

Crucial decisions in the Eurogroup

The case of collateral agreement and two-level games

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Abstract

This paper is a qualitative study of interactions between domestic and EU-level politics. I'll apply the model of Two-Level Games by Robert D. Putnam on the 2011 Euro-crisis scenario where Finland hindered the negotiations of the new bailout package because they wanted to get collateral as a condition for future loans for the problem countries like Greece. First, a brief overview of the scenario is presented. Then, using the theoretical concepts of the Two-Level Games, Win-Sets for both Finland and the Eurogroup are presented. The domestic power balance, political institutions and preferences of the Chief Negotiators determine the Win-Sets. When a better picture of the Win-Sets is constructed, I'll apply the model of Two-Level Games on this specific scenario. The study shows that the collateral demand negotiations had very distinct Two-Level dynamics and the decisions were made using a rational logic since the information flow and planning was very efficient in the final phase of the negotiations.

Key words: Two-Level Games, domestic policies, political bargaining, Eurogroup, Finland

Words: 9968

Abbreviations and concepts

Collateral = something pledged as security for repayment of a loan, to be forfeited in the event of a default.

EFSF = The European Financial Stability Facility

ESM = European Stability Mechanism

Eurogroup = Meeting of the Finance Ministers of the Eurozone chaired by the President of the Eurogroup Jean-Claude Juncker

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1 Introduction

In this chapter I'll first give a brief overview of the case and after that I will go more into detail and explain the central problem of my research paper. Finally, I will present the structure of my research in disposition chapter.

1.1 Background

Year 2011 has been a year of economical turmoil worldwide. Some of the biggest economies such as the USA and Europe experienced great problems while trying to keep their economical stability on course. Uncertainty of the future has disturbed global financial markets, which in turn has raised the price of government bonds in many countries. For those countries that already had remarkable budget deficits, structural problems and huge public debts, the financial crisis hit them hard. This was the case especially in EU and among the Eurozone countries. The common European currency faced a variety of problems during the crisis mainly from defect member states such as Greece, Ireland and Italy. These national economic shortcomings evoked questions about solidarity, economic integration, economic regulations, economic responsibility and most importantly the credibility of the common currency among its member states, financial markets and the rest of the world. Short-term and long-term solutions needed to be found in order to save the Euro. Such solutions saw the daylight after 2010 when the Eurozone member states created The European Financial Stability Facility (EFSF) and other collective bail-out programs to provide low interest rate loans for troublesome member states i.e. Greece that otherwise couldn't get low interest rate credit from the capital markets, and thus was in danger of falling into insolvency (EFSF 2011).

Regardless of some success in the field of European co-operation and common policies, the road towards these rescue packages and other solutions has been far from being a nice Sunday ride on an autobahn. Instead, the road trip towards common policies and agreements suffered from various traffic jams and collisions. To name one interesting scenario was the Finnish collateral demand where Finland demanded collateral as a strict condition for forthcoming EFSF, ESM and Eurogroup bailout packages for problem countries in June 2011 (Council of the European Union 2011).

This collateral demand was especially crucial in the negotiations after June 2011 when the Eurogroup members, IMF and private investors were negotiating a new 109 billion € rescue program for Greece (ibid.). It was very important for all stakeholders that each Euro member state was supporting the program. This

was also Finland's interest but not without collateral. After the announcement about Finland's collateral plans with Greece, other Euro members got interested about demanding collateral as well, such as Austria and the Netherlands. In the worst case, this could have endangered the whole financial rescue plan if the amount of accumulated collateral grew too high. After several negotiations and meetings, the Eurogroup finally accomplished with a solution which satisfied equally all member states and gave the opportunity for everyone to demand collateral if wanted. The outcome was that Finland was the only country to use this opportunity even when everyone else was given the same right with the same conditions.

1.2 Problem formulation

The scenario in question is interesting from various different perspectives of political studies such International Relations and Foreign Policy Decision-Making (FPDM). Rather than focusing on a system level, like IR, I decided to take a more detailed look at the decision-making process that occurred between Finland and the Eurogroup. Central question in my study is: *How can we understand decision-making procedures in the Eurogroup?* In order to seek answer for this question, I've decided to focus on the case of Finland's collateral demands and analyze how domestic politics might influence Euro-level decision-making, and vice-versa, directly and indirectly.

This central question is followed by several other questions such as: *How domestic constituencies and decision-makers influence Euro-level decisions and how much power do they have? Does Euro-level decisions affect the domestic decision-making in member states?* Since Eurogroup decisions are done among the Finance Ministers of the member states, which in turn have their mandate from the domestic parliament, this dynamic integration between domestic vs. international level decision-making makes this scenario about collateral very interesting. To understand the factors behind the Finnish demands another question is also relevant: *What was the reason for Finland to demand collateral and how did that decision come up?*

Seeking an answer to all of these different questions my ambition is therefore to analyze this scenario about collateral with theoretical tools and Two-Level Game model hoping that this study could offer clearer and more structured picture of this, somewhat complicated scenario. In a more general context I also believe that this scenario is a great opportunity to validate the Two-level Game theory as well as it might help us to understand how international and domestic politics overlap in general.

1.3 Disposition

In chapter 2, I will explain the method of my research paper in more detail and explain how I'm going to use my theoretical toolbox to understand this case. Chapter 3 explains the theory I'm going to use, and those theoretical concepts and indicators, which are going to be in a central role when applying the theoretical model. Chapter 4 is the central area of my study where I'll apply the theory and the theoretical concepts on this specific case allowing the theory to sum up possible regularities from the scenario. It is divided into four parts where the first part gives an objective overview of the whole decision process. The second part takes focus on the Finnish domestic politics explaining how the political power is distributed in the state and which political institutions are important in EU matters. The third part brings this "plate" of information closer to the theory where it is used to determine different domestic and international Win-Sets. When these Win-Sets are determined, it becomes possible to apply the model of Two-Level Games to understand the decision-making scenario as a whole, which will be discussed in the fourth part. The final 5th chapter sums up the whole study and gives some incentive for further studies.

