

STABILIZATION PLANS: AN APPROACH FROM THE AUSTRIAN SCHOOL OF ECONOMICS

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Abstract: In economic literature, stabilization plans designed to overcome high inflation or hyperinflation are usually classified as either “orthodox,” with a monetarist origin, or “heterodox,” with a Keynesian approach, depending on the policy tools used. However, an alternative based on the principles of the Austrian School of Economics is often overlooked. This approach not only aligns with the monetary and exchange rate policy proposals of Austrian thinkers but also respects the fundamental principles of money as a key social institution. Moreover, it includes a proper theory of capital, which is lacking in both monetarist and Keynesian traditions.

Keywords: stabilization plan, exchange rate regime, interest rate, monetarism, Keynesianism, central bank, Austrian school of economics, real interest rate.

JEL Classification: E5; N1; N2.

I. INTRODUCTION

Every stabilization plan ultimately aims at achieving a sustained reduction in inflation. While the immediate cause is often attributed to the excessive creation of fiduciary media by governments—which erodes the purchasing power of the currency—this is usually just a symptom of a deeper issue: structural instability

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stemming from excessive state intervention in the economy. In this regard, high inflation may be persistent, but it is neither the only symptom nor exclusively caused by the monetization of fiscal deficits. Excessive government intervention creates distortions that affect multiple dimensions of economic life. Therefore, reducing inflation alone does not guarantee the success of the stabilization program if its underlying causes are not addressed. Otherwise, instability may shift to other key variables, such as domestic and foreign interest rates or the spreads between them, ultimately undermining the sustainability of the stabilization process. For example, when one considers that Argentina's national debt in 2001, when the country became insolvent, amounted to only 64% of GDP¹, it immediately becomes clear that, from the perspective of the Austrian School of Economics, the monetization of the deficit was not the sole or ultimate cause of the insolvency.

A government implements a stabilization plan in response to a destabilized economy, whose most visible manifestation is usually a high inflation rate, given that money—being the foremost social institution—is, in most (if not all) economies today, controlled by the State. However, the early success of some stabilization plans—reflected in a sharp drop in the inflation rate—is not a sufficient condition for their permanence. Such plans may still need to be abandoned prematurely or may eventually lead to a more severe macroeconomic crisis over time.

Under an orthodox, monetarist-style stabilization plan, an economy may succeed in reducing inflation by controlling the money supply—either through a monetary rule or by using the nominal exchange rate as an “anchor”—as a result of balancing the public accounts and eliminating the fiscal deficit. However, despite these efforts, internal and external tensions may still emerge, ultimately leading to the abandonment of the program.

Today, governments have a monopoly on money and control over monetary and financial institutions. Most of the time, these institutions follow rules based on political goals rather than the

¹ Krüger, Anne (2002): “Crisis Prevention and Resolution: Lessons from Argentina”. International Monetary Fund / National Bureau of Economic Research (NBER): Conference on „The Argentina Crisis“, Cambridge, 17. July 2002

spontaneous order of the market, which would otherwise guide the evolutionary development of such institutions. While it is reasonable to expect any stabilization plan to include a fiscal adjustment aimed at eliminating the monetization of the deficit, from the perspective of the Austrian School of Economics, this is not necessarily the sole or ultimate cause of the inflationary process.

From a monetarist and fiscalist viewpoint, achieving fiscal balance ensures that money is not excessively issued through deficit financing. However, economic instability may also arise from the excessive involvement of the state in various sectors of the economy. For instance, a balanced budget may be achieved through higher taxes, which does not necessarily reduce the state intervention that generates said instability. Furthermore, even if deficit monetization and monetary expansion are reduced, the effective demand for money may remain weak, especially when the national currency is imposed coercively through legal tender laws. In addition, a fractional reserve banking system can expand the supply of fiduciary media through credit that grows faster than deposits, contributing to financial instability. These situations can occur separately or at the same time. As a result, even if a stabilization plan seems successful at first, it may eventually fail when a new macroeconomic crisis emerges.

