

## Trojan horses: Putnam, ECU linkage and the EU ambitions of Nordic elites

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### ABSTRACT

This article argues that the decision by Nordic elites to link their respective currencies to an ECU basket is consistent with a Trojan horse strategy for membership in the European Union. After alternative explanations for ECU linkage are tested, the article shows how Nordic elites used their control over exchange rate regime choices to facilitate greater EU participation, in spite of the hesitancy voiced by domestic constituents. In order to make the argument, Putnam's two-level metaphor is amended to accommodate a bargaining situation where negotiators have independent policy preferences. This amended model provides seven lessons for negotiators willing to manipulate win-set contours with an eye toward affecting public support. These lessons are then juxtaposed with the Nordic decisions to link their currencies to an ECU basket. The article concludes that ECU linkage can be explained in terms of, and is consistent with, a strategy based on the EU ambitions of Nordic political elites.

### KEYWORDS

Putnam; exchange rates; ECU; EU; Norway; Sweden; Finland.

In 1972 we had a referendum, and the exchange rate question and monetary union were a part of the reality on which we took a position. Should we now, six years later, quickly and without careful consideration slip into a new Snake system, we would be presiding over an act of political disingenuousness of important dimensions on the part of the government.

(Stein Ørnhoi before the Norwegian Storting (parliament)  
28 November 1979)

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On 19 October 1990, Norway unilaterally pegged its krone to a basket centered on the European Currency Unit (ECU). In May and June of the following year Sweden and Finland (respectively) followed suit. At the time, European Community<sup>1</sup> membership was (and remains) politically contentious; in 1990-1, political elites – in all these countries – were unwilling or unable to place EC membership formally on the political agenda. While these elites (to varying degrees) have been suspected of Euro-sympathies since the early 1970s, support for EC membership among the population at large has been significantly smaller. Despite this, all three countries held referendums on EU membership in the fall of 1994.

Why would political elites in the Nordic countries risk political capital by linking their currencies in 1990-1 to the politically contentious ECU basket? Among Euro-skeptics it is commonplace to suggest that ECU linkage was a back-door attempt by political elites to prepare for Nordic entry into the European Community.<sup>2</sup> After all, in the late 1970s, both Sweden and Norway withdrew from the European 'Snake' (formally, the European Common Margins Agreement) and established their own trade-weighted currency baskets. As the introductory quotation suggests, much of the justification for pulling out of the Snake, and refusing to participate in the new European Monetary System (EMS), was framed in terms familiar from the EEC debate in Scandinavia.<sup>3</sup> Indeed, in the wake of the anti-EEC referendums, each attempt to establish closer monetary and economic relations with the European Community was met with great political resistance; each was interpreted as an attempt by Euro-friendly political elites to sneak the Nordic countries into Europe through a back door.

This article is an attempt to test the Trojan horse<sup>4</sup> hypothesis: can Nordic ECU linkage be explained in terms of, and is it consistent with a strategy based on, the EC ambitions of Nordic political elites?<sup>5</sup> Did Norway, Sweden and Finland all tie their currencies to the ECU as part of a pre-negotiation EC membership strategy?

As this argument tries to pinpoint elite motives, it is not easily proven. To prove it adequately (and to avoid the political conspiracy trap), I will first need to show that there is not sufficient economic justification for linking the Nordic currencies to the ECU. Once this main, competing, hypothesis is removed, I will need to show that the actions of Nordic elites are strategically consistent with a deductively formulated multi-level negotiation model. Finally, the story should make intuitive sense and complement the historical record.

Section I of the article shows how economic arguments alone are insufficient for understanding Nordic ECU linkages. Nordic central bankers and economists were not only very skeptical about the economic gains from ECU linkage, they were also quite explicit about how the decisions reflected political, not economic, realities.

In order to satisfy condition two, we need to find a multi-level negotiation model which provides strategic lessons for political elites. To my knowledge, no such model exists.<sup>6</sup> Thus, much of this article is aimed at amending one of the better-known two-level negotiation models<sup>7</sup> (Putnam, 1988) to meet these objectives. In Section II I relax Putnam's assumption that negotiators do not have independent policy preferences. The result is a three-dimensional model which provides strategic prescriptions for negotiators hoping to manipulate win-set contours (and with them agreement outcomes).

If the hypothesis is to be proven positively, we should expect that several of these lessons could be traced onto a historical sketch of the actual linkage decisions. Although it will be impossible to establish with complete certainty the reasons for each country's ECU linkage, we can form general expectations on the basis of the degree of fit between the actual decisions and the lessons traced in Section II. In other words, if EC membership motivations are dominant, then we would expect the historical record to replicate the lessons derived from the deductive model; if EC motivations are irrelevant, then we should expect no overlap between the model's lessons and the historical record.

Section III juxtaposes the strategic lessons against the historical record. While the Norwegian case is the strongest, Nordic ECU linkage in general is shown to fulfill several of the prescriptive lessons drawn from the amended Putnam model. Whereas there appears to be a strong relationship between expectations formed by the deductive model and the actual empirical record, we cannot with certainty argue that Nordic political elites were cognizant of the long-term strategic consequences of their decisions.

## I THE ECONOMIC ARGUMENT FOR NORDIC ECU LINKAGE

The economic justifications for a given exchange rate regime are quite complex, and I cannot hope to provide a thorough argument in this brief section. Generally, however, we might consider three economic criteria for evaluating the benefits of a given exchange rate regime: an economy's trade orientation, flexibility and credibility. This section will briefly look at each of these criteria and follow up with explicit statements by relevant Norwegian actors about the motives behind ECU linkage.

Prior to their ECU linkages, each of the Nordic countries maintained trade-weighted domestic basket indexes for determining the external value of their respective currencies. Finland was the first Nordic basket-maker, employing a home-made basket from 1973. Sweden had maintained its own basket index since it withdrew from the European

Snake arrangement in 1977, and the external value of the Norwegian krone had been basket-determined since 1978.<sup>8</sup>

Before moving on to the three main (competing) economic arguments, it should be pointed out that the ECU linkage decision cannot be explained in terms of a new-found desire for a fixed exchange rate regime.<sup>9</sup> Each of the Nordic countries had been formally committed to such a regime since the early 1980s, under their previous basket arrangements.<sup>10</sup> Indeed, in regime terms, Nordic ECU linkage did not represent a major shift. As the ECU is a basket consisting of mostly ERM currencies (though not exclusively – the Greek drachma and the Portuguese escudo are in the ECU but are not members of the ERM), an argument can be made that the ECU link was simply another basket regime, though made up of different currencies.<sup>11</sup>

### 1.1 Trade orientation

By definition, a basket index consisting of EMS currencies (i.e. ECU linkage) is bound to be less trade-oriented than a basket consisting of

Table 1 Weighting differentials between Norwegian basket and ECU linkage, 18 October 1990

	Basket weights	ECU weights
Swedish krona	15.0	—
Finnish markka	3.0	—
US dollar	11.0	—
German Mark	17.7	30.3
UK pound	14.7	12.6
Danish krone	6.8	2.5
French franc	9.2	19.3
Dutch guilder	4.6	9.5
Italian lira	3.3	9.8
Belgian franc	2.4	7.8
Luxembourg franc	—	0.3
Japanese yen	6.0	—
Swiss franc	1.2	—
Spanish peseta	—	5.3
Austrian Schilling	1.5	—
Canadian dollar	3.6	—
Irish pound	—	1.1
Greek drachma	—	0.7
Portuguese escudo	—	0.8
ECU%	58.7	100

Source: Norges Bank (1991a: 8).

Table 2 Weighting differentials between Swedish basket and ECU linkage, 16 May 1991

	Basket weights	ECU weights
Norwegian krona	8.4	-
Finnish marka	7.0	-
US dollar	21.0	-
German Mark	17.6	30.3
UK pound	10.1	12.7
Danish krona	7.3	2.5
French franc	5.4	19.1
Dutch guilder	4.7	9.5
Italian lira	4.3	9.9
Belgian franc	3.7	7.8
Luxembourg franc	-	0.3
Japanese yen	3.9	-
Swiss franc	2.2	-
Spanish peseta	1.8	5.4
Austrian Schilling	1.4	-
Canadian dollar	1.2	-
Irish pound	-	1.1
Greek drachma	-	0.6
Portuguese escudo	-	0.8
ECU%	54.9	100

Source: Lindberg and Lindentus (1991: 18).

trade-weighted currencies. Prior to ECU linkage, the Nordic countries sought average price stability across a broad spectrum of currencies relevant to the home economy. The trade importance of a given currency to each of the Nordic economies determined its relative strength within the basket index. Switching to an ECU basket means forfeiting important trade-relevant currencies for less relevant (in trading terms) EC currencies.

