences and change their "expectations and political activities" which consequently results in the development of a new political community (Haas 1958, 16): "Political actors are persuaded," as famously stated by Haas, "to shift their loyalties, expectations, and political activities toward a new and larger centre, whose institutions possess or demand jurisdiction over the pre-existing national states" (Haas 1961, 366-377). Technical and administrative elites are thus considered to play a crucial role in the integration process.

Secondly, neo-functionalism assumes more or less "unintended consequences" and that the actions of the new institutions create a process of "spill-over" from an initial institutional setting in a particular sector (presumably the least controversial ones) into other policy areas (Lindberg 1963, 11). Linkages among different sectors (trade, fiscal and monetary policy, for example) are assumed to serve as transmission belts of integration (Choi/Caporaso 2002, 485). From the perspective of neo-functionalism, integration is an ongoing step-by-step process of expanding cooperation from depoliticized technical sectors to more and more political and societal areas led by a supranational authority. Despite this crypto-automatism, member states remain important actors in the integration process. They set the terms of the initial agreement but they do not exclusively determine the direction and extent of subsequent changes (Schmitter 2003, 46). This evolutionary integration process is the core of the so-called Monnet-method: "*petits pas, grands effets*".

Since the beginning of theoretical reflections on the integration process, neo-functionalism has had many ups and downs. The early optimistic expectations that the integration process would spill-over from one issue area to another were rather quickly frustrated. Schmitter (2005, 262-263) argued that one of the reasons for this frustration was the paradox of the neo-functionalist approach. On the one hand, Schmitter argues, the non-controversial arenas had to be politically relevant in order to expect any further expansion. On the other hand, if the proponents of integration chose an issue area with a greater potential and the capacity to attract the efforts of a wider set of actors, governments of member states might choose to refuse to enter such arrangements in the first place or pull the plug before the process has advanced too far.

However, in spite of the approach's setbacks in the course of the integration process that later led Ernst Haas to disclaim some of the principles of neo-functionalism and even call the approach "obsolescent" (Haas 1975), (5) his idea has been buoyant in regional integration theories ever since and became (and remained) influential both in the scientific community and even within European institutions (Schmitter 2005; Rosamond 2005; Moravcsik 2005; Mattli 2005; Schmitter 2003). With the treaty reforms beginning with the Single European Act, virtually the entire scope of government functions previously performed at the national level became part of European policy-making (albeit to a varying degree). Spill-over took place. Yet whether this was due to those explanatory variables that were suggested by the neo-functionalist approach remains contested (Moravcsik 2005; Farrell/Héritier 2005; Grossman 2004; Pollack 2001; Bulmer 1983).

Although the role of the secretariat, the "unintended consequences," the conditions for spill-over as well as other possible explanations for the success or failure of regional integration are not entirely clear both in the neo-functionalist approach and in the empirical world (Mattli 2005, 343), neo-functionalism and the Monnet method are today, decades after Haas's *Uniting of Europe*, still highly relevant in Brussels. One official from the Directorate-General (DG) for Trade argues that "the neo-functional argument is the definition of the EU. You know, taking the Coal and Steel Community that did that well, you extend it to the internal market and so forth" (Interview EU7, 14 April 2005, Brussels). Among those officials that took the leading role in creating the Athens process, neo-functionalism was still the primary approach to explain regional integration. Elements of neo-functionalism became the recipe for drafting the institutional set-up of the Energy Community.

4.3. Creating the Energy Community of Southeast Europe

The "popular version" of the neo-functional approach is still relevant and was at the heart of the the Athens process and the emergence of the Energy Community of Southeast Europe. This popularised version included the foundational tenets that integration has to start from a technical and non-controversial policy arena and would later – initiated and accompanied by a secretariat that increases the frequency with which national representatives and experts meet – spill-over into other fields.