2 Method

2.1 Hypothetic-deductive method

Before going any further, some important issues need to be motivated: the scientific basis of my research, and the way I use empirical material and analyze empirical material. The study is going to be a qualitative case study about Eurogroup decision-making procedures focusing on the case of collateral demand from Finland. Since my ambition is to gain understanding about this specific scenario it means a great significance is put on they way I interpret empirical material in relation to the theoretical framework. In general, the main framework of the study, or the methodological basis is hypothetic-deductive “method”, which in fact can be understood as the fundamental logic behind all social scientific inference (Teorell & Svensson 2007: 99). In my study the hypothetic-deductive method can be illustrated as following:

- (1) Recognizing empirical outcomes from the case
- (2) Formulation of a hypothesis
- (3) Applying the hypothesis with the empirical material
- (4) Conclusion whether the hypothesis is valid or not
(Ibid.)

Hypothetic-deductive method can be understood as the background logic of my study. In this context the hypothesis - let us call it a theory - is playing a crucial role when answering the central question of the study. Since I’ve decided to use Two-Level Games, I’m expecting this theory to match with the empirical material delivering coherent explanations.

2.2 Previous research

The evolvement of the EU has created many parallel and competing theories of how the decision-making works inside the EU. A mixture of intergovernmental collaboration and complex supranational institutions has also expanded the amount of decision-making procedures within the EU. EU politics can no longer be portrayed as a part of nations FPDM but rather an extension of their domestic politics. Therefore it is maybe more suitable to talk about nation’s EU integration policies or just EU policy decision-making (Raunio&Wiberg 2001).

There have been numerous studies about EU integration and how decisions are made on the EU level. A majority of the theories attempted to argue how integration can be understood or how the power is distributed in the Union. Like in IR, the most popular theories have been based on state-centric or institutional theories. Later on, (social)-constructivism has also taken its part among scholars trying to understand power relations in the EU (Gowland *et al.* 2006). When the majority of the studies focused on the system level, few studies have actually strived to explain the connection between domestic and EU-level decision-making procedures in detail. Majority of the explanations see member states and other EU institutions as unitary actors and quite often forget to take a look at the domestic sphere behind facet of the member states.

In this field, FPDM theories could offer a vast catalogue of different models and perspectives helping to understand EU-level decision-making. Nevertheless, the problem is that FPDM studies, in quite many ways, are relatively USA centric and the majority of the theories can only be applied on certain governmental backgrounds where a nation has a strong leader with a rather great amount of individual power. Such models and theories do not work if one wants to study parliamentary political systems like Finland or union-level co-operation where no individual leader has power to override domestic parliament's preferences when foreign policy decisions are being made. Traditional FPDM theories appear to be defect also when countries with a diverse political party system are being studied. One major defection in many FPDM theories is also their focus on one level analysis leaving some essential factors in the background or completely unanalyzed (Moravcsik 1993, p. 5-8)

2.3 Material

In addition to traditional theoretical literature, the main weight of the story telling lies on news articles, interviews and TV-broadcasts. The case is relatively new and at the time of writing no other research has been done of the same case. Therefore, a great confidence is put on media and other interviews. To get as reliable information as possible, I've tried to use as many information channels as possible and compare the content of different news agencies. Thus, I've have not relied on a single news source in any of the cases and always used several other sources helping to verify the content of the information provided.

Another challenge has been the confidential nature of the negotiations which have been in central role in my study. Since almost every EU-level negotiation or summit took place behind closed doors, it's almost impossible to say what really happened in the negotiations. The only source of information has been the interviews of the statesmen after the negotiations. In general though, this has not been a significant problem since the most important factors in this analysis have

been the negotiation outcomes, which with the help of the Two-Level Games model, are used to reconstruct the reality.

3 Theory

Because my research has its main ambition on understanding Eurogroup negotiations focusing on the case of collateral demands during the Euro crisis, I've decided to analyze this complicated scenario using the framework of Two-Level Games by Robert D. Putnam. Two-Level Games follows the same logic as Rational Actor Theories meaning that states or single decision-makers always make their decision rationally meaning that they tend to compare and measure different decision alternatives before choosing the most attractive one, which in their minds, offers most satisfaction (Mintz&DeRouen 2010, p. 57).

Using such theories makes already a presumption of my ontological stand point and how I perceive the international system and which actors I find most important in this scenario. In the case of EU and the Eurogroup, the most central actors are the representatives of domestic constituencies i.e. Chief Negotiators (CH) and chief officials representing the Eurogroup. Two-Level Games principally does not limit or make statement of the international power balance like institutionalists and realists, thus giving space for international and domestic interest groups to influence international negotiations. In this case however, the actors where the statesmen of the Eurozone and the Eurogroup officials.

The main purpose of the Two-Level Games theory is to explain how domestic politics interact and determine international relations and vice versa. It helps understanding the linkage and integration between domestic and international sphere (Putnam 1993, p. 436).

The "rules" of the game are not strictly bounded which means the model is very open to alterations such as adding more levels if needed. For instance, a decision scenario where Greece and Finland made a bilateral agreement, had to be ratified by the Eurogroup and their domestic constituencies. In Two-Level Games, the main decision-makers who participate in the process of integrating domestic policies with the international sphere are seen as mediators, although in practice, they are rather not neutral in their intentions as it's explained later on (ibid, p. 450-451).

3.1 Two-Level Games

As mentioned before, explanations about the international political reality are quite often leaving the importance of the domestic politics secondary or taking them as granted (Moravcsik 1993, p. 9). Even a majority of Rational Actor theories, when studying FPDM, haven't successfully connected domestic preferences with international negotiations. Although some efforts have been made, they still remain as ad hoc explanations and their spectrum is quite narrow. For instance, Bureaucratic Politics was an effort to understand how domestic bureaucracies compete with each other in order to affect nation's FPDM decisions (Mintz&DeRouen 2010, p. 70). The theory is very likely to be valid when the object of study is a presidential power where party or interest group politics play a secondary role like in the USA but when the object of study is a parliamentary power where political parties are in the core of political allocation, Bureaucratic Politics lacks explanatory power completely.

Robert D. Putnam's metaphor of Two-Level Games is presumably the most successful effort in understanding international negotiations, bargaining, double edged diplomacy and the linkage between domestic and international politics. Domestic and international politics are often understood as separate levels and the understanding how these two levels interact is somewhat unclear from the systemic perspective. Thus, Putnam has created a theoretical framework which links these two Levels successfully whether it was a case of coercive or co-operational negotiations.