For example, Norway's linkage to the ECU basket meant that the krone's external value was still to be determined by a basket, but the currencies in the new basket were those of the EMS countries. Several currencies which are important for Norwegian trade, such as the US dollar and the Swedish krona, were no longer represented in the basket. Table 1 shows the radical change in basket content from the original Norwegian basket weights to the new ECU weights. Indeed, less than 60 percent of the trade-weighted basket version consisted of ECU currencies; after 22 October Norway's ECU basket contained currencies

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Table 3 Weighting differentials between Finnish basket and ECU linkage, 6 June 1991

	Basket weights	ECU weights
Swedish krona	18.7	-
Norwegian krona	4.0	-
US dollar	8.6	-
German Mark	19.4	30.3
UK pound	12.6	12.6
Danish krona	4.5	2.5
French franc	6.9	19.1
Dutch guilder	5.0	9.5
Italian lira	5.2	10.0
Belgian franc	3.3	7.8
Luxembourg franc	-	0.3
Japanese yen	5.7	-
Swiss franc	2.4	-
Spanish peseta	2.1	5.4
Austrian Schilling	1.6	-
Irish pound	-	1.1
Greek drachma	-	0.6
Portuguese escudo	-	0.8
ECU%	59.0	100

Source: Aaltonen *et al.* (1994: 60).

of questionable value in terms of their relative foreign trade content (e.g. the Greek drachma).

ECU linkage contained similar dilemmas for Sweden and Finland; the ECU basket does not reflect their foreign trade interests. In Sweden, the most important missing currency was the US dollar, which made up 21 percent of the previous basket (see Table 2). Thus, the Swedish krona, linked to the ECU, "could no longer protect itself from real exchange rate swings between the dollar and the Deutschmark.

In Finland the story is repeated. Important currencies such as the US dollar and the Swedish krona are no longer part of the Finnish currency basket; the marka drifts freely against them. As Table 3 shows, ECU currencies had (directly) accounted for about 60 percent of the former Finnish currency index.

Although ECU linkage may encourage trade with EU member states (because of now more stable exchange rates) an ECU basket is not optimal in terms of the foreign trade relevance of various currencies for Norway, Sweden and Finland.<sup>12</sup> At the time of linkage, EMS currencies made up less than 60 percent of Nordic foreign trade accounts, and

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important international (e.g. US dollar, Japanese yen) and neighboring currencies were not included. Thus, in terms of trade orientation, ECU linkage does not make economic sense for the Nordic countries. A better economic argument can be made for retaining the previous basket indexes.

### 1.2 Flexibility

The second economic issue to be addressed is the degree of flexibility and compatibility among Nordic and EMS member-state economies. As the switch to ECU linkage cannot be understood solely in terms of a new-found commitment to fixed exchange rates, it is the nature and content of the ECU basket which is of economic relevance. What is the importance of switching from a basket of trade-weighted currencies to one that consists solely of EC currencies?

The literature on Optimum Currency Areas suggests that irrevocably fixed exchange rates between various economic regimes require (among regions): flexible prices and factor mobility, as well as similar economic institutions, policy ambitions and market structures.<sup>13</sup> It is not possible to provide an adequate overview on each of these issues for all the countries concerned, so I will concentrate on one simple aspect of the flexibility issue: the degree to which each economy is susceptible to asymmetric shocks (of either the demand or supply type).<sup>14</sup>

Of the three Nordic economies under consideration, Sweden's is probably the most diversified and the most integrated with Europe,<sup>15</sup> Swedish industry and capital have long been interested in establishing their European credentials, and the previously 'niche' nature of the country's export economy has been eroded over time. Because of Sweden's economic diversification and integration with the rest of Europe, it is probably the least likely (of the three) to be affected by asymmetric shocks, and would probably benefit the most from a fixed price relationship with EMS currencies.

The Finnish and Norwegian cases, however, are quite different. In Finland, the forest industry sector is by far the most important foreign currency earner. Throughout most of the postwar period, the Finnish 'devaluation cycle' shadowed ten-year market fluctuations in that dollar-based sector (Korkman, 1978). Finland's over-dependence on this volatile sector means that it is susceptible to international market fluctuations which will affect its economy much more dramatically than those of the other European countries.<sup>16</sup> As the Finnish economy is very susceptible to asymmetric shocks, it is relatively costly for it to link to a currency basket less responsive to those shocks.<sup>17</sup>

In Norway, economic dependence on a single export niche is even more precarious. Of the Nordic economies, Norway's is probably the

most prone to be affected by asymmetric shocks, due to its dependency on (dollar-denominated) oil income. An oil price shock affects the Norwegian economy in exactly the opposite way from the rest of Europe's. When the world price of oil rises, the Norwegian economy begins to boom, while the remainder of Europe is hit by increased production costs.

Thus, in terms of economic structures, only Sweden seems to benefit economically from linkage to EMS currencies. Even in this strongest case, however, the previous basket index would have been the most stable regime for Sweden; the ECU basket makes up only 55 percent of Swedish foreign trade (see Table 2 above). The Norwegian and Finnish economies are currently too dependent on dollar-based export sectors which (potentially) require autonomous policy action in response to asymmetric shocks. Because of these export structures, linkage to a basket which excludes dollars is costly for both Norway and Finland.

### 1.3 Credibility

The best economic argument for ECU linkage has to do with the credibility windfalls that are associated with what is seen to be a new, firmer, commitment to the fixed exchange rate regime. The foreign reserves of these small countries are entirely insufficient to defend against market speculation. As ECU linkage was accompanied by short-term swap agreements with EMS-country central banks,<sup>18</sup> the hope was that market actors would: (1) be intimidated by the new, larger, reserves at the disposal of Nordic central banks for defending the proposed intervention margins; and (2) interpret the new commitment, though unilateral, as a move by Nordic governments toward placing greater constraints on their devaluation options.

The problem with these two arguments, as the fall of 1992 has shown,<sup>19</sup> is that: (1) European reserves, together, are insufficient to repel speculation against a given currency (whether unilaterally pegged, as the Nordic currencies were, or as part of full-fledged EMS-membership); and (2) the unilateral nature of the ECU peg, in actuality, provides few credibility windfalls. As the Nordic countries were still free to de/revalue when necessary (i.e. without consulting their European partners, as is required of EMS member states) market actors were leery of lending too much credibility to the new regime.<sup>20</sup>

While the earlier basket indexes were recognized as providing a great deal of stability, especially *vis-à-vis* the dollar, the problems facing the Nordic countries in the latter part of the 1980s were more closely related to market credibility and confidence, not necessarily stability *per se*. Indeed, in the period preceding the ECU linkages, Nordic currency markets were surprisingly stable. While the credibility argument, in a

period with rapid short-term speculative capital flows (and before the most recent crisis), provides the best economic justification for Nordic ECU linkage, it alone is insufficient to justify that linkage. The unilateral nature of the pegs contained no greater adjustment restraint than the earlier basket arrangements.<sup>21</sup>

#### 14 Motives

The final argument to be made about the potential economic benefits of ECU linkage can be found in the statements of the responsible actors themselves. What did Nordic central bankers themselves have to say about the reasons for linking to the ECU? As Norway was the first country to link unilaterally to the ECU, and the Swedish and Finnish decisions (as we shall see below) were largely triggered by the Norwegian decision, the response by Norwegian officials is highly instructive.

Since it had advised against joining the EMS in 1979, the Governing Board of Norway's central bank, Norges Bank, had been opposed to closer monetary links with the European Community. The majority position, since 1979, was defended frequently by Norges Bank's long-time Governor, Hermod Skånland. In 1988, before the Norwegian decision to link to the ECU, Skånland had voiced his skepticism about the European cooperative monetary project in no uncertain terms:

It is possible that I sound unnecessarily skeptical with regard to the sort of cooperation that central bank Governor Duisenberg [of the Netherlands] is suggesting. My skepticism is not aimed at cooperation within the Community *per se*. Personally, I have long been – and remain – of the opinion that Norway should apply for membership in the EC. But for me, questions of monetary and exchange rate cooperation are intimate questions: the most intimate sort of partnership that exists. I do not wish to sound like an orthodox moralist, but I am still of the opinion that this sort of intimacy should be postponed at least until the wedding has been announced.<sup>22</sup>

After the decision to link the Norwegian krone to the ECU had been made, Norges Bank's annual statement made its hesitancy well known; it could not find a strong economic argument for linking the Norwegian krone to the ECU basket:

It is difficult to justify the ECU linkage with any legitimate economic argument other than to mention that the large majority in the Storting which stood behind the decision wished to go on record as having considered the need for economic stability to the

same degree as other countries in the EC which have joined the Community's basket system.<sup>23</sup>

Hermod Skånland's reaction to the decision was interesting in its ambivalence. While recognizing the fact that the old basket regime would provide maximum stability for the krone across a wider spectrum of important currencies, he explained the adoption of the new regime in terms of a sort of political fatalism. It was not economic considerations which prevailed, Skånland said, 'Other considerations weighed more heavily. In the final analysis, this was a political decision.'<sup>24</sup>

Political opposition in the Norwegian parliament (Stortinget) was well aware of the economic costs of ECU linkage; concern was voiced over the fact that the decision had been framed in technical terms; about the unilateral nature of the government decision, and about the economic costs of ECU linkage (see below, pp. 401–2).

