At the beginning of the new millennium, the global financial crisis caused an earthquake that changed the European economic governance landscape for the years to come. It took some time before it was acknowledged that a mysterious monolith had appeared in Europe, soon to be known as “the Troika”. European citizens realized only that it was made up of the International Monetary Fund (IMF), the European Commission (EC) and the European Central Bank (ECB), but they were unaware of each institution’s individual role and of the modalities of their cooperation.

The origins of the Troika and the ESM Treaty

The Troika arrangement dates back to 2008-09, when the crisis struck three eastern European countries that were not yet members of the euro area: Hungary, Latvia and Romania. Assistance to these countries was provided by the European Union in close cooperation with the IMF. The Hungarian case, in particular, set a precedent for subsequent IMF-EU conditional lending operations. On that occasion, the EU adopted internal guidelines (yet to be disclosed) to ensure early consultation and ongoing exchange of information with the IMF as well as consistent policy advice, synchronization of disbursements and programme reviews.

The involvement of the IMF was considered necessary because of its technical expertise and crisis-management experience, while the EU was considered a junior partner in the endeavour. Later on, coordination between the EU and the IMF was enhanced to provide financial support to Greece, Ireland, Portugal and Cyprus (all Eurozone members), although always in the absence of a clearly defined legal framework.

Among the several possible conflicts of interest that have been identified, there is the “dual role” played by the ECB, which is at the same time negotiating financial adjustment packages and enforcing conditionality.

Eventually, in 2012, the Treaty establishing the European Stability Mechanism (ESM) regulated the relationship between the IMF and the European institutions more clearly. Art.

13 of the treaty entrusted the European Commission—"in liaison" with the ECB—with the tasks of assessing the existence of a risk to the financial stability of the euro area as a whole or of any of its members; assessing the debt sustainability of the Member State requesting financial support and its actual or potential financing needs; negotiating a Memorandum of Understanding (MoU) on the economic policy conditionality attached to ESM financial assistance; finally, monitoring the implementation of the adjustment programme.

The IMF instead was expected to provide its stability support "wherever possible" to requesting countries. Moreover, the Fund was to cooperate in close connection with the EC and the ECB in debt sustainability assessments, in negotiations of MoUs and in the monitoring of compliance with policy conditionality. It is worth underlining, though, that the ESM Treaty is not binding upon the IMF, which did not take part in its drafting. In fact, the IMF Executive Board took no explicit decisions on its participation in the Troika or on the modalities for its operations.

Some problematic aspects of the Troika's operations

The Troika arrangement raises many concerns, in particular considering the special position of the ECB in it. In its written testimony before the EU Parliament, the ECB claimed that its role within the Troika was limited to coordination and assessment functions:

> *ECB staff provides advice and expertise on a broad range of issues which are relevant for ensuring a proper functioning of the transmission mechanism of monetary policy (including debt sustainability), contributing to financial stability, and ultimately supporting the general economic policies of the Union. The decision to grant financial assistance, including the conditionality attached, lies with ECOFIN and the ESM Board of Governors.*

However, in spite of its expert advisory role without any decision-making power, "the ECB has been very much part of the decision-shaping process". In fact, the central bank played a significant part in drafting programmes, both because of its stance on several threshold issues (like debt restructuring and fiscal adjustment) and its activities (i.e. providing liquidity to banks and lowering sovereign interest rates via the purchase of sovereign bonds on the secondary market).

Among the several possible conflicts of interest that have been identified, there is the "dual role" played by the ECB, which is at the same time negotiating financial adjustment packages and enforcing conditionality. On this point, however, the ECJ did not follow the opinion of the Advocate General Cruz Villalón in the Gauwelier case, who claimed that "[u]nilaterally making the purchase of government bonds subject to compliance with conditions when those conditions have been set by a third party is not the same as doing so when the 'third party' is not really a third party."

Furthermore, many deem inappropriate that the ECB and the IMF are sitting on the same side of the negotiation table. In addition, the Troika arrangement gives rise to a large information asymmetry within the IMF Executive Board in favour of euro area Directors, who collectively have more than one-third of voting power. Last but not least, since coordination between the IMF and the European institutions leads to the adoption of separate but parallel lending operations, consistency of programme design and conditionality is critical.

Is the Troika really a monolith?

The design of programme conditionality was not always a smooth operation. In the case of Latvia, for instance, the European institutions were against the devaluation of the Lats, which was instead supported by the IMF. The EU's position eventually prevailed. On that occasion, the IMF showed that it did not intend to take into account the policy constraints deriving from Latvia's membership in the Exchange Rate Mechanism 2 (ERM2)—or more generally from EU membership.