A basic framework in Two-Level Games includes two separate levels; domestic (Level II) and international (Level I). Domestic level is where political parties, interest groups and public movements shape the outcomes of the domestic polity. This is also called the domestic constituency. Distribution of power, political coalitions, preferences and institutions are important in determining national preferences. International level, on the other hand, is where domestic leaders, i.e. negotiators try to match demands and preferences of the domestic sphere the best way they can with the other constituents on the international negotiations table. In theory a preliminary agreement, accomplished on the Level I, always needs to be ratified by the domestic constituency, formally or informally. The ratification on the Level II is always in a form of "yes" or "no" (Putnam 1993, p. 439).

It is not a concrete hypothesis making restrictive explanations about political behavior but rather a theoretical framework consisting of three theoretical building blocks that can be customized in order to fit the characteristics of the

case. These building blocks are: specifications of domestic politics, international negotiations environment, and chief negotiators preferences (Moravcsik 1993, p. 23). It is therefore the responsibility of the author to use and apply these fundamentals in order to create a more specific hypothesis.

The logic of the Two-Level Games can be understood best from the perspective of the Chief Negotiator (CN). The negotiator is usually a statesman who has an official mandate to represent national polity in international negotiations. This can be e.g. the president, minister of finance or some other important political leader. The negotiator is seen as a “Janus-faced” actor trying to balance between international and domestic challenges in which he or she faces “distinctive strategic opportunities and strategic dilemmas” (Moravcsik 1993, p. 15; Putnam 1993 p. 459).



Figure 1. The negotiator has to balance between domestic and international demands

3.1.1 Win-Sets

One of the core components of Two-Level Game model is Win-Sets. Domestic Win-Set means, according to Putnam (1999 p. 439), “[...] the set of all possible Level I agreements that would [...] gain the necessary majority among the [domestic] constituents – when simply voted up or down”. This means that all opponents on the international level have their own domestic Win-Sets, and if an agreement is accomplished and ratified on Level II, then the Win-Sets *overlap*. The size of the Win-Set depends on the preferences of domestic and international decision-making arenas and, most importantly, on the interactive relationship between these two levels (Moravcsik 1993, p. 26).

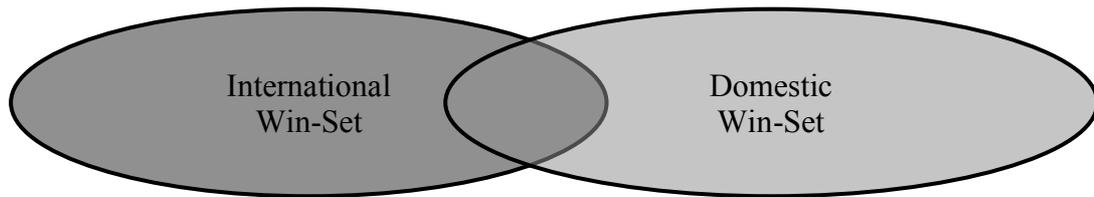


Figure 2. Overlapping Win-Sets indicate those Level I agreements that can be ratified on Level II

Domestic constituency cannot ratify agreements outside the overlapping area. Therefore, in order to determine the size of the Win-Sets, it is important to know characteristics and the environment of these two levels. In order to do that, I'm going to use a characterization schema. By identifying and analyzing the decision environment in both domestic and international arenas as well as the strategies of the negotiators, I believe the study could offer a comprehensive illustration about the foreign policy decision-making process in Finland and in the Eurogroup. Furthermore the results could be used in a comparative study among other countries or cases.

Determinants of the Win-Set. As mentioned earlier, Two-Level game has three central building blocks. To understand how Win-Sets are composed, it is therefore important to take a look at the power distribution, preferences and institutions of the domestic constituency. Studying the following determinants, it can be possible to compose nations' Win-Set.

- Heterogeneity/homogeneity of the constituency
- Ratification procedures
- Side payments
- The role of the political institutions

3.1.2 Negotiator's strategies

After domestic Win-Sets are determined it is possible to see how the negotiators act on Level I. Depending on the strategy and the interactive nature of the game, it is still possible that domestic Win-Sets change during the negotiations. Therefore no Win-Set can be understood as static. Level I decision environment is also important for the outcome.

4 Analysis

4.1 Overview

Before going into detail, it is essential that a comprehensive overview of the Collateral Demand (CD) scenario is done. Since the ambition of this study is to understand the interactive Two-Level nature of the Euro decision, the overview will only cover the areas of Finnish politics and some of the most important negotiations, thus leaving outside possible resolutions taken place in the domestic discourse of the other Euro members. Therefore the overview is not about the agreement between 17 countries but an agreement between the Eurogroup and Finland thus presenting the Eurogroup as a uniform actor.

4.1.1 Finland's Parliamentary Elections 2011

The idea about CD is not new in Finland's EU-politics. Such CD proposals were prevalent already in the previous government in case of Ireland and Portugal, albeit the nature of the demand was not as persistent as it was one year after in 2011. In the Eurogroup meeting in November 2010, Finland's proposition about collateral was considered and investigated by the Eurogroup but finally rejected because it was most likely to slow down the whole process of solving the sovereign debt crisis and thus bringing instability to the markets (Isotalus 2010).

After the Finnish parliamentary elections in 2011 there was a different tune in the Finnish EU-politics. The current Prime Minister Jyrki Katainen had a difficult task in keeping his fragile coalition government in one piece and balancing between pro-euro and anti-euro camps. Followed by the election's result, the former pro-EU center-right party National Coalition, whose leader Katainen was, had to make drastic compromises with the other government parties in order to find a common direction for the Finnish polity. The second biggest party in the government, The Social Democrats, successfully added CD and investor responsibilities to the new Program of the Government (PG), which was soon to become the common stance of Finland (Skinnari 2011).

The government was finally formed among The National Coalition Party (NCP), The Finnish Social Democratic Party (SDP), The Greens of Finland (GF), The Swedish People's Party (SPP), The Finnish Christian Democrats (FCD) and The Left Alliance (LA). On the 22nd of June the parliament accepted the PG which included conditions about the CD, which meant that Finland's stance was now unconditional (VNT 2/2011 vp).