In short, the influential Norwegian decision to link to the ECU was almost certainly politically inspired. Not only were the economic costs of such a move quite evident but the new policy was introduced against great skepticism and resistance by the community of Norwegian economists and bankers. As we shall see in Section III, the Norwegian decision was absolutely critical for the decisions which followed in Sweden and Finland.

Economic justifications for Nordic currency linkage to the ECU are insufficient. The credibility argument seems to provide the only legitimate economic justification for the linkage, and this argument is highly suspect. Nordic trade orientation and market structure suggest that the previous basket regimes were much better suited for dealing with the peculiarities of Nordic foreign trade dependence. In short, we need to search for more political motives behind the decision to link to the ECU basket.

It is the working hypothesis of this article that the EC ambitions of Nordic political elites are critically responsible for that decision. In order to establish the validity of this hypothesis, we need to employ a theory of international bargaining strategy. This theory could then explain the relationship between ECU linkage and broader EU negotiating strategy. The following section presents and amends a well-known international relations negotiation model. The amended model is capable of proposing a series of deductively derived lessons about international negotiations. The final (third) section will then show how the ECU linkage decision is largely consistent with the lessons formulated in the following section.

Obviously, there are shortcomings to such a simple hypothetico-deductive approach. This is only one means of addressing the problem at hand. In pursuing this approach I do not mean to suggest that the

same (or similar) conclusions cannot be reached by other means. Indeed, by employing a more reflective and systematic scrutiny of the available evidence, and/or a series of in-depth elite interviews, we might greatly contribute to our understanding of these issues. Such (alternative) approaches could help us to describe the formation of the specific contexts, identities and interests which I take as given, below. With that caveat, we proceed to the game.

## II PUTNAM'S GAME

One of the best-known models for negotiations in the realm of international relations is Putnam's 1988 two-level game approach (Putnam, 1988).<sup>25</sup> Although Putnam's model was developed with an eye toward genuine international policy coordination, exemplified by the 1978 Bonn accord, it is easily traced onto other negotiating environments when analysts are interested in the domestic-international entanglements of diplomatic negotiations.<sup>26</sup>

To accomplish this, Putnam developed a two-level game, where negotiators must satisfy demands at two negotiating tables simultaneously: one international, the other domestic. An important assumption of the model (which Putnam later relaxes) is that each seat at the international negotiation table is filled by a single chief negotiator with no independent policy preferences. The aim of this negotiator is simply to obtain an agreement that will be attractive to her constituents (Putnam, 1988: 436).

The bargaining process is then divided into two distinct stages. The first, a negotiation stage, occurs between negotiators (Level I) at the international table and leads to a tentative agreement. The second, ratification, stage consists of a game between each negotiator and her domestic constituents (Level II). The only formal constraint on the second stage is that Level I agreement cannot be amended at Level II without reopening the Level I negotiations (*ibid.*: 437).

In Putnam's model, the likelihood of an agreement is dependent on the contours of the Level II 'win-sets', i.e. the set of all possible Level I agreements that would 'win'.<sup>27</sup> Level II win-set size and shape contribute to two important generalizations. First, the larger the win-set, the more likely a Level I agreement. Second, the larger the *perceived* win-set of a negotiator, the weaker her relative bargaining position *vis-à-vis* other Level I negotiators. Within this context, win-set size and contours are determined by three sets of factors: Level II preferences and coalitions; Level II institutions; and Level I negotiators' strategies.

Mentally juxtaposing the Nordic-EU bargaining process against Putnam's model reveals three shortcomings of the model. First, the assumption that negotiators do not have independent or vested inter-

ests is highly problematic. On the issue of EU membership, political elites in all the Nordic countries have quite different policy preferences from their constituents. On EU issues, political elites are *affecting* public opinion, not just responding to it.<sup>28</sup>

Nor is this phenomenon confined to EU issues. Negotiators are seldom agnostic with regard to policy preferences and outcomes. Many trade agreements can be characterized by enthusiastic support from political elites and government representatives, *and* by general public skepticism. Thus, an attempt to expand Putnam's model to account for the strategic interests of negotiators could bring broad analytical purchase.

While Putnam does relax this assumption in the latter part of his article, he fails to anticipate several possible outcomes. The reason for this lies in the second shortcoming of his model: the implicit working assumption that international agreements are necessarily a desirable good. While this may be (tautologically) true for negotiating partners at the Level I table, it is not necessarily true for the domestic constituents whom they ostensibly represent. This normative assumption is highly problematic and often leads to questionable premises.

Thus, when Putnam relaxes the assumption about disinterested negotiators, the options available to them are confined largely to vetoing possible agreements.<sup>29</sup> In this scenario, the 'problem' is a shrinking common win-set.<sup>30</sup> For Putnam, the number of dilemmas facing Level I negotiators is limited to two: (1) constituents may be more eager for an agreement; or (2) constituents may be more worried about 'no-agreement' (*ibid.*: 438). As a result of Putnam's normative assumptions about the desirability of international agreements, his model cannot accommodate a third possibility: that constituents might not want an agreement.

The third shortcoming of Putnam's model which emerges when it is juxtaposed with Nordic EU membership negotiations is the problem of confining the negotiation process to two formal stages: it is just too simple to assume that there are only two stages to the negotiation process. Much of the game is already played before the actors sit down to hammer out Level I's tentative agreement. In what might be called a prelude to Level I, negotiators are engaged in a series of agenda-setting struggles at *both* tables. Negotiators are aware of the importance of win-sets (if not aware of the terminology coined by political scientists to explain their behavior), and try to organize the agenda in ways which will aid them in obtaining desirable ends.<sup>31</sup>

### III.1 A new, agnostic, model of negotiations

In attempting to correct these three shortcomings of Putnam's model, a new model should anticipate the possibility that negotiators have

a vested interest in specific outcomes, and are willing to pay the political costs – even when large.<sup>32</sup> To do so, negotiators might manipulate two parameters of the model: one spatial, the other temporal.<sup>33</sup> Advocate negotiators<sup>34</sup> will try to arrange the agenda and its timing to insure desired outcomes.

As Putnam explains how win-sets can be enlarged or refigured, his model provides potential lessons to negotiators interested in manipulating win-sets. By emphasizing some aspects of the negotiations over others, advocate negotiators can increase (or redraw) their constituent win-sets to optimize the likelihood of an agreement. In other words, Putnam's model can be employed as a strategy play-book for negotiators wishing to change public opinion on international agreements. Whereas Putnam's model is aimed at describing the likelihood of different negotiation outcomes, in particular international policy coordination, I intend to use his model to explain the negotiation strategy of Nordic political elites aiming to secure an international agreement despite a reluctant home constituency.<sup>35</sup>

In order to provide some context, but wishing to retain the model's utility in general and parsimonious terms, we can begin by assuming a negotiating situation similar to the one facing the three Nordic countries in their attempt to join the European Union. Generally, we can speak of an international body negotiating bilaterally (and sequentially) with a series of autonomous states seeking membership. We also assume that each of the applicant states has membership preferences that differ from those of their constituencies.<sup>36</sup> In addition, we can assume that the costs of increased membership to the international body are relatively small.<sup>37</sup>

Obviously, there will be differences as to the exact criteria and costs for each applicant state. At the margins, the costs may become so large that a tentative agreement is not acceptable, even to advocate Level I negotiators. Generally speaking, however, we can expect a fairly large area of win-set overlap (among negotiators) at the Level I negotiation table. The size of the win-set overlap of actual constituent populations will be much smaller.

Remembering Putnam's first generalization about the relevance of win-set size (see above), and assuming that both Level I negotiators desire a favorable tentative agreement, we can expect that both negotiator groups will try to influence the size of their relative domestic constituent win-sets in an attempt to secure a final agreement. If we assume (for simplicity) that the international organization's negotiators (IO) represent their constituents' interests (i.e. *à la* Putnam), and we distinguish between nation-state negotiators (NN) and national constituent (NC) interests, the problem for nation-state negotiators can be sketched graphically.

As Putnam assumed that the relevant bargaining cleavage lay between Level I negotiators (and not between elites and their constituents), he could schematically depict the implications of win-set size along a single (zero sum) axis (Putnam, 1988: 441, Figure 1) stretching between the maximum bargaining outcomes of the two negotiating bodies. However, if we are to capture the (elite-constituent) cleavage with which we are concerned, another dimension needs to be added to accommodate the different win-sets of negotiators and constituents.