Thus, this paper is structured to characterize “orthodox” and “heterodox” stabilization plans, differentiating the elements used in each case in Chapter II. Chapter III will address the choice of different exchange rate regimes in these plans. Chapter IV will analyze the relationship between fiscal and monetary policy in an Austrian-style stabilization plan, followed by a discussion of the role of money in any stabilization plan in Chapter V, and finally, some conclusions will be outlined in Chapter VI.

II.

STABILIZATION PLANS: BETWEEN “ORTHODOXY” AND “HETERODOXY”

There is a certain consensus within the mainstream that inflation is caused by the monetization of government budget imbalances—in other words, fiscal deficits. Therefore, it is generally expected that

any stabilization plan should include a fiscal adjustment to remove this source of instability. History also shows that every relatively successful program eventually includes such an adjustment. However, from the perspective of the Austrian School of Economics, how this adjustment is achieved is not a trivial matter. It also matters for the sustainability and durability of the program.

Stabilization plans can be classified as orthodox or heterodox, depending on the economic policy instruments used in their implementation. In general terms, orthodox stabilization plans place emphasis on reducing the fiscal deficit and the resulting monetary issuance. Since the fiscal deficit is considered the cause of monetary expansion, it is assumed that correcting the government's budget imbalance will be enough to stop the expansion of the money supply.

Heterodox stabilization plans, on the other hand, are based on the premise that what they consider to be "inflationary inertia" must be eliminated and therefore include various additional economic policy instruments. However, this idea of inertia refers to the tendency of inflation to remain persistent once it has started. Yet this persistence may actually result from government objectives that seek to maintain high inflation. Thus, it is contradictory to treat inflationary inertia as an inherent characteristic of inflation when, in some cases, it is deliberately maintained as a policy goal, for example, to reduce the real value of public debt or to avoid a fiscal adjustment that could affect the government's voter base.

According to this view, eliminating the fiscal deficit and the resulting monetary expansion might not be enough to stabilize the economy. However, the measures proposed often involve various forms of intervention in the market, weakening its coordinating role. If government intervention itself is the cause of economic instability, then more intervention across different areas of the economy cannot be a sustainable solution.

The idea of "inertia" comes from applying tools from physics to the phenomenon of inflation, removing all human action from the analysis—even though human action is the very essence of economic science. Moreover, the concept of inertia captures the speed of a price index, making the price level and its variation the central focus of the inflation problem. This mainstream approach, which

uses mechanistic techniques from the exact sciences to study inflation, moves away from the role of human action as the key to understanding economic phenomena.

According to the heterodox view, eliminating the fiscal deficit—and therefore money issuance—may not be enough to reduce inflation. In their view, price and wage freezes are also necessary. This means companies are forced not to raise any prices, workers are told not to demand higher wages, certain prices considered “too low” by policymakers are adjusted, private contracts are interfered with, and public utility rates are frozen. In short, the price system is undermined through greater state intervention, disrupting its role as a coordinating mechanism for the economy. Supporters of these stabilization policies argue that orthodox plans based on monetarist and fiscal principles may take too long to bring inflation down, especially in highly indexed economies. They may even claim that a sharp exchange rate appreciation causes a recession.

Although such effects can occur during the implementation of stabilization plans, further intervention that disrupts the price system or violates private property by breaching contracts does not eliminate the destabilizing force that the state itself introduces by intervening in the economy.

Recommendations for these kinds of policies are usually based on empirical evidence or historical cases considered “successful.” But who defines success? Success is often defined by the policymakers themselves, based on how certain aggregate variables behave. But is violently and coercively breaking a private contract really a success for the people who signed it? Moreover, these policies often ignore the possibility that if they fail, many of the emergency measures will remain in place, causing greater long-term damage. A clear example is the many “temporary” emergency economic laws in our country that have remained in force for years through repeated extensions.

III. THE CHOICE OF EXCHANGE RATE REGIME

Another key difference between stabilization programs is the choice of exchange rate regime. The debate is usually limited to picking between a fixed or floating exchange rate. However, in a stabilization program, it's important to look more broadly at the entire monetary framework, where both monetary and exchange rate policies work together.²

Setting aside that broader discussion for the moment, in a fixed exchange rate regime, the exchange rate serves as the nominal anchor used to reduce inflation and influence agents' expectations. To maintain this fixed parity, money is issued only to the extent that the demand for domestic currency increases.