4.1.2 Eurogroup Summit the 21st of July

The next momentous step in this scenario was the Eurogroup Summit on the 21st of July in Brussels. The main purpose of the Summit was to agree on new stabilization policies in the Euro area, linking the loans of Greece to the EFSF and establish a second rescue program for Greece. In the Summit, Prime Minister Jyrki Katainen was able to add the CD to the final statement.

”Where appropriate, a collateral arrangement will be put in place so as to cover the risk arising to euro area Member States from their guarantees to the EFSF.” (Council of the European Union 2011)

The content and the meaning of the agreement is rather dull and lacking any specific information about the possible arrangement of how the collateral will be implemented. Despite of the vagueness of the agreement, it was still a success for Finland because the CD was now officially in the agenda and it was somewhat accepted by the other Euro members and financial leaders, although not very specifically. After the outcomes of the summit were published, the collateral agreement did not receive any noticeable media attention in other Euro countries according to Finnish news correspondents (*Kymmenen Uutiset*, 2011a).

4.1.3 Bilateral Agreement with Greece

The bilateral agreement between Greece and Finland on the 16th of August was notably the date when the CD received worldwide attention among the other Euro leaders and the media. Until this date, Finland’s collateral demands were considered more as a domestic problem, not as a Euro-problem. Following the summit in July the Finnish and the Greek Finance Ministers Jutta Urpilainen and Evangelos Venizelos agreed on a bilateral collateral where Finland would get assets from Greece in a form of cash deposits (Finland’s Ministry of Finance 2011). It was also stated in the statement that this agreement needed also acceptance of the other Euro members which turned out to be very problematic for the agreement later on. After the agreement was done, other smaller Euro countries such as Austria, Holland and Slovakia wanted to get their piece of the collateral as well. The Greek government immediately rejected these demands as they said that they would only give collateral for Finland (*Reuters* 2011). The French and the Germans opposed this bilateral agreement as well and indicated that the agreement needed to be formed by all of the Eurogroup members. As the bilateral agreement became highly criticized by the rest of the Euro members, as well as other political leaders such as the European Commissioner for Economic and Financial Affairs Olli Rehn and the Eurogroup President Jean-Claude Juncker, it became impossible to implement. Despite of the failure in bilateral agreement, Finland announced that they will not back off in their collateral

demands and referred to the paragraph agreed in the July EU summit (*Seitsemän Uutiset* 2011a).

4.1.4 September Eurogroup Summit

After the failure of the bilateral agreement, Euro countries started a challenging process where a solution about the CD was needed urgently in order to save Greece and the Euro area from collapsing. The new bailout package agreed in July was not possible to implement if the question about collateral was not solved. The next step was the Eurogroup Finance Ministers' meeting in Wrocklaw, Poland the 16th-17th of September. Expectations were high before the summit and it was hoped that the Eurogroup would finally find a solution for the awkward problem.

Couple of days before the summit, the Finnish Prime Minister and the Chancellor of Germany Angela Merkel convinced the public that a solution will be soon ready and the responsibility for solving the case was now thrown to the national Finance Departments and EU civil servants (*Seitsemän Uutiset* 2011b). Some important resolutions were made during the summit but as a surprise for everyone no final agreement was made due to the new information that Greece had not implemented those budgetary cuts and measures that were agreed in July summit. Therefore the final agreement was postponed until October. The case of collateral was also left open and no agreement on the conditions was made. However, two premature proposals were strongly discussed. First, the possibility for collateral was available for every Euro country. This meant that Finland did not have a privilege in this matter. Second, if a country wanted the collateral, there was going to be a price tag. Hence, some of the leaders were speculating that the price for the collateral was going to be set high enough so that only few countries could accept it. For instance, the Finance Minister of Austria stated that the collateral system was more likely to be "repulsive and expensive" enough so that few would want it. The final content of collateral and other conditions was however yet to be resolved in the October summit (Kymmenen Uutiset 2011b). It was also reported by the media that the stubborn stance of Finland might have caused some frustration among the other Euro leaders.

4.1.5 The Final Agreement

Finally, in October the 4th after couple of week's public silence Eurogroup leaders announced that they have successfully agreed on the collateral issue. Commissioner Rehn described that the solution was fair and available for everyone. So far only Finland announced that they would take the collateral. Other members were not interested about the collateral because they found them too expensive and not worth paying for. The head of the EFSF Klaus Regling stated in the media conference after the meeting:

"... every member state of the Euro area can request such collateral deal. At the same time there is a price to be paid [...] that is why it is unlikely that any other country than Finland will make this request." (Eurogroup press conference 2011)

The Finnish Finance Minister Jutta Urpilainen and Prime Minister Jyrki Katainen described that the collateral for Finland got was good and will protect the tax payers money. The reception of this collateral solution woke up divided feelings in the Finnish parliament, media and public. Directly after the agreement, opposition leader Mari Kiviniemi (Center Party) and Timo Soini (True Finns) criticized the collateral package as insufficient and that the benefit was closer to zero. Some financial experts embraced the same stand as well. Most of the public felt that the collateral solution was impossible to understand and made no sense. However, the agreement locked some positive opinions as well, especially among the Social Democrats where the agreement was received as a political victory. The Finnish PM (NCP) stressed that the solution was good because now we can really focus on the real problem meaning saving the euro.

4.2 Finnish politics

In the following, the form and the role of Finnish domestic politics will be discussed. Using the theoretical framework of Two-Level games, the next chapter will analyze the Finnish domestic level and determine domestic Win-Sets, thus striving to find understanding why Finland decided to act as it did and how did its original demands change in the end.