Figure 1 depicts win-set size and overlap along three axes. The maximum bargaining outcomes for the international organization, the nation-state negotiator and the national constituents are IOm, NNm and NCm respectively. Each of the three boxes represents a three-dimensional win-set, with the large vertical box representing the win-set for the international organization. IO and IO\* represent the minimal outcomes that could be ratified by the IO along the NN and NC axes. The two shaded areas represent win-set overlap. The larger the size of the win-set overlap, the greater the likelihood of an agreement. Thus,

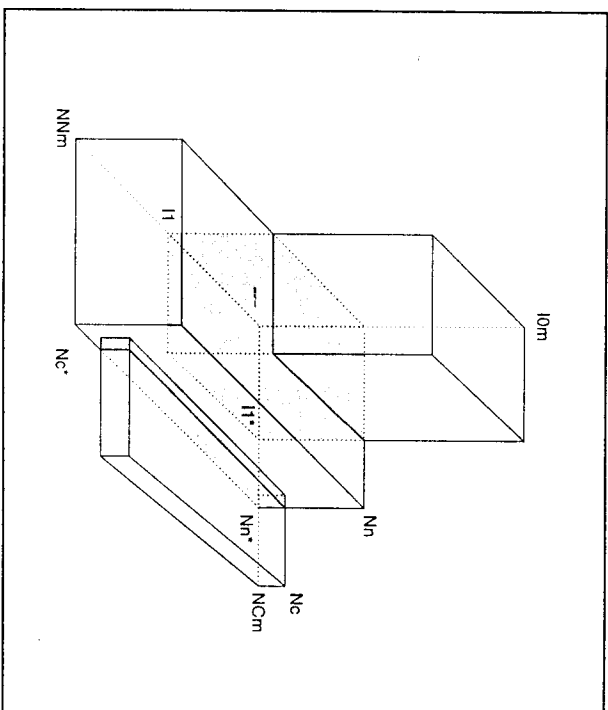


Figure 1 Putnam's model amended to three dimensions

in the Figure 1 depiction, there is significant overlap between the IO and NN win-sets, suggesting that the likelihood of an agreement between them is relatively high.

While this figure employs the same logic as Putnam's single-dimensional depiction, it requires a few additional caveats. First, the distance between axes will not always be equal, as depicted here. Sometimes there will be greater commonality between elite interests,<sup>38</sup> at other times, national elite-constituent interests will tend to share common ground.<sup>39</sup> In addition, the depiction in Figure 1 is exaggerated in that there is no win-set overlap between the IO box, the NN box and the NC box (the small flat box to the right).<sup>40</sup> Other examples might have the NC box stretching over into the IO and NN overlap area.

In this depiction, the objective of nation-state negotiators (NN) is to try and increase the win-set of their constituency<sup>41</sup> by expanding the NC\* frontier to the left (in the direction of the negotiator's maximum outcome: NNM), and the NC frontier upwards (toward the IO's maximum outcome: IOM). The more that national negotiators can increase the size of their national constituents' win-set box, both vertically and horizontally, the greater the likelihood that they can secure and ratify an international, Level I, agreement.

Thus, by changing an initial assumption in the Putnam model (non-autonomous negotiators) and by relaxing his implicit assumption that international agreements are always desirable, we have expanded the model to accommodate a wider variety of international negotiation situations, including the game played between the EU and the Nordic countries over membership. In this new model, the strategic interests of national negotiators play a much larger role. Advocate negotiators will try to increase the size of the NC win-set by manipulating the negotiating agenda.

The next section looks at how win-set size and configuration are determined in the original Putnam model. If win-set size is susceptible to manipulation by national negotiators (or, more accurately, their government sponsors), Putnam's model may present a strategy-path for nation-state negotiators (again, read government sponsors) wishing to influence the likelihood of an international agreement.

## II.2 Win-set determinants

Putnam suggests that there are three types of factors which determine win-set size: Level II preferences and coalitions; Level II institutions; and Level I negotiators' strategies. How might Level I negotiators strategically exploit these determinants to expand the NC win-set space? We will consider each determinant separately. In the examples below,

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our concern is with how national negotiators can expand the national constituent win-set (NCm-NC-nC\*), not their own win-set (NNm-NN-nN\*). From each set of determinants a specific lesson for national negotiators can be derived. In the empirical section which follows, we will then check to see if these lessons provide any descriptive purchase in the ECU linkage cases.

### II.2a Level II preferences and coalitions

In the spirit of Putnam's article, I intend to concentrate on more general determinants of Level II preferences rather than try to employ an in-depth analysis which utilizes a specific theory about power and preferences at the domestic level. Putnam mentions five general factors related to constituent preferences and coalitions which can affect win-set size. The first two factors are structurally grounded, leaving little flexibility for short-term political manipulation by advocate negotiators. When negotiators cannot change the spatial agenda because of structural constraints, I assume that they will turn to the temporal agenda. The other three factors are more open to agenda manipulation within the nation-state.<sup>42</sup> Thus, each of these five factors offers a lesson as to how they might be used by negotiators wishing to manipulate the negotiation agenda.

1 *Relative size and self-sufficiency.* Putnam argues that the more self-sufficient a state, the less likely it is to support an international agreement (Putnam, 1988: 443). As this is a structural characteristic, there is little that a given Level I negotiator can do to change the outcome. But if we consider action along both temporal and spatial axes, some possibility for strategic manipulation does arise.

If nation-states applying for membership in an international organization vary in terms of dependency (or, inversely, degree of self-sufficiency), there may be some room for temporal manipulation. If an advocate negotiator can control the timing of her nation's ratification rounds<sup>43</sup> (relative to the ratification rounds of other nation-states), we would expect less self-sufficient states to choose to make important ratification decisions *before* more self-sufficient states.<sup>44</sup> This we can call **Lesson one**.

2 *Hetero vs. homogeneous constituent preferences.* Generally, homogeneous preferences among constituents decrease the likelihood of involuntary defection from international agreements (ibid.: 444). In the absence of transnational alignments, the opposite is the case for heterogeneous constituent groups.<sup>45</sup> Thus, speaking in very general terms, homogeneous constituent preferences are more likely to inhabit larger win-sets.<sup>46</sup> Like the first group of factors, these rest on structural bases such that spatial agenda manipulation by advocate

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negotiators is problematic. Although negotiators might be able to emphasize or ignore the degree of preference homogeneity, and thus influence the likelihood of a successful agreement, the main avenue for negotiator influence is again temporal.

Therefore, **lesson two** might be that in the absence of transnational alignments, we would expect nations with more heterogeneous preferences to act on ratification decisions *after* those nations with homogenous preference structures.<sup>47</sup>

**3 Synergistic issue linkage.** Level I negotiators may be able to create new policy options by encouraging tradeoffs across different issue areas. New policy options can expand potential win-set contours. While much of this agenda will be decided bilaterally among Level I negotiators (and therefore cannot be used unilaterally by negotiators to manipulate their constituents' options), or is determined by the nature of the agreement being negotiated (i.e. single- or multiple-issue agreements), one specific variant of issue linkage may have some unilateral strategic application.

Putnam expects synergistic linkages to become more likely with increased interdependence (ibid.: 447-8). Economic interdependence, for example, expands the set of feasible alternatives (by encouraging transnational entanglements) such that there are greater opportunities for altering domestic coalitions (and with them, win-set structure). Thus, **lesson three** would have negotiators attempting to increase constituent win-sets by promoting integration (with the future contracting body) – thereby increasing interdependence – in the prelude to the formal negotiation process.

**4 Abstention rate.** Constituent participation in the ratification process varies across groups and issues, such that it has important implications for win-set size (ibid.: 445). Groups that are most affected by an agreement will have the greatest interest in trying to influence the negotiation outcome. Thus, low-participation issue areas would be areas in which the negotiator could expect a greater amount of autonomy (from her constituents).

The lesson which follows from this, **lesson four**, might be formulated in these terms: negotiators should attempt to manipulate the agenda such that discussion of low-participation issue areas precedes discussion of high-participation issue areas. In these (low-participation) issues, Level I agreements are more likely as there will be fewer Level II distractions.<sup>48</sup>

**5 Politicization.** Politicization is the flip-side of the abstention lesson above; and it provides the last lesson for manipulating constituent preferences and coalitions. In the same way that constituent participation varied by issue, constituent composition varies by the politicization of a given issue. Increased politicization reduces the

effective win-set by drafting into action groups who were originally less worried about the (costs) benefits of (non-)agreement (ibid.: 445-6).