Others choose the money supply as the nominal anchor, in which case the exchange rate is allowed to float. A third option is inflation targeting. This approach has become popular among major central banks. Moreover, inflation targeting has not been successful in economies where the demand for domestic currency is structurally weak and the state plays a large role in the economy.

Therefore, for any stabilization plan to succeed, an increase in the demand for money is necessary. No matter how much fiscal and monetary discipline is imposed, if money demand does not recover, there will always be an excess money supply that either puts upward pressure on prices—through a loss of purchasing power of the currency—or on the exchange rate. This is the opposite of the case analyzed by Bagus (2021)³, who examines a deflationary process driven by an increase in cash balances. Thus, any decline in the demand for money results in a reduction in its purchasing power. Since no compensatory measures can be applied to

² Cavallo (1999) discusses different alternatives for emerging economies but does not mention options from the Austrian School of Economics. Mainly, the approach promoted by Professor Huerta de Soto, based on a 100% reserve banking system.

³ See Bagus (2021) for an in-depth analysis of the different types of money demand and their causes.

preserve the purchasing power of money, a fall in money demand will generate an inflationary process.

From this mainstream perspective, it is “expected” that, as inflation declines due to the stabilization plan, money demand will recover. Under a fixed exchange rate regime, any increase in money demand leads to an expansion of the monetary base, matched by a rise in international reserves.

Under a floating exchange rate regime, with the money supply fixed, the adjustment occurs through the nominal exchange rate. If money demand increases more than the supply, the nominal exchange rate will fall, causing real appreciation. However, if a limited expansion of the money supply is expected, it becomes harder to influence expectations, which may further weaken money demand.

The main problem with stabilization plans under a floating exchange rate regime is that if monetary policy is too tight, it can trigger a recession; if it is too loose, it may fail to stabilize the economy in the face of falling money demand and rising inflation expectations. (Braun & Llach, 2018).

IV.

AN ALTERNATIVE BASED ON AN “AUSTRIAN” APPROACH”

The analysis starts from the premise of an intervened economy. That is, an economy where the State, through the government, carries out public spending and also has a Central Bank that monopolizes the domestic legal tender currency and operates under a fractional reserve system.

Mainstream monetary theory, which was mainly designed to analyze the general price level, has contributed little to the study of inflation, overlooking the central insights of the Austrian School of Economics. Inflation primarily causes changes in relative prices, thus affecting the entire productive structure of the economy. Understanding this requires a proper theory of

capital, which is lacking in both Keynesian and monetarist theories.⁴

Following Ribas (2024), the study of inflation problems was largely relegated to countries formerly known as developing or underdeveloped. Structuralist theories emerged, viewing inflation as a result of underdevelopment and peripheral economies. Keynesianism won the political battle in the developed world, while in the developing world it evolved into a development theory under the banner of “structuralism,” intellectually driven in part by the Argentine economist Raúl Prebisch.

Following Ribas: “...There is no doubt that Keynesianism, which first won over the academic world, inevitably triumphed in the political arena.

Socialism and the concurrent expansion of the state over society characterized the contemporary political process, and Keynesianism provided the pseudo-scientific instrument of academic justification.

Gradually, monetarism — the theoretically opposing view that control of the money supply is the key economic determinant — began gaining ground in academia, based on studies from the University of Chicago and under the intellectual leadership of Milton Friedman...” Ribas (2024, p. 17)

Following the author, we can generally and politically state that Keynesian ideas lead to inflation, monetarism to stagflation, and in between lies the trapped choice between socialism and liberalism according to the “mainstream.”

Today, the developed world faces permanent stagflation, where Donald Trump’s extreme protectionist policies add to the Federal Reserve’s difficult balancing act as it tries to meet its goals. At best, the Fed aims for a “soft landing,” meaning a slowing economy (stagnation) with inflation above the target set by monetary authorities—an elegant way to describe stagflation!