4.2.1 Preferences and coalitions in Finland

At first, it is important to understand what circumstances affected the Finnish Win-Set size. As Putnam puts it: "*The Size of the Win-Set Depends on the Distribution of Power, Preferences, and Possible Coalitions among Level II Constituents*" (1994). As it is mentioned in the overview section, a change in political power changed most likely the characteristic of the Finnish EU-polity. The CD was no longer on the wish list but it was actually consolidated to a strict demand after the government negotiations. The result from the elections indicated strongly that an anti-Euro atmosphere was growing strongly in the Finnish public. This was manifested in two ways. First, the anti-EU populist True Finns party became the third biggest party in the parliament gaining 19,5% of the seats (*Eduskunta* 2011). Second, it seemed that the overall atmosphere in the rest of the

parties changed as well. Formerly very pro-EU parties such as the SDP and the Center Party campaigned on behalf of stricter EU policies as well as other parties announced their growing unhappiness and insecurity towards the current situation and the policy direction where the EU was going. Therefore, if the winning party leader Jyrki Katainen wished to form up a functioning majority government, he had to make compromises. Although Katainen and his party were in favour of collateral, the issue was most intensely promoted by the SDP. It became SDP's absolute condition for entering the government coalition. After the elections it was also clear that majority of the public was also in favor of collateral (*HS-gallup* 2011). Although there were common patterns in EU-skepticism, political parties were nevertheless quite dispersed about the way EU-problems should be taken care of.

For a small country like Finland, it is a very important issue to build up a sound and unified government coalition. This is important especially on the EU-level. According to Mouritzen: "*The presentation of one homogeneous position in the negotiations in the Council and its preparatory fora was considered to be a satisfactory instrument for effective behavior in Brussels.*" (Raunio&Wiberg 2001). Even though government cabinet parties had ideological conflicts and differences, the most important task was to establish a unified solid policy that was accepted and supported by all government parties. This "forced" *homogeneity* was necessary if Finland wanted to keep its power position in the EU. In the matter of collateral, Finland could be argued to be a homogeneous actor. Majority was in favor of collateral but the biggest disagreement was *how* far one should go. Therefore, before entering the EU-level negotiations, Finland's strength was that it had the support and pressure of the other political parties to demand collateral although the trust among the opposition parties was traditionally not the highest. The main issue opposition was worrying about was that the government would not be strong enough to negotiate collateral for Finland.

4.2.2 Institutions on Level II

Another essential determinant behind the Win-Set is Finland's domestic political institutions. In fact, I'll argue that the political system of Finland was probably the most influential factor that directed Finland's Win-Set during the negotiations. Thus, it is important to understand the political system of Finland.

Finland can be described as a parliamentary power (Raunio&Wiberg 2001). *Parliamentarism* becomes a very important concept when trying to understand the decision-making and political relationships in Finland. Nowadays Finland cannot be described as a semi-presidential power since the power of the president has been reduced drastically after entering the EU and the power of the Prime Minister and the parliament has been increased. The president no longer represents Finland in the European Commission or the Council of Ministers

meetings, thus leaving the mandate for the PM and for the other ministers (Raunio&Wiberg 2001). During this collateral scenario the most dominant actors were the PM Jyrki Katainen and the Finance Minister Jutta Urpilainen. However, it is incorrect to suggest that these actors had the absolute power to make decisions for Finland in this case. When EU decisions are on board, three central political institutions have to be examined before we can understand the role of the CN such as the PM and the FM: Specialized Standing Committees, the Government and political parties. Even more importantly, it is essential to understand how these institutions are positioned in relation to each other.

Specialized Standing Committees. According to the Finnish constitution, the power of the state belongs to the public which is represented by the parliament. The 200-seat parliament does not directly have any remarkable power in EU issues while the legislative amendments have led to a power increase for the Government. Anyhow, each Member of the Parliament (MP's) has an indirect possibility to influence such issues through the Committees. Committees' central task is to prepare cabinet's proposals, bills, briefings and reports for the plenary sessions. There are 16 different specialized Committees in the Finnish parliament divided by the different policy areas. Rather than allocating all EU-issues for just one institution, all committees concerned by the policy area are participating actively in the decision processes (Eduskunta 2011a). However, in the most important EU issues the Grand Committee plays a central position. The seats in the Committees are divided along the same power division as in the parliament, thus being "miniature" parliaments. The Grand Committee works as a representative of the parliament in EU issues giving the mandate for the Ministers to make decisions on the EU-level. Grand Committee members have a direct access to the same information available for the government and the CN in EU level negotiations. The Government is responsible of briefing the Grand Committee before, during and after EU-level meetings giving report of their policies they are planning to implement, how the negotiations are progressing and what has been agreed. The Grand Committee has also the possibility to judge if the Minister has exceeded his or hers prerogative. One significant characteristics of the Grand Committee work is that all Grand Committee MP's including the opposition party members have equal access to EU-level information like the Government parties, which means that the information is distributed equally to all parliament parties (Wiberg&Raunio 2001).

Political parties. Because the Committee work allows even opposition members an equal distribution of information from the EU-level, it makes EU issues integrated to the parliament work already in a very early stage. Therefore the relationship between the Government and the Committees enhances the role of the political parties in the EU-level decision-making. It intensifies the scrutiny put on the chief negotiator by the Government- and opposition parties, thus decreasing chief negotiator's Win-Set. This means that the role of parliament groups is very important giving an importance to party discipline. Thus, in a situation where the Chief Negotiator needs a legitimate mandate for his/hers actions on the EU-level,

it is important that at least all of the cabinet parties give their acceptance for the CN.

The Government. In government work, two essential players have to be mentioned. First, the role of the minister as the CN is undisputedly very central as it's the official representatives of the whole nation. This role will be discussed in the chapter later on. The second important players are the civil servants. As the former Finance Minister and current presidential candidate Sauli Niinistö mentioned in his memoirs, the role of civil servants, both in domestic and EU-level politics, is highly underestimated (Niinistö 2011). As the Governmental decision-making in Finland has been highly sectionalized in EU matters, the workload has increased the number and the importance of civil servants (Raunio&Wiberg 2001). For instance on the EU-level the Committee of Permanent Representatives (*Coreper*) plays a crucial role in minister meeting preparations and provides information for the ministers and civil servants. In the domestic sphere, State Secretaries and Director Generals play an important role and can effectively have their influence on driven politics (Niinistö 2011). For instance the Government representatives in Finland don't enjoy a great autonomy in decision-making since the governmental work includes various other interest groups and government officials such as the leader of the Central Bank. CN's autonomy is also restricted through the Committees and political parties which makes CN's strategies very important when balancing between different interests.