One important instrument for overcoming politicization is the use of secrecy in the negotiation process. As this (like issue three above) is most likely to be decided among Level I negotiators, it is not usually available to them unilaterally. The advocate Level I negotiator, however, is not left without options. Politicization is also affected, like abstention, by an issue's opacity. More opaque issues tend to be less politicized. Thus, we can derive from this factor a simple applicable lesson, **lesson five**, which holds that negotiators should try to focus pre-negotiation strategy on non-politicized, technical or opaque issues.

### II.2.b Level II institutions

It is obvious that various ratification procedures and institutions affect the size of win-sets and influence the likelihood of achieving international agreements. In particular, Putnam lists two specific ways in which institutions matter: the nature of ratifying institutions and the degree of institutional autonomy. As with the last section, these two factors will be briefly explained from a strategic perspective, and from them lessons for the advocate negotiator will be derived.

**1 Ratifying institution.** The greater the threshold for ratification, the smaller the likely win-set (ibid.: 448). The most common example of this rule is that a ratification procedure which requires a two-thirds majority corresponds to a smaller win-set than one in which a simple majority is required. The choice of institutions (and correspondingly, the rules that govern them) used to ratify the agreement becomes an important strategic choice. **Lesson six** for the strategic advocate negotiator is to insure that the ratification hurdle is as low as possible. Although this choice will decrease the bargaining power of Level I negotiators, it will insure the likelihood of Level II ratification.

**2 Institutional autonomy.** The greater the autonomy between a negotiator and her constituency, the less relevant is the distance separating their two win-sets (ibid.: 449). If, as we have assumed, the negotiator is more interested in achieving an international agreement, the likelihood of an agreement increases with the degree of institutional autonomy. Thus, in a situation where several institutions (and issues) are negotiating (being negotiated), the more autonomous institutions are more likely to broker international agreements. In this context, **lesson seven** would have it that the head negotiator should prioritize negotiations among institutions which are relatively more autonomous.<sup>49</sup>

*H2.c Level I negotiator strategies*

Putnam's Level I negotiator strategies are aimed mostly at encouraging cooperation among negotiators, rather than trying to influence domestic constituent audiences. When a negotiator does wish to expand her win-set, Putnam argues that using side-payments is probably the most accessible instrument at her disposal (*ibid.*: 450-1).<sup>50</sup> The effectiveness of side-payments, however, is largely determined by the nature of the rules in the ratifying body. If ratification depends on the votes of a few, side-payments (to members of parliament, congressmen, etc.) might be relatively effective. If, however, ratification occurs in a general referendum, side-payments will be less effective.

Thus, the lesson from this could be attached as an appendix to lesson six above. Lesson 6A holds that, given ratification institutions (rules) that focus political power in the hands of a few, negotiators can be expected to offer concessions that aim to tip the balance with swing voters.

Finally, Putnam mentions that win-set contours are responsive to changing levels of popularity for negotiators and political leaders: an increase in popularity at home increases the size of a negotiator's constituent win-set (*ibid.*: 451). Obviously, this must remain an exogenous variable, less susceptible to strategic manipulation at the hands of negotiators acting unilaterally. But as both Level I negotiators respond to media attention, status and the possibility of increased popularity by participating in international negotiations, one would expect that they would tend to emphasize negotiation publicity over substance. Once again, however, this is a bilateral arrangement; strategic negotiators will not be able to use this unilaterally to affect the size of their constituent win-set. Thus, this last factor provides no unilateral lessons to the advocate Level I negotiator.

We began with the assumption that Level I negotiators have an interest in affecting the domestic agenda as a means of insuring an international agreement (despite public reluctance). Putnam's model was then redrawn along three dimensions to show, graphically, how advocate negotiators might affect win-set contours. Finally, Putnam's determinants for win-set contours were reframed in more strategic terms – providing seven lessons for advocate Level I negotiators hoping to enlarge their constituent win-set.

Although one can find many amendments to the Putnam model, and there exist several similar models from which additional lessons might be drawn, for methodological reasons it is important for us to stick with Putnam's original model. If these lessons are to provide any analytical purchase in the section which follows, it is important that they are the product of an independent, deductive model – not constructed, *ad hoc*, with an eye toward (a) specific empirical case(s). I have attempted this

in the section above. The next section will provide a brief historical overview of Nordic ECU linkage in terms of elite strategies for future EU membership.

## III NORDIC ECU LINKAGE

As the introductory section hinted, previous exchange rate regime decisions in the Nordic countries have also been painted in pro-EC/anti-EC colors. The framing of earlier exchange rate regime decisions and debates in both Norway (1973, 1978) and Sweden (1973, 1977) were in exactly these terms.<sup>51</sup> Both Sweden and Norway had decided in the late 1970s against continued Snake/EMS cooperation because of political resistance to the tighter EC ties that it implied. Because of the nature of Finnish neutrality, EC membership was a less relevant political issue, and various EC-based monetary cooperative arrangements were never previously considered.

As the first section made clear, the Norwegian community of economists was opposed to the government's unilateral decision to link the Krone to an ECU basket in October 1990. In this regard, the nature of the decision was quite peculiar for Norway. In previous Norwegian regime decisions (e.g. Bretton Woods, the Snake-in-the-Tunnel, the Snake, the trade-weighted basket) parliamentary and expert committees were established to draft the economic consequences of various options, and the decisions were thoroughly discussed in the parliament. The 1990 decision to link to the ECU basket was made without the advice of any expert committees on the matter, and was (with the exception of one of the anti-EC parties: the Socialist Left – SV) met by little resistance or debate in the Norwegian Storting.

The SV's finance spokesman, Eilif A. Meland, was especially critical of the way in which the regime decision was made and the consequences it would have on Norwegian policy autonomy:

EMS linkage is a clear accommodation to the EC, completely independent of the EEA [European Economic Area] negotiations. There does not exist professional economic support for this decision – none whatsoever. It cannot be defended on the grounds of interest rate developments or by references to the instability of foreign currency markets. More and more economists have said that the best krona basket is the one we have today, and they strongly warn against letting go of the yen, dollar and Swedish krona. Clearly, by switching to the EMS, the Norwegian economy will be negatively affected.<sup>52</sup>

Hermud Skånland, then Governor of Norges Bank, described the decision as very much a political one, tied to the European ambitions of

(especially) two state secretaries: Trond Rheinardsen and Bjørn Skogstad Aamo (Skånland, 1993). Their heavy lobbying secured a consensus for political affiliation which had not existed in earlier periods. When the Syse government fell on 29 October 1990 – largely because of division on the EC issue<sup>53</sup> – the new Brundtland government promised that Norway would adopt a 'more flexible' position in its negotiations with the EC.<sup>54</sup>

In Norway, the decision to link to the ECU basket was made by Euro-friendly political elites, against the recommendations of Norwegian economists and the central bank. In Sweden and Finland, where political support for EC membership (*at that time*) was even more problematic, the decision path varied. In these two countries, ECU linkage was first introduced by the central banks and later supported by incumbent governments. This decision-making responsibility was grounded in central bank legislation which allowed more autonomy for the Swedish Riksbank (in relation to its government) than for either the Norwegian or Finnish central banks on exchange rate regime issues.<sup>55</sup>

On 17 May 1991, the Swedish Riksbank unilaterally (i.e. without the government) decided to link (unilaterally) the Swedish krona to the ECU basket; the government was only informed after the decision-making process had been set in motion. While the impetus and decision were largely the central bank's, the growing consensus among Swedish political elites for EC membership played an essential and determinate role. Already in the fall of 1990, the Swedish Riksdag (parliament) had begun discussing the possibility of applying for EC membership. At about the same time, in September, several government members had publicly suggested (at the Social Democratic Party Congress) that an EC application was a definite possibility. These public ambitions by Sweden's political elites prompted market expectations of a future krona/ECU link. As the formal application deadline approached,<sup>56</sup> market speculators would be allowed a field day unless a decision to link *preceded* the formal EC membership application.

Governor Bengt Dennis' interpretation of these events and their timing is very revealing.<sup>57</sup> He suggests that the central bank's hand was forced by political discussions in the Riksdag about possible EC membership. Had the Riksdag decided against applying for EC membership, Dennis argues that the decision to peg the krona to the ECU would have been postponed, or quite possibly dropped. But, as EC membership was now on the political table, it was important for the Riksbank to take action or risk increased speculation against the krona.

Dennis thought that if the Riksbank waited until after the Riksdag's decision to apply formally for EC membership, market speculators would relentlessly drain the Swedish foreign reserves. From his perspective, it was much better to decide to link the krona to the ECU basket

while it was still a question of 'if' they should link, rather than a question of 'when' they would link (Niemyer and Lundgren, 1991: 566).

The decision to link was made secretly among the Riksbank's Governing Board over the preceding month. On 13–14 April, when the original plans were being formulated, the government's Finance Minister, Alan Larsson, was informed of the options being discussed (ibid.). While Larsson was apparently kept abreast of developments in the Riksbank's Governing Board, the rest of the government was formally informed only a couple of hours before the final decision (Höngren, 1993).