Ribas (2024) analyzes the problem of inflation within a framework that seeks to determine the extent to which resources are transferred from the more productive sectors to the less

⁴ For a detailed treatment of the topic, see Chapter V of the book *Dinero, Crédito Bancario y Ciclos Económicos*, Huerta de Soto, (2011).

productive ones, and vice versa. When such intervention generates credit expansion, it also artificially alters interest rates, producing an unsustainable boom that will sooner or later result in an economic recession (Bagus, 2021). Credit expansion may even increase virtually without limit.⁵

Following Ribas (2024), from an economic perspective, inflation (understood as money issuance) is just a particular case within the broader concept of the arbitrary reallocation of resources, that is, the disregard for the market process as the best way to allocate resources, beyond its effects on the price level (price inflation). Therefore, we can characterize economies undergoing “stabilization plans” and suffering from high and persistent inflation as economies where the State, through coercive actions, arbitrarily reallocates resources.

In this sense, inflation becomes a tool or mechanism to carry out that transfer of resources—from productive sectors to unproductive ones. In other words, it is an instrument whose use is driven by an ideological view that trusts in the State and distrusts the market (Ribas, 2024).

These are opposing concepts, since the State operates in the economic sphere without a budget constraint. In this way, Ribas (2024) challenges a fundamental assumption of monetary analysis, whether from a Keynesian or monetarist perspective.

According to the author: “...That premise is that real government spending is defined a priori, and therefore inflation is simply one of several means to obtain the necessary resources. This is the implicit assumption behind the concept of the inflation tax, which could be calculated in advance in much the same way as revenue from a value-added tax or income tax is estimated...” (Ribas, 2024 p. 21)

Therefore, the inflation tax can be added to other taxes to cover the gap between government spending and revenue. From this perspective, the budget deficit becomes the main driver of inflation, and its elimination is the foundation of any anti-inflationary policy.

⁵ See Rothbard (2011).

It's correct to say that, according to this premise, the State manages to appropriate all the resources it intends to spend. While government spending itself may represent an inefficient allocation of productive resources, eliminating inflation by eliminating the fiscal deficit also removes the distortions that inflation causes in the rest of the economy.

But Ribas (2024, p.21) opposes this monetarist and fiscalist view: "...The previous conception, although it could be accepted as valid when the State's involvement in the economy is relatively limited and it restricts itself to providing certain services, loses its validity as the State expands its role in the economy..."

This point is central to the analysis of stabilization plans, as reducing inflation — and thus the fiscal deficit — is not sufficient to ensure the program's effectiveness. While it is clear that lowering inflation helps eliminate many of the distortions it creates in the economy, a stabilization plan can only be sustainable if the root causes of inflation are properly addressed.

Economic instability is caused by the "excessive" involvement of the state in the economy, which manifests as high and persistent inflation resulting from monetary disorder with fiscal origins. However, simply balancing the fiscal accounts and seeing a drop in inflation does not guarantee sustainability, especially if the imbalance caused by state intervention shifts to other areas or variables within the economy.

Ribas's (2024) approach rejects the previous premise and states the following:

- Government spending is projected in nominal terms, and its real value depends on monetary or exchange rate policy. In other words, it is not determined by the government; only the nominal spending is set.
- As this participation is variable, it does not depend on the inflation rate, and the inflation tax in real terms is indeterminate.
- Since the true transfer of resources from the private to the public sector (that is, from productive to unproductive sectors) results from the interaction between monetary and exchange rate policies, it cannot be said that any reduction in

the inflation rate improves the allocation of resources overall by reducing distortions within the private sector.

i) The Role of the State in Considering a Stabilization Plan

Traditional economic theory has considered the State as neutral regarding the productivity of the economy. Although some empirical studies point to a negative impact on productivity, generally the problems related to the State have been addressed within political philosophy, while economics has focused on what we call the market. In the mainstream view, the State is just another economic agent.⁶

However, following Ribas (2024, p.22), Keynes assigned the State an economic role in terms of objectives: "... In other words, it is different to say that government spending has a cost and is therefore economic, than to say that the State spends with the specific purpose of producing an economic result..."