The role of different institutions play a significant role when determining the domestic Win-Set. As it turns out, there are multiple different ratification levels in the domestic sphere which all need to be taken under consideration by the CN.

4.2.3 Negotiators' strategies on Level I

As mentioned in the previous chapters one has to understand how the power has been distributed among the parties in Finland and how the political institutions are organized in order to determine the domestic Win-Set. Thereby there are some strategies the CN can choose when balancing between domestic and international preferences. In addition, the CN is not a neutral broker between Level I and Level II but has his/hers own preferences as well.

The CNs Jyrki Katainen PM and Jutta Urpilainen FM showed no remarkable strategic control over the Win-Sets. This characterized their role as an Agent representing the overall position of the domestic constituency as it was. Even though *tying hands* strategy was prevalent, it was reality in the domestic politics rather than a strategic effort of altering the Win-Set. A lot of effort was needed from both of the CNs to convince other Eurogroup members about the domestic situation in the Finnish politics. Often the CN is the only formal link between Level I and Level II (Putnam 1993:456).

4.3 Win-Sets

4.3.1 Finland's domestic Win-Set

Taking all of the three determinants into consideration it is thereby possible to construct the Finnish domestic Win-Set. From interviews of the FM and the PM it seems quite obvious that all outcomes that include collateral for Finland are acceptable. No-agreement leads therefore into situation where Finland is not participating EFSF. When Finland's demands are being unconditional, it means that without collateral they are out of the rescue packet. Thus, participating in EFSF without collateral seemed impossible due to the public opinion and pressure from the cabinet and opposition parties. The worst-case scenario for Finland would have been participation in EFSF without collateral leading most likely to a break down of the Government (Bloomberg 2011). This would have given the opportunity for the True Finns to participate in the government collaboration if the leading NCP was left in the opposition. From the perspective of the EU, this would have been very bad option for the whole Union if an anti-euro party gained more power in one of its member states.

The second worst-case scenario would have been that Finland didn't get the collateral and therefore was left outside the EFSF. This could have led to drastic international and domestic problems according to many experts. First, Finland's influence and power in the Eurozone was most likely to decrease if it stood outside the central decision making core. Second, the rejection of the EFSF could have decreased Finland's political capital on the whole EU-level. International coincidences could have been total endangerment of the ESFS and the Euro. Since Finland was an AAA country, meaning that it had the highest credit rating, it was very important for the Eurogroup that Finland was participating in the EFSF. Market-wise it was also important to show unity among Euro members to reassure the stability and the performance of the Eurozone. In general both options, no-agreement and agreement without collateral were very risky because of the uncertain repercussions it might cause.

However, different possible causal effects are not directly significant in Two-Level Games. When constructing the Finnish and Eurogroup Win-Sets, it is only relevant to take those Level I negotiation outcomes under consideration that could be ratified by the domestic constituency. Thus, the option where Finland was left without collateral and still participating in the EFSF was outside the Finnish Win-Set simply because the CD was already supported and demanded by the majority of the parliament parties and the public. Hence the available options for Finland were agreement with collateral or no-agreement making the conditions simply as in or out.

4.3.2 Win-Sets on the EU-level

As mentioned before, I will not take a detailed look at every Eurozone member in these negotiations nor try to uncover the preferences of each and every member state because that would be simply time consuming and irrelevant, particularly in this scenario. Moreover I will not discuss about the possibility of the other countries to get collateral and therefore only focusing on the Win-Set in the case of Finnish collateral thus leaving out other possible collateral solutions in the Eurozone. The reason why the preferences of all member states are irrelevant in this case is that the rest of the Eurogroup acted more or less as a unitary actor during the negotiations with the exception of few situations. After the bilateral agreement between Greece and Finland failed due to the rejection of the other member states and the collateral issue was moved to the Eurogroup level, the leadership of the Eurogroup officials played a dominant role. Only few countries, such as Austria, the Netherlands and Slovakia were interested about the collateral deal, however without any compelling stipulation from the domestic constituency, like in Finland. After the bilateral agreement, the Eurogroup president Jean-Claude Juncker announced that no other country would receive collateral, as the whole packet would become impossible to implement. Since Greece had already insufficient funds and the constitution didn't allow the release of national infrastructure or real estate as collateral, it became impossible to give collateral for anyone else than Finland.

The Win-Set of the Eurogroup experienced a change during the scenario. At first, as it was vaguely stated in the July 21st summit agreement, member states had the possibility to demand collateral. It was also argued that the discussions during the July summit made it unclear how the collateral would actually work so there was some confusion among the member states. As the German Minister of State Werner Hoyer expressed it "*Nobody sitting around that table imagined that cash collateral would be involved*" (HS 2011). At that time, the understanding was that Finland would presumably get Greek real estate or infrastructure as a collateral thus making Finnish CD fit inside the Win-Set. An option that Finland would not demand collateral was also, by all means, ratifiable for the rest of the Eurogroup.

As it turned out to be after the Finnish-Greek bilateral agreement, the collateral deal now included 880 million € in cash to be deposited into the Finnish account. The rest of the Eurogroup turned down this arrangement since the cash for the collateral was taken from the rescue package granted by the EFSF i.e. the other Euro countries. As the situation became clearer and each part started to realize the true nature of the collateral issue, the Eurogroup Win-Set did not include the cash collateral agreed with Greece. Thereafter, the only possible collateral deal was a Nash-equilibrium where the benefits of the collateral did not harm the rest of the Eurogroup and to cost of the collateral was so high that only Finland would agree on the conditions. Another possibility where Finland would not demand collateral was nevertheless the most unproblematic option for the Eurogroup.

4.4 Applying the Two-Level Game

In the following chapter, I'll thus apply the framework of Two-Level Games to this scenario of collateral and try to see how the Two-Level characteristics are prevalent in this situation. The main ambition is therefore to see how domestic constraints affect international negotiations and cooperation, and how negotiators follow the dynamics of Two-Level Games in this situation. Keeping in mind the central argument of the Game theory, an international agreement always needs to be ratified domestically (Moravcsik 1993 p. 33). Since the scenario was consisted of two separated negotiations, I'll divide my analysis in two parts. First, I'll explain the scenario of the bilateral agreement using the Two-Level Game theory and present the reasons why the agreement experienced an involuntary defection in September. The second part will explain how the Eurogroup used creativity to successfully bind together two conflicting Win-Sets after the failure of the bilateral agreement.