With neo-functional ideas and the history of European integration as a model of regional integration in mind, the European Commission started with an integration process in the field of energy. As was mentioned above, in 2001 the European Commission took over from the Stability Pact and became the leading actor in the Athens process. The Commission quickly gained a strong position in this process that resulted from two interrelated motivations. First, after the violent conflicts of the 1990s in the area of the former Yugoslavia and the NATO-bombings of Serbia in 1999, much of the energy infrastructure had been destroyed. In order to rebuild it, the countries were reliant upon external financial assistance; assistance which was, however, dependent on certain conditions. Regional reconciliation was one condition; accepting Commission initiatives was *nolens volens* another. Secondly, with the prospect of membership the EU provided a clear incentive to all states in the Western Balkans to reform their energy sectors and adopt the relevant parts of the *Acquis Communautaire*. The prospect of EU-membership was already the most important incentive for reforms in Central and Eastern Europe and secured the EU enormous leverage in domestic reforms (see, e.g. Vachudova 2005; Schimmelfennig/Sedelmeier 2005; Schimmelfennig/Sedelmeier 2004; Wallace 2000; Sedelmeier 2000; Grabbe/Hughes 1998). In Southeast Europe the Commission continued its most successful external strategy and complemented it with a regional dimension.

This specific political situation gave the Commission officials the leverage to push the Athens process and continue with the neo-functionalist project in Southeast Europe. The goal was, in a first step, to introduce the EU regulatory principles for the energy sector and establish consensus on these rules. Since all of the states wanted to become members of the EU, the crucial question was not so much the acceptance of the EU directives but the timeframe in which the implementation should take place.

The first results of this discussion process were two memoranda of understanding. The countries in the region committed themselves to create a regional energy market in electricity and natural gas on the basis of EU energy regulations (the so-called Athens Memoranda) (6). The participating parties pledged to adopt the EU energy and gas directives (2003/54/EC and 2003/55/EC) by July 2005. The memoranda demanded the liberalization of the electricity and gas sectors, the setting up of national regulatory authorities independent of the energy industry, the unbundling of the vertically integrated national electricity and gas companies, and the establishment of transmission and distribution system operators (TSO, DSO) for the national energy networks. Additionally, the participating countries are required to establish common rules for the transmission, distribution, supply and (for natural gas) storage of energy to facilitate cross-border cooperation and, essentially, energy trade. Shared grid codes and other technical and commercial codes, regulated third-party access to the networks and a reform of the tariff systems also had to be implemented (Röhm-Malcotti 2005, 36-37).

Following the Athens Memoranda the Commission pushed for an internationally-binding treaty that would finally lay the foundation for a regional energy community. It was in the negotiations for this treaty that the Commission “reproduced” the institutions that were created by the founding fathers of the European Communities and reproduced its own institutions outside its borders. The Treaty establishing the Energy Community was signed in Athens on 25 October 2005. It was the first legally-binding treaty between the countries of the Western Balkans since the wars of the 1990s. The signatory parties were the European Union together with Croatia, Bosnia and Herzegovina, Serbia, Montenegro, the Former Yugoslav Republic of Macedonia, Albania, Romania, Bulgaria and UNMIK (European Commission 2005c). Turkey participated in the Athens process but in the end did not sign the treaty (7).

The overall principle of the treaty, which entered into force on 1 July 2006, is to extend the EU's internal energy market to the South East Europe region. Therefore, the participating parties agreed to adopt the relevant *acquis* in electricity, natural gas, environment, competition, renewables and efficiency. The treaty defined the tasks of the Energy Community, namely to create a stable regulatory and market framework, create a single regulatory space for trade in network energy, enhance the security of supply and provide the regulatory environment for connections to Caspian, North African and Middle East gas reserves, improve the environmental standards, and develop market competition. Five institutional bodies were created to govern the Energy Community: a Ministerial Council, a Permanent High Level Group, a Regulatory Board, different fora and, last but not least, a Secretariat based in Vienna.