Therefore, mainstream economic theory views fiscal and monetary policy as mere alternative tools to achieve different economic policy goals. Most economies in the world operate with this approach. This implies some implicit assumptions: that the real spending of the State is defined in advance and is fixed for the rest of the economy. Also, inflation is seen as a tax that replaces other taxes. In other words, the revenue from the inflation tax is the difference between the State's total real spending and the revenue from other taxes in real terms.

Given these assumptions, inflation was seen as an inefficient way for the State to raise resources. This view has another implicit assumption, according to Ribas: that the State's spending was a

⁶ See Ocampo (2018): "... Varios estudios empíricos confirman que, por encima de cierto nivel, el aumento del gasto público tiene efecto negativo sobre la productividad (Barro, 1991a; Barro, 1991b; Grier and Tullock, 1989; Hansson y Henrekson, 1994, y Tanzi y Zee, 1997; Mitchell, 2005). Estos resultados dependen en gran medida de la composición del gasto, de la transitoriedad del aumento y de su magnitud en relación a la economía (...) En cuanto a la relación entre gasto público y la tasa real de interés, la evidencia empírica también sugiere una fuerte relación positiva (Barro, 1986) ..."

small part of the economy, and that the State was generally a consumer of goods rather than a producer of goods and services.

As this stop being true, the other implicit assumptions also lose their validity. Following the author: "...That is, in a producing State where efficiency is confused with its function of providing employment, the entire decision-making process substantially changes the allocation of resources and the resulting productivity of the economic system..." (Ribas 2024, p.23)

Thus, Ribas changes these assumptions in his analysis by stating that public spending in real terms is endogenous to the system. In this way, the State's role in the economy results from monetary and exchange rate policies, which are the tools available to policy-makers in coordination with fiscal policy. This means that the nominal amount of spending and its variation are determined within the system.

However, Ribas (2024) assumes that it is not possible to conceive of a society without a State. Therefore, there is an optimal level of State involvement, beyond which the economy's productivity begins to decline.

Beyond whether it is possible to imagine a society without a State—even if that is not feasible at the moment—there is no such thing as an "optimal" level of State involvement. This is because State intervention in the market process causes harm by preventing the generation of new relevant information needed for the entrepreneurial function to operate.

What is true is that the less the State participates, the smaller the distortions and, therefore, the less noticeable its impact is to other economic actors. However, it is far from possible to determine an optimum level within the dynamics of markets and human action themselves.

It is true that the State makes spending decisions without budget constraints, distorting the market process and causing a poor allocation of resources. Therefore, following Ribas' argument, there is a process of economic deterioration as the State grows. However, it is important to highlight that this is not only due to the macroeconomic size of public spending and its financing difficulties, but also because it is based on the systematic exercise of institutional coercion over individuals (Huerta de Soto, 2010).

Following Huerta de Soto: “Only a proper understanding of the general theory of human action can clarify the unavoidable consequences that always arise when the free exercise of entrepreneurial action is forcibly prevented. The focus of our analysis is, therefore, the human being, understood as an acting and creative subject, who struggles throughout history to express and exercise their most intimate nature, free from the obstacles and coercions that are systematically imposed on them under the most varied and unjustified pretexts...”

It is important to understand the social disorder caused by statism. Focusing only on its effect on the productivity of the economic system, by preventing the proper functioning of the entrepreneurial role, coercively stops individuals—according to Huerta de Soto (2010, 2012)—from taking advantage of profit opportunities that arise from the imbalances generated in any dynamic market process. As a result, new information is not created, disrupting social coordination. This makes it impossible for the state, as the directing authority responsible for exercising institutional coercion, to coordinate society through its mandate because it lacks the information that is not produced due to its own coercion. In other words, the state lacks the information needed to coordinate precisely because its coercion prevents that information from being generated.⁷

Economies with persistent and high inflation over time, or those that have experienced hyperinflation, show the advance of statism in certain areas of economic life. This is what causes the destabilization, but orthodox stabilization programs ignore it by focusing only on the monetary aspect of the fiscal imbalance. This is what Ribas called “monetarismo cum estatismo”.⁸

So, for a stabilization plan to work well, it needs not only to fix the government budget but also to reduce public spending. This helps

⁷ On this topic, see the *Theory of Dynamic Efficiency* developed by Huerta de Soto (2004).