4.4.1 The first effort

In the Finnish ratification procedure the institutional arrangements play central role. In contrast to the classical example of the Two-Level Games, the ratification of the international agreement takes already place before the actual negotiations because the Grand Committee authorizes the actions of the CN. Comparing this arrangement with Lisa Martin and Kathryn Sikkink's ratification procedure typology (Moravcsik 1993), the Finnish ratification procedure includes characteristics from both *authorization* and *acquiescence* types. This means that in both negotiations efforts the Grand Committee, represented by the relative proportion of the parliament groups, gives a negotiation space for the CN in a form of mandate thus making the procedure as *authorization*. After the Level I agreement is done, there is no ex post ratification procedure if each part in the domestic constituency is principally satisfied with the agreement. If disagreement and dissatisfaction arises in the Grand Committee, the Committee members may vote if the CN has exceeded his/hers competence.

As it turns out to be in both agreement efforts, the *tying hands* strategy was used both by Urpilainen and Katainen but in a different motivation. *Tying hands* is a negotiation strategy where the CN constricts the domestic Win-Set by proclaiming that the domestic constituency won't give him/her much negotiation space in this matter (Moravcsik 1993 p. 28). Although Urpilainen was in the center point of being responsible of the collateral arrangements, Katainen was also obliged to defend Finland's position in this matter. Urpilainen argued that the whole Finnish electorate stood behind the CD but Katainen framed the situation that his Government would likely to collapse if Finland didn't get collateral in change (Bloomberg 2011). Anyhow, the *tying hands* strategy was by no means

meant to give modified picture of the domestic situation. It was an actual fact that the Finnish CNs were in a position where their acceptability-set was very constrained by the domestic constituency.

Did this strategy work for Finland? In the first agreement effort where the negotiation parties were the Finance Ministers of Greece and Finland, the *tying hands* strategy seemed to work as they agreed on full cash collateral with the Greek FM.

4.4.2 The second effort

After the shortcomings in the bilateral agreement the whole Eurogroup started to work on the collateral issue. Despite its failure, the first agreement effort can be described as a wake-up call for the rest of the Eurogroup that Finland was indeed serious about the collateral. It was no longer considered as an issue of Finland, but an issue of the Eurogroup thus becoming an obstacle that needed to be overcome before the final agreement about the new bailout package could be done. At this point the crucial glue between the Euro members was their common goal and will. The Euro needed to be saved, no matter what.

At first it seemed like the situation was in dead end. The relationship with Finland and the rest of the Eurogroup was like in a U2 song “*With or without you*”: Greece couldn’t give cash or real estate as collateral. Finland would be out of the bailout package if they didn’t get collateral. Nobody, including the Finns, wanted Finland to be outside because it could jeopardize the whole rescue package. Because privileges couldn’t be given for single member in the name of fairness, everyone should have the same rights for collateral keeping in mind that Greece was capable of giving collateral for only one country, namely Finland. A slack was difficult to find in this political and legal quagmire.

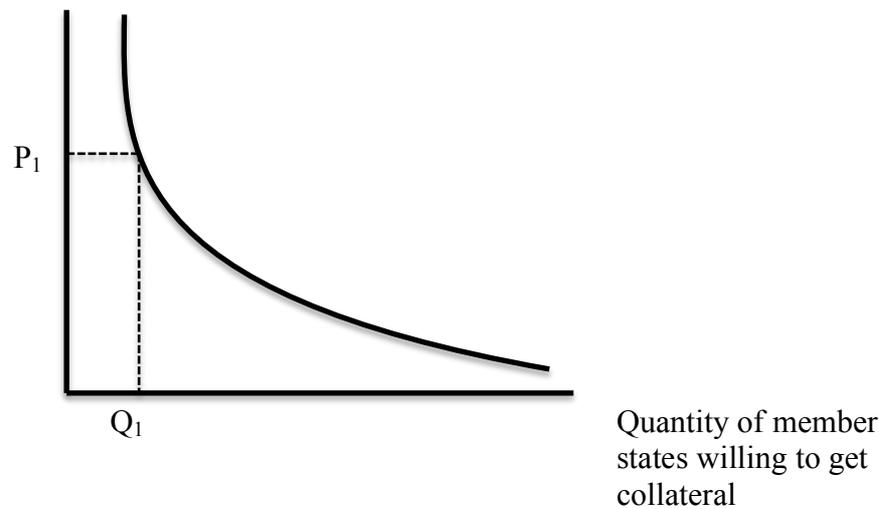
Side payments. Trade off benefits. Level I positions were changed in the second effort. The Eurogroup officials became mediators in the negotiations finding a solution which would be acceptable and beneficial for each one. At this point however, it seemed like there was no good or beneficial alternatives, only less bad alternatives. Because Finland’s unconditional demand was the collateral, which can be understood as a benefit for Finland, some bargaining possibilities opened up between the negotiators. If one wanted to get benefits through negotiations, one should also pay for it. Therefore, the policy-makers *commoditized* the nature of the political bargaining and the collateral became nearly a product. The price for the collateral was following:

1. Finland pays 1.4 billion euros into the new permanent European Stability Mechanism (ESM, which will replace EFSF in the future) in one tranche where other members pay it in five tranches.

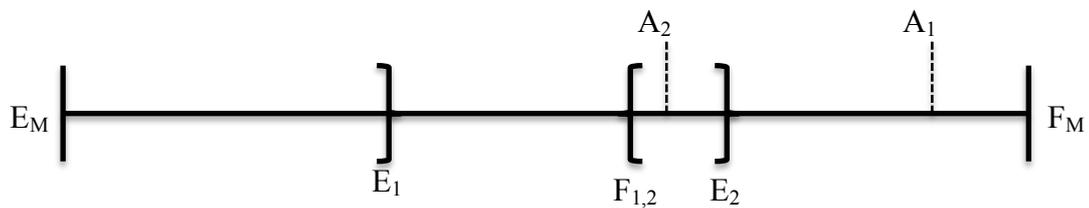
2. Finland will get reduced profit from the EFSF.