The organisational structures are to a large extent similar to those existing within the EU. The Ministerial Council is responsible for the general guidance in energy policy. It has the same decision-making role as the Council within the EU and is composed of one representative from each signatory party and two representatives from the European Commission. It can delegate some of its powers to the Permanent High Level Group, the Regulatory Body or the Secretariat. The Permanent High Level Group (PHLG) prepares the work of the Ministerial Council, takes measures according to the competences bestowed on it and establishes working groups to support its work. It consists of one representative of each Contracting Party and two representatives of the European Community. Similar to the central position of *Coreper* and other preparatory bodies in the institutional system of the EU (Lewis 2000; 2003), the High Level Group is a de-facto decision-making body. The idea was to create an institutional structure that has the potential to foster a supranational character through informal integration despite a formal intergovernmental design. Unlike *Coreper*, however, the members of the High Level Group are not situated in Vienna, the frequency of meetings is lower and thus the chances for “creeping competences,” i.e. the extension of discussions into areas that are not yet defined by the treaty as Community subjects, are lower (Lewis 2003, 1010).

The Regulatory Board is the equivalent of the European Regulators' Group for electricity and gas (EREG) within the EU, an advisory group of independent national regulatory authorities. The Regulatory board meets in Athens. It is composed of one representative of the energy regulator of

each Contracting Party, pursuant to the relevant parts of the *acquis* on energy. It is responsible for advising the Ministerial Council or the Permanent High Level Group on the details of statutory, technical and regulatory rules, for recommendations on cross-border disputes involving two or more regulators, and for measures empowered by the Ministerial Council. Similar to the position of the European Regulators' Group within the EU, which is also a coordinating body but first and foremost a lobbying group for the regulator's and the Commission's position vis-à-vis the member states and the industry, the Regulatory board should form a counterweight to governments and the energy industry.

The electricity and gas fora that were established by the Treaty are advisory bodies for the Energy Community. They are composed of representatives of all interested stakeholders, including industry, regulators, industry representative groups and consumers. They are similar to the Florence and Madrid fora within the EU (Vasconcelos 2001). These fora and regulatory networks – just like those within the Union – were founded to remove the deficits of too much decentralization, without simultaneously being dependent on formal centralization (Eberlein/Grande 2005, 100). Working groups can be formed for all different kinds of issues in order to speed up decision-making and have an expert forum without political factionalism.

Finally, a Secretariat was established in Vienna that provides support for all other bodies and is the main executive body. With an overall budget of around EUR 3 million per year it monitors the implementation of the obligations stemming from the treaty and executes all operational tasks received by the other bodies. In different task forces, workshops and donor conferences the Secretariat provides the necessary framework that should support the parties to implement the obligations from the treaty. The Secretariat took over from the Athens Process Secretariat that was effectively run and funded by the Commission (Interview EU9, 8 September 2006). If and how far the competences of the Secretariat will extend in the future is not yet clear. It requires a consensus among the parties of the Energy Community for the Secretariat's competences to be expanded and for qualified majority voting to be introduced in some areas. The Energy Community formally has no supranational competences and the interim Secretariat falls short of having the power of the European Commission in Southeast Europe. However, here too, the idea of the Commission officials involved in the process was to create a place for permanent and intensive communication and interaction that might eventually – similar to *Coreper* or other preparatory bodies of the EU – lead to informal supranationalism.

Despite the organizational problems connected with establishing the Energy Community, once the institutions were in place and the work of the Athens process began, one important goal of the Commission's strategy had been achieved: that of having a locus of communication about highly technical issues with the potential for creating an institutional dynamic and stabilizing the region.

However, the concrete results in implementing the treaty in electricity, natural gas, renewables, and security of supply are mixed. According to a report by the Energy Community Secretariat (2007), typical remaining problems involve persistent cross-subsidies and a politically motivated low level of energy tariffs, missing metering and billing of customers and hence a high rate of non-payment, a lack of both domestic generation and cross-border transmission infrastructure, and generally a low level of investment in production, transmission and distribution. Moreover, while reliable and detailed data are critical for informed policy decision making, recent reports highlight that energy data statistics as well as socio-economic statistics in the Western Balkans are weak and fragmented (Renner et al. 2008; IEA 2008b). As a consequence, it is not likely that all treaty obligations will be duly implemented. All parties, however, implemented the institutional structures foreseen by the Treaty.