⁸ Ocampo (2018): “...Con este marco conceptual podemos reinterpretar la teoría de Ribas. Su punto central es que es un error combatir la inflación únicamente con una política monetaria contractiva, especialmente cuando el nivel del gasto público es elevado en relación al PBI. Esto es justamente lo que Ribas denominó “monetarismo cum estatismo...”

ease the pressure the State puts on the economy. This is important for the plan to last over time. Only through the free exercise of entrepreneurial function are the creative and productive forces of individuals unleashed, generating in society the necessary information to expand resource use and even create new means to achieve new ends.

Ribas (2024) argues that as the State's role in the economy increases, the average productivity of the economy decreases, which can be measured by the natural rate of interest (Wicksell). He also links this to the real market interest rate, explaining that as the State's participation grows, the real market interest rate tends to rise as well.

ii) Fiscal, Monetary, and Exchange Rate Policy

Starting from this analysis, the only variables the government can control are nominal variables, since real variables adjust accordingly. Thus, the government can set the nominal level of spending and the money supply, or the devaluation rate as part of exchange rate policy. However, this analysis does not distinguish between monetary policy and the monetary regime.

Moreover, it is not true that the government can fully determine the money supply in an economy, even under a monetary regime controlled by a Central Bank monopoly. This is especially the case in a fractional reserve system. While Central Bank has tools to influence the money supply, it does not control it directly, as it ultimately depends on decisions made by the public and banks—that is, on money demand. These issues are crucial when considering a successful stabilization plan.

What is novel in Ribas' analysis is that he treats the state's share of GDP as an endogenous variable, along with the natural rate of interest (which he links to the real market interest rate), the inflation rate, the nominal interest rate, the devaluation rate, and the real market rate. Meanwhile, the budget deficit is seen as one more way to create money in certain cases.

a) *Monetary Policy*

When analyzing the effects of increasing the money supply while keeping public spending constant (fiscal policy), monetary policy is determined. It is assumed that reducing the rate of money supply growth leads to a decrease in the nominal interest rate—not immediately, but as a consequence of lower inflation. Avoiding the mechanistic monetarist view, changes in relative prices occur, which affect the productive structure of the economy.

However, if public spending remains unchanged, the state's share in the economy increases. This reflects the state's need to finance its spending through higher taxes or debt, which raises its economic participation and, consequently, the real interest rate.

On the other hand, if the money supply growth rate increases, the long-term nominal interest rate rises due to higher inflation, which also distorts relative prices and the productive structure. This contradicts Keynes's mistaken idea that the interest rate is simply the cost of money. Moreover, Keynes did not properly define money demand, as it depends on the interest rate, which in turn depends on money demand in the money market, creating a circular indeterminacy.

Secondly, with increased money supply growth, the state's share in the economy decreases, and the real interest rate falls (also due to higher inflation).

b) *Fiscal Policy*

By reducing government spending while keeping the money supply growth constant, the nominal interest rate decreases, as does the state's share in the economy, and consequently, the real interest rate. Conversely, an increase in the growth rate of government spending leads to a rise in the nominal interest rate, the state's share, and the real interest rate.

Therefore, monetary and fiscal policies have opposite effects in the long run. Also, we must consider that money is never neutral, not even in the long run as monetarists claim, since, like Keynesians, they lack a proper theory of capital.

In the long run, monetary policy has effects on the real interest rate that move in the opposite direction, while fiscal policy causes effects that move in the same direction. According to Ribas (2024), this is due to the impact these policies have on the State's share of the economy and its effect on the natural rate of interest.

This point is crucial when considering the tools used in a stabilization plan for an economy with a fractional reserve banking system and, therefore, a central bank, which is implicit in Ribas's analysis.