As with the Norwegian case, and in contrast to the decision to join (1973) and leave (1977) the Snake, there was surprisingly little parliamentary discussion about the economic costs and benefits of ECU linkage. As the political elites in Sweden's main political parties were supportive of EC membership, the decision was no longer politically divisive.

The Finnish decision to link the markka to the ECU basket, following in the wake of the Norwegian and Swedish linkages, is not surprising.<sup>58</sup> As with Sweden, the 'neutrality' issue was becoming less and less relevant for deciding these sorts of questions. Finland's trade with the Soviet Union was seriously deteriorating, and this was forcing Finns to plan their future economic strategy along broader geopolitical horizons. EC membership, for the first time, became a realistic possibility. With the possibility of Finnish EC membership being discussed, and the currencies of Finland's western neighbors already linked to the ECU, political and economic arguments for markka/ECU linkage were no longer controversial.

As in the Swedish case, the impetus for the Finnish link came from the central bank. Like the Riksbank's Governor Dennis, the Bank of Finland's Governor, Rolf Kuilberg, forced the government's hand. But the Finnish institutional context requires more active support from the incumbent government, which was – at the time – divided over the issue. This made the bank's influence all the stronger in that it could lobby various factions within the government on the necessity of ECU linkage.

In contrast to the Norwegian and Swedish cases, the decision to link to the ECU in Finland entailed a bit of political tightrope walking. In April 1991, a new center-bourgeois party coalition had taken over the reins of government – the first bourgeois government in Finland since 1966.<sup>59</sup> The coalition, however, was a rather unstable one, and the question of ECU linkage, and its pro-EC connotations, were issues which could have potentially threatened the government.

This new government, under the prime ministership of Esko Aho, came to power during a period of serious economic problems, and was

internally divided about possible solutions to Finland's economic woes. Aho needed to vindicate the electorate's faith in his party by somehow increasing Finland's competitiveness; unfortunately, he had few firm ideas as to how this might be achieved. Greater Euro-cooperation, including linkage to the ECU, was one option available. But linking the markka to the ECU was a potentially divisive issue among cabinet ministers.<sup>60</sup>

In the end, ECU linkage was the only solution upon which the government could actually agree. ECU linkage was assumed to be good for industrial and internationalist supporters; Sweden had just made the link, so the policy was not novel; and it was believed that the decision would bring down interest rates, sparking domestic development and an internal devaluation. It was also a policy that was being heavily lobbied for by the Bank of Finland.

Pressure from the Bank of Finland had come in the form of a surprise press release by its then Governor, Rolf Kullberg. Immediately following the Swedish Riksbank's decision to link the krona to the ECU, Kullberg sent out a peculiar press release: in it Kullberg announced that Finland could also benefit from a similar linkage to the ECU. It is uncertain to what degree Kullberg was acting on his own initiative or how much support he had for this press release inside either the government or the bank.<sup>61</sup>

On the surface, this should not seem like such a radical move. For some time, the government's official program had vaguely hinted at how the markka should be integrated into the European exchange rate system; but the policy formulation remained purposefully vague. There was apparently an understanding among government civil servants and policy makers that a formal decision would be contemplated later – possibly in the fall (Korkman, 1993: 14).

Of course, after Kullberg's press statement it would have been very difficult for the Bank of Finland *not* to tie the markka to the ECU; the market was now expecting it. After Kullberg's speech, *not* linking would have triggered an enormous speculative wave – as market actors would interpret the decision not to link as a decision to devalue in the future.

Thus, potential EC membership played a much smaller role in the Finnish decision to link the markka to the ECU. Political support for linkage stretched across parties in the Aho government – along sectoral lines. More significantly, it was the only solution which could unite the interests of externally oriented industrialists, supporters of potential EC membership, and those concerned with restructuring the Finnish economy along broader (read non-forest industry) lines. It was also a policy that was being heavily lobbied for by the Bank of Finland.

While EC factors played a smaller role in Finland, they were not insignificant; their effect was amplified, however, by indirect factors.

In particular, the market expected that the markka would soon need to follow the Norwegian and Swedish krona/a in linking to the ECU. This was especially true after Kullberg's press release confirming these expectations. In other words, the EC-driven decisions in Norway and Sweden set the ball rolling for a similar decision in Finland.

### III.1 Explicit lessons

Formal applications for EC membership were not forthcoming until July 1991 (Sweden) and November 1992 (Norway and Finland). To what degree can ECU linkage be interpreted as the first concrete step taken by Nordic political elites on the path toward EU membership?<sup>62</sup> How can the decision to link, and the timing of the decision, be understood in terms of the model amended in Section II?

From the perspective of those specific lessons, we see that several of the decisions (and their timing/order) can be explained in terms of a possible win-set extension strategy on the part of Nordic elites. Of the seven lessons derived from the amended model, five (i.e. 71 percent) seem to have direct applicability to the ECU linkage decisions and their relative ordering. The remaining two lessons seem less relevant for explaining the motives of Nordic elites.

The decision to link a national currency to the ECU basket is a highly technical, very opaque issue which generates little politicization or participation. Few other EU membership issues are less understood than those that deal with exchange rate regimes, currency swaps and Optimal Currency Areas. In this regard, the decision is consistent with lessons four and five: not only does this issue area have an extremely high abstention rate, but it invokes very little politicization.

As exchange rate regime decisions in general, and ECU linkage in particular, are generally made by autonomous institutions (central banks), these decisions are consistent with lesson seven as well. In Sweden, the central bank was institutionally autonomous with respect to decisions about exchange rate regime policy. This was not the case in either Norway or Finland, where government and/or parliamentary boards had much more say in the matter. In both Sweden and Finland, where the political consequences of EC membership were more contentious, it was the central banks that initiated and drove the ECU linkage project. In Norway, where there was more political support among elites, the decision was made by the government, against the recommendation of its central bank.

The national ordering of the decisions (i.e. Norway first, Sweden and Finland afterward) seems to satisfy a tangential lesson, lesson two – about homogeneous and heterogeneous interests. Because Norwegian elite interests were more homogeneous than in the other two countries

(on EU membership), it is consistent with lesson two that they should have been the first of the Nordic countries to make the ECU fix.

Lesson three, regarding synergistic issue linkage, also seems to fit these decisions. ECU linkage obviously includes several levels of economic integration. As with its complement, the European Economic Agreement, ECU linkage undermines significant aspects of national policy autonomy and contributes to the need for European policy convergence along several dimensions.

Finally, two lessons do not seem relevant for describing the timing and agenda of Nordic ECU linkage. Lesson six (and 6A), about the ratification hurdle, is obviously irrelevant for describing the decision to link to the ECU (though not for other aspects of EU negotiations).<sup>63</sup> Lesson one, as well, does not seem to contain much descriptive or analytical purchase. Arguably, the degree of self-sufficiency does not vary enough among the Nordic countries to make use of the first lesson.

As five of the seven strategic lessons for agenda manipulation seem to have been fulfilled by the decision to link to the ECU, it does not seem unreasonable to suggest that this decision was made as part of a larger EC membership strategy on the part of Nordic elites. Obviously, however, we cannot be certain of elite motives, and there is some likelihood that the relationship found above is only coincidental. Better evidence may some day be available, when today's political elites begin to discuss (in the post-referendum period) their strategies and motives during this critical time.

#### IV CONCLUSION

In this article I have rather ambitiously attempted to test a popular political argument on a subject of great current interest in the Nordic region. This constitutes my first problem. As the above pages endeavored to show, it is always safer to negotiate depoliticized issue areas.

The argument being tested asks: Can the decision by each of the Nordic countries to link their currencies to an ECU basket be explained as an attempt by political elites to grease the skids leading to Nordic EC membership? Before that question could be legitimately posed, it was necessary to eliminate the main contending argument for ECU linkage: economic necessity. The first section of the article attempts to do just that.

The second problem herein is derived from the fact that my objective is to establish the subtle motives of political elites acting on an extremely contentious issue. In an attempt to provide some external standard by which we might measure elite actions (and motives), I rework Putnam's original two-level negotiating model in more strategic terms. Section II provides seven strategic lessons for political elites wishing to manipulate Level II win-set contours.

The third section gives a brief historical description of the process by which each of the Nordic countries linked their currencies to the ECU basket. These descriptions provide a few general observations which are shown to correspond with the amended Putnam model; the degree of overlap between the lessons of Section II and the empirical observations of Section III is quite high. As the previous section showed, there is a fairly significant fit between the model's strategic lessons and several aspects of the actual linkage procedure in each of the Nordic countries.