A crucial issue associated with the liberalization of the energy sector in Southeast Europe is fuel poverty. With vertically integrated and state-owned energy providers, energy tariffs were set according to political, economic and also social considerations. Energy tariffs were used as an

instrument for social policy. In a liberalised energy system, however, energy tariffs should be raised at a cost-reflective level and subsidies should be removed. Yet increasing energy tariffs hurt the poor. In order to tackle the social challenges, the parties to the Energy community agreed on a Memorandum of Understanding on Social Issues. The parties recognized the need to address the social impact of the Energy Community provisions in order to reinforce the acceptance of the reform process. The parties intend, therefore, to involve the social partners, provide financial assistance to support training and mobility for particularly low-skilled workers and to develop social plans in each participating country. The European Commission promised financial assistance for social measures within the framework of Pre-Accession Funds and Structural Funds of the Union. The Memorandum of Understanding on social issues was signed in Vienna on 18 October 2007 and is a reminder of Jean Monnet's social dimension in his plans for a Coal and Steel Community in the 1950s.

Although the Memorandum has no legally binding status, it is the recognition that the Energy Community Treaty needs flanking measures and is emblematic of the potential for a spill-over to other policy fields. It thus reflects the initial intention and the theoretical background of the Commission officials involved: "It is clearly written in terms of neo-functional policy that energy will have an effect on transport, energy will have an effect on environment, will have an effect on social policy and then, as you start to regulate the energy sector you also need flanking measures in social issues" (Interview EU3, 12 April 2005, Brussels). The Commission officials reproduced their own ideas, rules and institutions in Southeast Europe.

5. Conclusion [↑]

The Energy Community is the adaptation of the European Union in Southeast Europe. The Athens process and the signing and ratification of the Energy Community Treaty is a prototype of how the European Union exports its own rules and regulation. External governance is the process of applying domestic solutions to political problems beyond the border. The Union's intention is to create a zone of extended governance around its own borders and thus export its *acquis communautaire* to non-member states. In Southeast Europe this intention has resulted in common institutions and the commitment of all parties to implement the *acquis* on energy, environment, renewables and competition.

Why did the parties of the Treaty agree to implement the energy *acquis* and contribute to the working of common institutions? The prospect for full EU-membership explains why all parties agreed to adopt the *acquis*. All non-member states in Southeast Europe are potential candidates. If they are serious in their demand for integration they will have to implement the *acquis* during the accession negotiations anyway. Moreover, accepting and taking part in the Athens process became part of EU's condition for further approximation within the Stabilisation and Association Process. The European Union's external energy strategy involves the export of EU rules and the intention to create a ring of countries outside the EU with stable regulatory rules in order to create a favourable climate for investments in energy production and transfer and thus secure the security of energy supply. With the Energy Community the EU rules were extended to the Western Balkans even before the countries are EU members.

The regional strategy that the Union envisaged for the Western Balkan explains the regional approach of the Energy Community. Even though all countries are "potential members" of the EU, the Council conclusions in April 1997 and June 1999 as well as the "Thessaloniki Agenda for the Western Balkan" made regional integration an important condition for closer cooperation with the EU. Hence the difference compared to the recent accession process that was largely a bilateral affair between the EU and the accession state.

Why did the Energy Community in its present form evolve? As it has been argued in this paper, neo-functional ideas within the European Commission and the narratives of the successful European integration process that started with the Coal and Steel Community in the 1950s explain the specific

institutional structure of the Energy Community. In its popularised and practically applied version, the neo-functionalist idea concentrates on the creation of a secretariat as a locus for communication and interaction as well as on the selection of technical fields of integration and the expectation to have a spill-over to more political sectors. The argument is neither that Commission officials are students of European integration theories, nor that all explanatory variables that have been mentioned in the five decades of neo-functionalism have been empirically verified. The point is rather that the foundational tenets of neo-functionalism and the myth of European integration have become guiding principles for the EU's external action.