Ultimately, a stabilization plan is a dynamic process of transformation whose final goal is to achieve a stable economic system by freeing the creative capacity of human beings. This process must be followed while restoring the proper functioning of the main economic institutions, among which money is the most important. Along the way, we need to think carefully about the best use of the available instruments within the current regime to navigate institutional changes that arise spontaneously in society. This should be done without falling into excessive "pragmatism," which, in seeking short-term results to meet often well-justified social demands, can interfere with government decision-making.

Ribas does not mention it explicitly, but these interventions by the State in managing money and spending—using fiscal and monetary policies as tools—affect the present and future decisions of economic agents by changing the interest rate, which in turn alters the productive structure of the economy. This issue has been extensively addressed by Austrian authors within the framework of the Austrian Business Cycle Theory (ABCT).⁹

In the context of a stabilization plan, one of the problems of inflation—besides causing distortions in relative prices that affect the productive structure of the economy, leading to bad investments and economic cycles—is that it transfers resources from the productive private sector to the unproductive State.

Following Ribas: "...Any attempt to fight inflation by causing a similar transfer is self-destructive, and the apparent stabilization

⁹ See Alonso Neira (2004, 2005), Garrison (2001), Hülsmann (2021) y Ravier (2010).

means an increasing statization of the economy..." (Ribas 2024, p. 29).

A stabilization plan can only be successful if it does not lead to an increasing statization of the economy. Lowering inflation is a necessary condition for success, but it is not enough. This surface result can hide underlying instability in other parts of the economy, which may cause the stabilization program to fail.

Thus, following Ribas: "...Only a reduction in the nominal rate of decrease in government spending can be accompanied by a reduction in the rate of monetary expansion that does not cause an increase in the real interest rate or an increase in the state's share of the economy. Monetary and fiscal policies are therefore relative concepts that complement each other in their effects, not alternative concepts..." (Ribas 2024, p. 29).

This highlights a significant difference in many stabilization programs that focus mainly on the fiscal deficit, including the "orthodox" programs of the International Monetary Fund. They take a fiscalist view of the problem, focusing only on the budget deficit and not on the relative size of public spending in the economy. In this way, with a mechanistic perspective, they treat a tax increase as equivalent to a spending cut in their policy designs. However, the expected results are not the same, since these measures affect the real interest rate differently.

Ribas defines it this way: "...The problem of the overall imbalance can be defined as the possibility of transferring more resources from the private sector to the public sector without causing the bankruptcy of the former. Or, in other words, without causing the real interest rate to rise above the natural interest rate (Wicksell), which is the average profitability of the economy. This is only possible in an economy with private capital, since the internal imbalance consists precisely in the increase of the debt-to-capital ratio as a consequence of the real interest rate rising above the natural rate..." (Ribas 2024, p. 29).

c) *The External Sector: Exchange Rate Policy*

In an open economy with a free foreign exchange market, the monetary authority can either fix the nominal exchange rate, which means the money supply is determined endogenously, or let the exchange rate float and control the money supply.

Although most central banks choose exchange rate flexibility and have shifted from targeting the money supply to controlling interest rates, for emerging economies like Argentina, stabilization plans focus on controlling the exchange rate.

This is due to the role of foreign currency as a store of value and unit of account, with the U.S. dollar serving as the reference for economic calculation. In this context, economic instability—driven by an increasing role of the state in the economy—is reflected in the deterioration of the national currency as a key institution for social coordination.

The real interest rate faced by producers of tradable goods can be considered an endogenous variable, with a direct relationship to the size of the public sector. At the same time, the public sector's share in the economy is the counterpart of changes in the real exchange rate. Among the key policy instruments are the rate of devaluation and the pace of nominal government spending growth.

Following Ribas, we can analyze changes in exchange rate and fiscal policies. Specifically, we can assess the impact of changes in the rate of devaluation while keeping the rate of nominal government spending expansion constant—what we refer to as “exchange rate policy.” Conversely, we can examine the effects of changes in the rate of expansion of government spending while holding the rate of devaluation constant—what we define as “fiscal policy.”

If the rate of devaluation is set below the rate of growth in government spending, the nominal interest rate will decline, but the share of the state in the economy will increase due to a fall in the real exchange rate and a rise in the real interest rate. This leads to a lower average inflation rate but also widens the gap between the prices of tradable and non-tradable goods, resulting in a shift in their relative prices.