In particular, the institutional autonomy of the Swedish central bank (and the lack of it in Norway) was highly relevant for understanding the nature of the decision, and its timing, in all three countries. Norway — where support among political elites for EC membership was greatest — was the first to link its krone to the ECU. It is also interesting to note that the decision in Norway was made by government officials, not by the central bank.

In Finland and Sweden, where political resistance to EC membership (even among elites) was stronger, the decision was made by central bankers, outside traditional political channels. This does not mean that the decision was opposed by political elites, it was simply less costly for them if the decision was made by autonomous, technical institutions. As Governor Bengt Dennis suggested, the combination of market expectations and the EC ambitions of political elites made it nearly impossible for the Riksbank *not* to link in the wake of Norway's decision.

In Finland, where EC support was (at the time) the most costly in terms of domestic political capital, the decision to link was forced by a renegade press release from the Governor of the Bank of Finland. In the Finnish example, political elite preferences were more divided (both among parties and between the government and its central bank), and the decision seems motivated more by the fact that Norway and Sweden had already linked and that market actors expected a future Finnish link. However, had political elites in Finland been adamantly opposed to EC membership, these expectations would not have played a significant role.

On this basis we might conclude that the initial hypothesis cannot be disproved: Nordic ECU linkage can be explained in terms of, and is consistent with a strategy based on, the EC ambitions of political elites.

#### NOTES

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- 1 EEC, EC and EU are used interchangeably throughout the article, depending on the acronym currently in currency.
- 2 This argument is not reserved to ECU linkage. It is frequently wielded to explain participation in the European Economic Area (EEA) and other aspects of EFTA-EC cooperation.
- 3 In 1972, both Norway and Denmark held referendums on EEC membership. The Norwegian referendum, on 25 September, narrowly opposed membership. The Danish referendum, on 2 October, supported membership by 63 percent. Although Sweden and Finland did not apply for membership during the 1970s (as neutrality was then seen as incompatible with membership), the terms of the debate were quite familiar and prevalent in both countries.
- 4 I am grateful to Kate McNamara for reminding me of this metaphor and its applicability to the problem at hand.
- 5 Obviously, the argument here parallels the one frequently voiced in the Community, where the EMS/EMU project is seen as a central element in the European integration movement.
- 6 Although there are several attempts at using existing models to encourage strategic moves by national elites hoping to influence the opinion and actions of their national-level counterparts, and thereby the outcome of international agreements (see, for example, Schelling, 1960; Schoppa, 1993; Grieco, 1990; Haas, 1990), there is very little written with an eye toward affecting the opinion of a skeptical domestic constituency. The only exception, though it deals with a different subject (labor negotiations), is Walton and McKersie (1965).
- 7 In this regard my project is not novel. Several others have noted the 'explanatory gaps' in Putnam's original model, and have tried to improve on it. See, for example, Milner (1992), Mayer (1992) and Finnan (1993). It is the specific architecture of my remodeling job which I hope is novel.
- 8 For descriptions and histories of each of these currency baskets, see Puro (1984) (Finland), Franzen *et al.* (1980) (Sweden), and Brekk (1986) (Norway).
- 9 The credibility windfalls of this decision, however, will be addressed below, in Section I.3.
- 10 Sweden was the first to commit itself to a fixed exchange rate (i.e. a commitment to prioritize price stability) in the wake of its 1982 'Big Bang' devaluation. Finland followed suit (albeit less credibly) in 1983, and Norway committed itself to a fixed regime, later, in 1986. See Moses (1995: Ch. 9).
- 11 Hermod Skånland, then Governor of the Norwegian central bank (Norges Bank), made this explicit in his 1992 annual speech to the bank's Supervisory Council: the fixed regime change had already occurred during the old basket, and was not a product of the ECU linkage. (See Skånland's speech of 20 February 1992 to Norges Bank's *representantskapsmøte* (Norges Bank, 1992: 21))
- 12 Simply put, stability is important for importers and exporters as unpredictable currency fluctuations are harmful for normal productive industries.
- 13 While the Optimum Currency Area (OCA) literature is enormous, there are several good references aimed at analyzing a potential European monetary union from the perspective of an OCA. See, for example, Gros and Thygesen (1992), De Grauwe (1994) and Dyson (1994). For a review of the literature with respect to the Nordic conditions, see Moses (1995: Ch. 2).
- 14 In terms of price flexibility and/or economic institutions and policies, the Nordic countries have previously distinguished themselves as being policy-

- autonomous. In the postwar period, Nordic labor markets have been some of the world's most organized. Also, when the Phillips Curve was seen as relevant, the Nordic countries were more willing than others to prioritize full employment over price stability objectives. In other words, there is good reason to believe that the Nordic countries do have different levels of price (wage) flexibility, different 'transmission' mechanisms in the domestic economy, and autonomous policy preferences – different from the USA, Japan and Europe.
- 15 For a closer examination of the degree to which the Swedish and Finnish economies might be susceptible to asymmetric shocks, see Moses (1997a, 1997b).
- 16 This is avoiding the possibility that Finnish officials are using ECU linkage as a means of forcing a structural adjustment onto the Finnish economy. As forest industry barons have an enormous influence over Finnish economic policy (in particular, the devaluation option), linkage to the ECU basket will bypass that influence and force internal devaluations. These internal devaluations should, in principle, help other – more labor-intensive – export sectors. See Moses (1996b).
- 17 This is true for two reasons. First, it is expensive in so far as markka fluctuations against the dollar are extremely costly for important export industries which deal in dollar-denominated trade (e.g. the forest industry). Linkage to a basket which does not try to stabilize the dollar-markka exchange rate will bring enormous costs to those industries. Second, the Finnish economy will not be able to adjust to business cycle trends which vary from those economies in the basket to which the Finnish currency is linked.
- 18 This second argument is based on some basic assumptions from macro-economic theory. The so-called Mundell-Fleming conditions have it that, in a world with free (financial) capital mobility, it is not possible to maintain both fixed exchange rates and an independent monetary policy. In a world with free capital mobility Finland will not be able to pursue a monetary policy which is independent from those currencies to which its markka is linked.
- 19 For example, when Norway linked to the ECU, Norges Bank signed swap agreements with EMS-nation central banks that were to provide access to short-term funds (totalling approximately 16 billion NOK) for intervention in defense of the proposed margins.
- 20 Obviously, this information was not available to policy makers at the time, and it would be wrong to read history backwards onto the perceptions of policy makers. My point is simply that without complementary EMS membership, the decision to link unilaterally to an ECU basket could not be made on credibility grounds. This should have been as obvious to policy makers as it was, later, to market actors.
- 21 Originally these three countries applied for full EMS membership (as did Austria), but all of their applications were rejected by the Community.
- 22 Had the three countries been allowed full EMS membership, this credibility argument would have been much more legitimate in the eyes of market judges.
- 23 EFTA (1988: 47), cited in Lybeck (1989: 88); translation (from the Swedish) mine.
- 24 Norges Bank (1991b: x); translation mine.
- 25 *Dagens Næringsliv*, 24 October 1990; translation mine.
- 26 As Putnam's model is well known within the field of international politics, I intend to provide only a brief summary of it in this section. More serious readers, obviously, should consult the original piece.

