BY ROBERT **J. BARR0**

THE IMF DOESN'T PUT OUT FIRES, IT STARTS THEM

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ENABLER: With help from the U.S., the fund encourages bad economic policy by rewarding failure with showers of money

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Congressional Republicans disgraced themselves before the recent elections by acting like Democrats. They approved far too much new federal spending, the worst of which was the $18 billion for the International Monetary Fund. No doubt some in Congress were convinced by President Clinton's argument that the IMF was the world's fire department, which ought not to be deprived of water while the fire was burning. But a better analogy would be to Ray Bradbury's *Fahrenheit 451,* in which the fire department's mission is to start fires.

The politics of IMF funding is as clear as it is insidious. If Congress does not provide money for the fund to bail out, say, Brazil, and Brazil collapses, then Congress gets blamed. But no one is willing to blame Congress if the IMF actually works to encourage Brazilian-type financial crises time and again. some economists believe that bailouts increase "moral hazard" by rewarding and encouraging bad policies by governments and excessive risk-taking by banks. Aware that they can be bailed out in the crunch, banks will often lend at interest rates that do not reflect fundamental risks. This, in turn, generates new financial crises and reduces world economic growth.

In Asia, a flood of low-cost capital from Europe, Japan, and the U.S. wound up financing real estate speculation and overcapacity, thanks in part to an assumed IMF "guarantee." But nobody will ever be able to prove that the IMF effectively starts new fires in this way. Hence, the political forces favor IMF funding and limitless bailouts.

CRUTCHES. IMF economists like to argue that these moral-hazard problems are minimal. But consider the case of the recent $42 billion package for Brazil. How did the Brazilians qualify for this support? They did so mostly by not exercising sound fiscal policies. If their policies had been better, they would not be in their current difficulties and would not qualify for IMF money.

Russia is another example. In most respects, effective reforms in Russia ceased by 1993. Since then. the availability of IMF and other foreign money provided an excuse to avoid making tough political decisions. Instead of cutting public outlays or increasing tax collections, undertaking efficient privatizations or enacting legal reforms, the government counted on foreign bailouts to hold things together.

An interesting question is what the IMF will do now in Russia. The current government will never formulate a sensible economic plan, and the fund therefore cannot demand that new lending be conditioned on sound policies. But if no money is forthcoming, then Russia will default on past IMF obligations, and the IMF will no longer be able to pretend that it always gets repaid. My prediction is that the IMF will come up with a way to keep up the chain-letter game in which it provides Russia. Ukraine. and Indonesia with enough money to keep payments "current."

MEXICAN MESS. The sequence of unrestrained global bailouts began with Mexico in 1995. In this case, the IMF- U.S. lending package was effectively a reward for corrupt and risky bank lending and poor macroeconomic policies. Particularly striking were the massive interventions of the Mexican central bank in an attempt to support the peso. The bank failed and lost billions of dollars in international reserves, but did not allow the money supply to contract. Not surprisingly, this policy failed to prevent a sharp devaluation of the currency.

The Mexican bailout kept foreign lenders whole. The mountain of bad bank loans. about 16% of gross domestic product. became a liability of Mexican taxpayers. The bailout also did not avoid sharp economic contraction and high inflation- both much worse than in Argentina, which ties its money supply directly to its international reserves.

The real shame of the Mexican bailout is that it was judged by many observers to be a success, mainly because the U.S. Treasury got repaid. If. instead, it had properly been labeled as a massive policy blunder. then subsequent unrestrained global bailouts might not have occurred. Countries such as Brazil and Russia would have had the appropriate incentives to implement good policies. instead of knowing that the IMF or the U.S. would respond to bad policies with showers of money.

One healthy consequence of the recent global financial crisis is the emphasis on increased transparency in financial transactions. In this spirit, the IMF might consider changing its name to the IMH- the Institute for Moral Hazard. Better Yet, the IMF could admit that it was insolvent and go out of business.