Despite the ideational foundation in neo-functionalism and the argument by the European Commission (2005c) that the Energy Community Treaty was consciously modelled on the European Steel and Coal Community, there are some fundamental institutional differences between the Energy Community and the EU. The first difference is the thus far limited power of the Energy Community – so far it is largely concerned with monitoring and supporting the participating parties in implementing the relevant *acquis communautaire* on energy, environment and competition. Although one Commission official metaphorically argued that the institutions of the Energy Community constitute merely a train and the direction has to be given by the parties (Interview EU3, 12 April 2005, Brussels), so far the room for manoeuvre beyond implementing the relevant EU directives is limited. At the same time, the Secretariat has not yet assumed its full tasks and is so far not designed as a supranational institution. It is too early to evaluate if the different fora, the High Level Group and, of course, the Secretariat can develop a form of “informal supranationalism” (Lewis 2003, 1014). What was noted by Raymond Vernon (1953, 183) in an early evaluation of the European Coal and Steel Community is equally true for the Treaty establishing the Energy Community: A great deal depends on the interpretations which the organs created by the treaty place upon their powers and whether the founding parties decide eventually to use their influence and their national sovereignty to suppress it.

Secondly, unlike the European Communities, the Energy Community Treaty has not established a court that is able to create an integrative dynamic similar to the “quiet revolution” of the early phase of the European Court of Justice (Weiler 1994). Article 94 of the Treaty establishing the Energy Community states that interpretations of any terms should be derived by the case law of the Court of Justice or the Court of First Instance of the EU. Where no interpretation is available, the Ministerial Council or, if the Ministerial Councils decides to delegate this competence, the Permanent High Level Group shall give guidance in interpreting the terms of the Treaty. Nothing, however, obstructs the partner states of the Energy Community from unanimously establishing a court at a later stage and thus creating another integrative engine.

The third fundamental difference to the process of European integration is the location of where the founding ideas were formed. Whereas the idea of a Coal and Steel Community was developed in France, i.e. within one of the six founders of the European Communities, the idea to create an Energy Community in Southeast Europe has its origin in an initiative by individual officials of the European Commission. The institutional structures for the Energy Community were “consciously modelled” on those of the EU. Moreover, the countries of Southeast Europe did not create their own rules for the regulation of their energy sectors within these institutions but committed themselves to adopt the relevant EU legislation. The discussion process in the different task forces of the Energy Community is unidirectional with EU officials and experts providing information and officials from the region try to implement the rules and directives in their countries. The EU “reproduced itself” in Southeast Europe and projected internal solutions to its external relations. In the Energy Community the European Union was active as a rule exporter and europeanized the countries by copying internal structures to Southeast Europe.

How successful the Energy Community will be in stabilizing the Western Balkan remains to be seen. The progress so far in implementing the Energy Community Treaty indicates that the fundamental problems of energy supply remain unresolved and that achieving a fully-functioning energy market

remains a long way off. Additionally, and particularly with respect to the volatile domestic situation in Serbia after Kosovo declared its independence, stability in the Western Balkans cannot be taken for granted. Nevertheless, the Athens process has had a causal impact on the energy policies of the participating parties. All countries – at least formally – implemented the institutions foreseen by the treaty and reformed their energy laws. Additionally, with the Memorandum on Social Issues as a first sign, the Treaty has the potential to ‘spill-over’ to other sectors and create the need for flanking measures. Hence, although Phillippe Schmitter (2003, 45) laments that ‘no theory of regional integration has been as misunderstood, caricatured, pilloried, proven wrong and rejected as often as neo-functionalism,’ the Energy Community in Southeast Europe is living proof of the practical relevance of this line of thinking in the external governance of the Union.