The Latvian case however is not the only episode of conflict within the Troika. Recently, the study on "The IMF and the Crises in Greece, Ireland and Portugal" by the Fund's Independent Evaluation Office revealed some cracks in the Troika's internal structure also as regards Greece. In 2010, the IMF was requested to provide the country with a €30 billion loan, alongside the €80 billion loan provided by the members of the euro area. Financing by the IMF to Greece was exceptionally large, amounting to 3,200% of the country's quota, the highest disbursement/quota ratio in the history of the Fund—well beyond its statutory limits.

When in 2012 debt restructuring became unavoidable, the private sector had to bear a 53% haircut on the nominal value of Greek sovereign bonds, with the debt officially passing from private hands to the public sector.

For such a decision to be adopted, the strict criteria of the IMF exceptional access framework had to be met. One of the preconditions was "a high probability that the member's public debt is sustainable in the medium term". At the time, the IMF seriously doubted that the Greek debt was sustainable without a restructuring that was strongly opposed by the European partners. Further pressure was added by the absence of a European firewall, by the risk of contagion and default (a large debt-service payment was falling due) and by the lack of time to organize an orderly debt restructuring.

Therefore, in the 2010 Stand-By Arrangement for Greece, the IMF staff quietly introduced an amendment to the exceptional access policy framework, which was approved together with the loan request. According to the amendment, exceptional access could be granted if it were judged that a debt restructuring needed to ensure a high probability of debt sustainability would have "adverse international spillover effects". According to Charles Wyplosz and Silvia Sgherri,

> *As it turned out, the decision not to seek preemptive debt restructuring fundamentally left debt sustainability concerns unaddressed, magnified the required fiscal adjustment, and thereby—at least in part—contributed to a large contraction of output and a subsequent loss of Greek public support for the program.*

The decision "delayed the restoration of debt sustainability, impaired the prospects of success for the country's economic policy program, and eroded safeguards for IMF resources."

For these reasons, the so-called "systemic exception" was removed at the beginning of 2016, but not before applying it to Ireland and Portugal. When in 2012 debt restructuring became unavoidable, the private sector had to bear a 53% haircut on the nominal value of Greek sovereign bonds, with the debt officially passing from private hands to the public sector.

While the EU (led by Germany) does not seem ready to change its stance on austerity measures, serious concerns are being raised on their effectiveness even from within the IMF.

The Greek debt issue came to the forefront again in April 2016, when an IMF internal document was leaked, revealing the Fund's intention to exert its pressure on European partners and on the Greek Government to accept further debt relief measures. Christine Lagarde had already affirmed that the Fund's participation in a new lending operation was conditional upon Greece receiving "significant debt relief" from official creditors:

> *Greece's debt has become unsustainable and […] Greece cannot restore debt sustainability solely through actions on its own. Thus, it is equally critical for medium and long-term debt sustainability that Greece's European partners make concrete commitments in the context of the first review of the ESM program to provide significant debt relief, well beyond what has been considered so far.*

While in May 2016, the Eurogroup finally agreed on a package of debt relief measures, the IMF was still lingering on a new financial assistance programme to Greece. Are the IMF/EU differences on the Greek debt sustainability irreconcilable? In December 2016, the Eurogroup endorsed an ESM debt relief proposal that only aims at reducing interest rates and smoothing Greece's repayment profile. This decision can improve prospects for a new IMF loan that is going to be discussed by the Executive Board before the end of the year. Despite these hoped-for measures, the recovery of the Mediterranean country remains however impaired by a public debt burden that ranks among the largest in the world economy.

Rethinking austerity from the inside

Divergences on Greece between the IMF and European institutions are just the tip of the iceberg. Indeed, while the EU (led by Germany) does not seem ready to change its stance on austerity measures, serious concerns are being raised on their effectiveness even from within the IMF. In June 2016, three leading IMF economists, Jonathan Ostry, Prakash Loungani and Davide Furceri, published an article entitled "Neoliberalism: Oversold" on the impact of neoliberal policies on recipient countries. Their conclusions are quite discomforting: it is an admission that, in some instances, the neoliberal reforms prescribed by the Bretton Woods organizations have not delivered the expected economic growth and have in turn increased inequality. Besides, they have increased unemployment and welfare expenditure.

In a separate interview, the IMF's chief economist Maurice Obstfeld stated that these findings are not a revolution, but would entail a natural evolution of the Fund's approach. While the IMF is acknowledging change in the political climate, Europe is turning a deaf ear on the ineffectiveness of austerity measures and on their negative impact on the lives of ordinary people. Can the Troika withstand criticism and continue working as a single entity or is it bound to split?

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