Since there are several guarantors in this case and Finland is the only one getting collateral for its share, it is only clear that Finland would need to give up some other benefits in order to get the collateral. Thus, the logic of this arrangement unveils the rational nature of the negotiators and making cost-benefit thinking very important.

Price for the collateral



The graph above describes the rational logic of the Eurogroup decision makers when setting the price for the collateral. The Eurogroup official who prepared the collateral model had to price the collateral to the level where only Finland would desire it P_1 . The price should be also optimal in that sense that it would not exceed Finland's willingness to pay. In that sense, the Eurogroup officials had to make estimations that this proposal would be also ratifiable by the Finnish constituency thus keeping the Finnish government together and keeping the more euro-friendly parties in power. Another challenging estimation was to price the collateral just over the level that would leave another willing member states outside. Strategically this whole solution needed a successful utility- and *willingness to pay* analysis of the participants, meaning in terms of Two-Level Games, the Eurogroup officials had to carefully consult each of the member state, especially Finland, in order to find a solution that makes Win-Sets of the Eurogroup member states to overlap.



The figure above illustrates different Win-Sets and how the agreements were positioned in relation with the points of minimum ratifiability during the first and the second effort. The figure is a variation of Putnam's (1993) original zero-sum game where overlapping Win-Sets were examined. E_M illustrates the most beneficial negotiation outcome for the Eurogroup where F_M illustrates the same outcome for Finland. In this case E_M means that no member state gets collateral or everyone gets collateral and F_M means that Finland gets full cash collateral for its share of the bailout package. Square brackets illustrate minimum ratifiable outcomes for each part. E_1 Means the minimum ratifiable outcome for the Eurogroup during the first bilateral agreement and E_2 the minimum ratifiable outcome during the second effort. $F_{1,2}$ is the minimum ratifiable outcome for Finland during both negotiations. A_1 is the agreement outcome from the first bilateral negotiations, which ended up in involuntary defection and A_2 the final outcome that was successfully approved by the Eurogroup and Finland.

What comes to the first agreement A_1 , and can see that the agreed conditions were inside Finland's desired Win-Set and quite close the optimal outcome since they agreed on 880 million euros cash collateral. However, this solution was far outside the Win-Set of the Eurogroup mainly because the solution left the rest of the Eurogroup as payers for the Finnish collateral. The reason for the defection was clear: why should we pay for the collateral and second, why should Finland have the privilege for the collateral? In the first agreement one should keep in mind that Greece and Finland were the Level I negotiators where the Eurogroup and the Finnish constituency were Level II players.

In the second agreement A_2 , new conditions for the collateral changed the size of the Eurogroup Win-Set thus leaving the Win-Set for Finland unchanged. Principally interesting thing here was how the new collateral model influenced the size of the Win-Set. When the first agreement failed, it seemed that a new agreement using the same conditions was very problematic to make because Win-Sets didn't overlap at all. Eurogroup officials realized that by changing the content of the collateral, it would be more likely that a solution could be agreed upon. Negotiation space was found in the Finnish Win-Set because Finland didn't set any specific conditions for the CD. The only condition was the collateral, nothing more. This however was not realized before and Finland had the freedom to make bilateral agreement with Greece because of the misperceptions after the

July 21st summit. The information that Finland would have to pay for the collateral didn't broaden or restrict the domestic ratifiability. Anyhow, the information that the collateral had a price tag changed the Win-Set of the other Euro members drastically. First, the new legal technical solution how the collateral was formed, didn't imply that the collateral would be taken from the EFSF fund. Since the collateral was now composed of Greek government bonds, it was not a problem for the other Euro members to accept it. Second, conditions 1. and 2. made the deal less attractive for the other member states, thus expanding the Win-Set and giving more room for the other Euro members to accept Finland being the only member to take the collateral. In that sense, the Eurogroup officials used *negative side payments* to compensate the benefits Finland acquired from the collateral thus highlighting the compensatory nature of the decision.

5 Conclusion

The dynamics of the Two-Level Games are rather prevalent in this scenario of collateral demands. I've have demonstrated in this study that Finnish domestic politics had a great impact on the outcome of the Eurogroup negotiations. Some substantial characteristics of the Two-Level Games can be found from this scenario. First, Finland's political power division and the public EU-criticism *homogenized* the government policies thus giving a bargaining advantage for the small nation since "the public" was behind chief negotiators back. On the other hand, an unanimous EU-criticism can also be argued to restrict the bargaining space of the CNs since they had no other choice than to demand collateral. This strategy of *tying hands* was nevertheless quite successful since Finland finally got the collateral thus the benefit from that was mainly a political victory for the parties demanding it the most, like the SDP. Economical benefit of the collateral has been highly criticized and divided many experts and politicians. The overall political benefit of the CD has also been criticized. Some politicians and experts argue that Finland has lost some of its political capital in the Eurogroup and in the EU in general since they put too much on effort on the collateral issue.

The ratification process of the Level I agreement differs from the "classical" Two-Level Games ratification. Because of the institutional political systems, the domestic constituency didn't have to ratify the agreement officially afterwards. If the Grand Committee members found the agreement to fall inside the CN's mandate, no voting about the issue needed to be made.

The Finnish CNs negotiation strategies didn't seemingly alter the domestic or international Win-Set since both, Katainen and Urpilainen adopted the role of an Agent. In the domestic sphere though, Urpilainen's was acting fiercely as a Hawk when urgently promoting the collateral as a condition for SDP's government partnership. When the CD was in the GP, the CNs just simply represented the will of the domestic constituency as Agents.

This study has shown the Two-Level Game dynamics of the first bilateral agreement and the following Eurogroup-powered agreement. In the first agreement the outcome was defect because the rest of the Eurogroup didn't ratify the agreement thus leading into an involuntary defection. This was because the Win-Sets between the Eurogroup and Finland didn't match. In the final agreement a successful ratifiable outcome was made with the active strategic planning of the Euro-level officials. The outcome showed a strong rationality in planning and information acquisition by the Eurogroup officials leading to a solution that satisfied more or less everyone but was not maximizing anyone's utility. The exploitation of willingness to pay was also prevalent in this outcome.

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