- 26 Examples of similar attempts include Mayer (1992), Schoppa (1993), Lehman and McCoy (1992) and Evans *et al.* (1993).
- 27 Putnam (1988: 437) defines win-sets for a given Level II constituency as: 'the set of all possible Level I agreements that would "win" – that is, gain the necessary majority among the constituents – when simply voted up or down'. See also Shepsle and Weingast (1987).
- 28 Obviously, this phenomenon is not confined to Nordic elites. Much of the European movement toward union can be read in terms of goading elites and hesitant publics.
- 29 The veto option dominates because two out of the three motives given to negotiators by Putnam have to do with increasing domestic political capital (rather than affecting its make-up). With this in mind, negotiators prioritize domestic calculus over their international counterparts. See Putnam (1988: 437).
- 30 Putnam does consider a third option, based on the costs of coalition building. In the Nordic EU examples we consider below, however, formal coalition costs are less of an issue: EU membership is favored by all the large political parties. It is not the political opposition that must be wooed into coalition, it is the public at large.
- 31 Obviously, allowing for a preliminary round introduces problems of restructuring and reverberation that complicate the game to an even greater extent. As a game-theoretic analysis requires the structure of both issues and payoffs to be specified in advance, the formal analysis at this point will necessarily break down. Still, much metaphorical utility remains. I should mention that Putnam notes the problems that restructuring and reverberation bring to the game, and provides an adequate response (1988: 454–6). Although the likelihood of reverberation increases in the revised model which follows, Putnam's caveats are still sufficient.
- 32 In particular, autonomous elite preferences might include (among other things):
- 1 *personal gain* (small fish – big pond syndrome): political elites in small countries may have personal ambitions that are larger than the countries in which they reside;
  - 2 *responsibility shirking*: as the realm of policy autonomy has shrunk with internationalization, and with the economic policy failures of the late 1980s still fresh in the minds of politicians, small-country politicians may find it easier to abdicate responsibility for costly policies to international institutions (for example, high interest rates and unemployment levels can be blamed on the Bundesbank, not on national politicians);
  - 3 *elite networking*: among social democrats, in particular, there is a solidaristic element whereby politicians are ideologically and socially committed to internationalism. Advancement within the party ranks has required cultivating international connections and commitments which, over time, have become as important politically as responsibility to home constituencies.
- 33 By spatial agenda I mean the actual issues which are placed on the negotiation agenda, by temporal agenda, I mean the order in which these issues are discussed and decided.
- 34 An advocate negotiator in this context is a Level I negotiator with an interest in a specific outcome, independent of constituent preferences.
- 35 My objectives here are not unlike those in the Oye (1986) collection. By better understanding the parameters of a given model, actors (or supervisory agents) can manipulate those parameters to encourage specific outcomes. For Oye and company, manipulating the payoff structure, the 'shadow of the future', and the 'number of players' affects the likelihood of securing a cooperative outcome. Although the Oye collection (as well as Putnam's article) assumes that cooperation is in itself positive, my argument is that cooperation is not necessarily positive in any normative sense, but is often the product of political bullying – via agenda manipulation – by political elites.
- 36 In the Nordic example this is not a problematic assumption, and is empirically verifiable. The general population in each of the Nordic countries was at best lukewarm in its support of the EU (Finland), at worst outrightly skeptical (Norway). On the other hand, Nordic political elites in government were ardent supporters of membership in the EU. The only exception to this rule was Iceland, where the relationship appears to have been just the opposite: hesitant elites and supportive populations.
- 37 This is, generally, one of the lessons from economic studies of international organizations. See, for example, Frattoni and Pattison (1982: 252–3). Again, in the Nordic EU example, this assumption is probably trivial. EU (Level I) negotiators can be expected to be relatively supportive of Nordic membership, if only because wealthy Nordic members represent potentially substantial budget contributions to the EU's future coffers.
- 38 In the Nordic EU membership example, common elite interests might (for example) focus on retaining the primacy of nation-state interests at the expense of the European Parliament; establishing the number of civil service positions in the European capitals(s); travel and conference funds for high-ranking politicians and bureaucrats; etc.
- 39 Here the case is more evident. Presumably, NN and NC interests should overlap on several issues of critical national importance.
- 40 This depiction best represents the Norwegian case, where public opinion was most skeptical toward EU membership (among the Nordic countries). Firms, who generally had a more positive attitude toward EU membership, might have found their win-set box stretching into the EU space.
- 41 This assumes, as is depicted in Figure 1, that there is sufficient win-set overlap between the IO and NN to insure a tentative agreement at the Level I table.
- 42 Though I have emphasized the spatial aspect of these latter factors, it is also possible to employ a temporal strategy in these cases. For example, if the likelihood of an international agreement increases given autonomous institutions, and the institutions in one nation-state are more autonomous than in others, we might expect advocate negotiators with less autonomous institutions to postpone discussions until (more likely) agreements are made by the (more autonomous) institutions in other nation-states. For simplicity's sake, however, I have explained the temporal strategy only when spatial manipulation is not likely or possible.
- 43 The ambiguity of this term is intended: I do not see negotiation exchanges limited to two formal periods, as does Putnam. Strategically minded negotiators can use the pre-negotiation period to manipulate several aspects of the negotiation agenda.
- 44 This argument entails an important assumption. Namely, that there is some 'domino effect' to ratification, such that the likelihood of a positive ratification vote increases, given the positive ratification by other, previous, applicant states.

- 45 As Putnam suggests, these situations are more complicated: sometimes divisions improve the agreements prospects, sometimes they do not. See Raiffa (1982: Chs 1, 2) and Putnam (1988: 444-5) for examples of both.
- 46 The nature of constituent preferences is most relevant when negotiators follow their constituents' advice. When dealing with an adroacte negotiator, homogeneity or heterogeneity refers to the consensus (or lack of it) among actual decision makers.
- 47 The same assumption and caveats apply to lesson two as did to lesson one.
- 48 As Raiffa's (1982: 166-86) description of the Panama Canal negotiations suggests, this lesson may have its costs as well. By settling these 'easier' issues first, fewer 'log-rolling' opportunities are left to help with tougher residual issues later.
- 49 This lesson assumes that there is a 'domino effect' associated with issue linkage; in other words, that the likelihood of an agreement in one issue area increases the likelihood of an agreement in other issue areas.
- 50 The literature on the use of side-payments for facilitating international cooperation is quite large. For some recent examples, see Grieco (1990), Haas (1990) and Friman (1993).
- 51 For the parliamentary debates surrounding these decisions, see *Forhandlingen i Stortinget nr. 257 (1972-73)*, pp. 2020ff., and *5. del 898 (1978-79)*, pp. 1247ff. (Norway); and *Riksdagens protokoll (1973: 48-49)*, pp. 26ff., *Riksdagens protokoll (1977/78: 5)*, pp. 81ff., and *Riksdagens protokoll (1877/78: 10)*, pp. 111ff. (Sweden).
- 52 The most interesting nexus of exchange rate regime changes and potential EEC membership occurred in Sweden in 1972. In March 1972 the Swedish Riksbank's Governing Board had decided to accept an invitation to participate in the new European Snake-in-the-Tunnel arrangement. Though the formal decision was taken by the Board, Governor Åsbrink did not implement it. In all likelihood, Olof Palme convinced Åsbrink of the need to side-track this politically contentious decision. See Moses (1995: chapter 6) and Eklöf (1990: 26).
- 53 Although the anti-EC Center Party was a member of the Syste government, and did in fact support the ECU linkage proposal, it did so on the basis of a misunderstanding of the economic and political consequences. Since 1990, the Center Party has reversed its position with regard to ECU linkage.
- 54 See the Brundtland government's policy position report to the Norwegian Storting on 9 November 1990.
- 55 See Moses (1995: Ch. 4). Central bank autonomy on exchange rate regime decisions can (and does) vary from more general issues of central bank autonomy. The Swedish Riksbank at the time under consideration was not more generally autonomous than its Finnish and Norwegian counterparts.
- 56 The actual application procedure began in December when the Riksdag voted 198 to 105 to give Prime Minister Carlsson a mandate to seek EC membership for Sweden.
- 57 Dennis' opinion, and the following description of the decision-making process within the Swedish Riksbank, comes from Bengt Dennis' speech to the Swedish Economists' Union. Highlights of that meeting can be found in Niemeyer and Lundgren (1991).
- 58 The Finnish decision of 7 June 1991 followed only three months after the Swedish.
- 59 The government consisted of the Conservative, Swedish-Speaking, Christian and Center Parties.

- 60 The division, however, was not along party lines, but within parties - along sectoral lines. In particular, the Finance Minister was in favor of maintaining the commitment to fixed rates, but all his colleagues within the same (Conservative) party were not. Within the Center Party there was apparently more sympathy for a devaluation strategy. The government, then, was deeply split over the issue, seriously enough for the coalition to be threatened.
- 61 Eventually Kullberg resigned, and there are rumors to the effect that his resignation was prompted by the ECU linkage scandal. These rumors are impossible to substantiate. What is fairly obvious is that there was a serious falling out between the Prime Minister and Kullberg, such that the latter's ability to pursue an independent bank policy was greatly circumscribed. If the ECU linkage scandal did play a role in his resignation, however, it was probably over the fact that he recommended linkage at the going rate, rather than accompanied by a devaluation - and this policy proved itself to be mistaken just a half-year later.
- 62 As one of the anonymous referees has rightly pointed out, there are several relevant turning points along the Nordic national paths to EU membership (or otherwise). By deciding to focus on the formal parliamentary decisions and diplomatic negotiations with the EC/EU, I ignore earlier elite ambitions with respect to EU membership (in the late 1960s in Sweden and Norway, and the late 1980s in Finland), the (later) formal government applications for membership, and the (eventual) date of the referendums. As the article emphasizes the strategic importance of setting the initial agenda, this criticism is pungent. My only defense is that we must start somewhere. Deciding where the initial agenda actually begins can lead us down a very slippery slope. In this light, it does not seem unreasonable to choose the formal parliamentary decisions and membership negotiations as the starting point.
- 63 One could suggest that pursuing an issue area for which responsibility lies with an autonomous institution (as is the case in the current example) is an attempt to shrink the ratification hurdle. This, however, seems a disingenuous devaluation of the model's analytical purchase. As I argued above, it is important not to perform *ad hoc* adjustments to the model in light of a case's empirical evidence.

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