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Endnotes

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(2) Directive 96/92/EC of 19 December 1996 concerning common rules for the internal market in electricity and Directive 98/30/EC of 22 June 1998 concerning common rules for the internal market in natural gas. The second generation of the electricity and gas directives (2003/54/EC and 2003/55/EC) were adopted on 26 June 2003. On 19 September 2007 the Commission adopted a „Third Legislative Package“ with proposals for Directives on common rules for the internal market in electricity and natural gas (COM 2007/0528 and COM 2007/0529), on cross-border exchange of electricity (COM 2007/0531), on access conditions to the gas transmission networks (COM 2007/0532) and a proposal for a Regulation establishing an Agency for the Cooperation of Energy Regulators (COM 2007/0530).

(3) There is an enormous amount of literature on the phenomenon of Europeanisation. Most of them are concerned with the effect of EU institutions on the political systems of its Member States and the challenges to national political systems to adapt to the European normative and strategic environment (Featherstone/Radaelli 2003; Cowles Green et al. 2001; Knill/Lenschow 2001; Tonra 2001; Börzel/Risse 2000; Mény 1996), as an equivalent of European integration, i.e. the emergence and development of distinct structures of governance at the European level (Cowles Green et al. 2001, 3), or as voluntary transfer of policy instruments and institutions among Member States. Johan Olsen argues that this inward-looking understanding is a twentieth-century phenomenon whereas ‘[h]istorically, Europeanization has been understood as the spread of forms of life and production, habits of drinking and eating, religion, language, and political principles, institutions and identities typical of Europe and unknown to the rest of the world beyond European territory’ (Olsen 2002, 937). Only after the most recent enlargement process has finished, the interest on Europeanization beyond the borders of the EU has been growing (Schimmelfennig 2007; Lavenex 2004; Papadimitriou 2003; Grabbe 2002; Engert et al. 2001).

(4) The partners of the Stability Pact are the countries of the region (Albania, Bosnia-Herzegovina, Bulgaria, Croatia, FYR of Macedonia, Moldova, Romania and Serbia and Montenegro), the EU Member States and the European Commission, Canada, Japan, Norway, Russia, Switzerland, Turkey, USA, International organisations (UN, OSCE, Council of Europe, UNHCR, NATO, OECD), International financial institutions (World Bank, International Monetary Fund, European Bank for Reconstruction and Development, European Investment Bank, Council of Europe Development Bank), and regional initiatives. The Istanbul Conclusions of the Stability Pact in 2001 delegated the coordination of energy issues to the Commission.

(5) Whereas neo-functionalism originally suggested a quasi-automatic and ultimately inevitable

process towards further integration – without having a specific goal or endpoint of the integration process – scholars such as Philippe Schmitter retreated from functional automaticity and pointed to interest-driven actors. Nye (1970) criticised that spill-over was merely a specific European phenomenon and could not be generalised to other regions. Spill-over was only one among a number of possible integration strategies such as *spill-around*, *buildup*, *retrench*, *muddle-about*, *spill-back* and *encapsulate* (see Schmitter 1971, 242). The complexity of such a model increased, however, and led to a “chaotic” theory of emergent properties, unintended consequences, strategies adopted under uncertainty, and successive decision-cycles (Schmitter 2003).

(6) Memorandum of Understanding on the Regional Electricity Market in South East Europe and its Integration into the European Union Internal Electricity Market („The Athens Memorandum 2002”), 15 November 2002, Athens; Memorandum of Understanding on the Regional Energy Market in South East Europe and its Integration into the European Community Internal Energy Market („The Athens Memorandum 2003“), 8 December 2003, Athens.

(7) The Commission officials gave different explanations for the Turkish refusal to sign the Treaty. The most plausible explanation is that Turkey, due to its geo-strategic importance in transporting energy to Europe that was mentioned above, would be better off to discuss energy policy within the accession negotiations where it can use it as a bargaining chip. Turkey wants full membership, not regional integration (Interview EU13, 9 March 2006, Brussels).