The opposite effects would occur if the rate of devaluation exceeds the rate of growth in government spending. According to Ribas (2024), the nominal interest rate and the average inflation rate would rise, while the share of the state in the economy would decline due to an increase in the real exchange rate. Consequently, the real interest rate would fall.

However, this specific situation—unlike what Ribas suggests—would not achieve any stabilizing effect when the foreign currency functions not only as a store of value but also as a unit of account, due to prolonged periods of instability in the local currency. It is necessary to stabilize both the domestic currency and its relationship with the foreign currency. If inflation is driven by a higher rate of devaluation relative to the growth rate of public spending, this may lead to a decline in money demand, further fueling inflation. As a result, the real exchange rate is affected, altering the State's share in the economy.

Ribas states that the budget deficit, far from being the ultimate determinant of the inflation rate, only determines the expansion of domestic credit.¹⁰ In other words, it is the internal component of the total monetary expansion, while the external sector creates the difference needed to finance the average expansion.

Focusing on changes in fiscal policy while keeping exchange rate policy unchanged, we observe that a decrease in the growth rate of government spending relative to the devaluation rate leads to a reduction in the nominal interest rate, a decrease in the government's share of the economy through an increase in the real exchange rate, and therefore a reduction in the real interest rate (for producers of tradable goods). Additionally, the average inflation rate and the gap between the inflation rates of tradable goods and services (non-tradables) falls.

¹⁰ This arises from his critique of the monetary approach to the balance of payments, which considers money neutral in the long run:

$$\begin{aligned}\Delta R &= \Delta BM - \Delta CI \\ &= \Delta BM - \Delta DF - \Delta RB\end{aligned}$$

where R stands for international reserves, BM for the monetary base, CI for domestic credit, DF for the fiscal deficit, and RB for bank reserves at the central bank.

On the other hand, an increase in the growth rate of government spending causes a rise in the nominal interest rate, an increase in the government's share of the economy due to a fall in the real exchange rate, and a rise in the real interest rate (for producers of tradable goods). Additionally, there is an increase in the average inflation rate and a wider gap between the inflation rates of tradable goods and non-tradable goods.

Therefore, following Ribas (2024), we can observe that when government spending grows faster than the devaluation rate, there is a greater transfer of resources from the tradable goods sector to the government. This transfer is relative, not absolute, since it depends on the growth rates of both in nominal terms, and is also influenced by the size of the government and the tradable sector in the economy.

This transfer of resources will also lead to an increase in the demand for credit, which will necessarily cause a rise in the internal interest rate. As a result, the real interest rate will exceed the natural rate.

Following Ribas, this process cannot continue indefinitely or without time limits: "... If the real market interest rate remains above the natural rate, private companies will keep borrowing to compensate for the loss of profitability, starting an accumulative process that will lead to business bankruptcies..." (Ribas 2024, p. 34).

iii) *The Impact on the Balance of Payments*

It is also important to consider the impact on international accounts, as most of the crises in Argentina and the abandonment of stabilization plans have been linked to balance of payments crises.

The interest rate differential between the domestic and foreign rates, adjusted for risk, is considered to balance the capital account in the balance of payments. The state's share in the economy affects the real exchange rate, which in turn impacts on the current account. A higher risk-adjusted interest rate differential attracts capital inflows, while a low or appreciated real exchange rate leads to a current account deficit.

Therefore, if the devaluation rate falls below the rate of growth of government spending — with the devaluation rate being the main stabilization tool as a “exchange rate anchor” — it leads to a lower nominal interest rate, an increase in the state’s share of the economy due to a fall in the real exchange rate, and a rise in the real interest rate. This causes a decrease in the average inflation rate, but it widens the gap between the prices of tradable and non-tradable goods, resulting in a relative price change between these two types of goods.

The fall in the real exchange rate causes a growing deterioration in the current account of the balance of payments (trade balance, tourism, and services). At the same time, the internal imbalance in the interest rate leads to a persistent surplus in the capital account.

The balance of payments can be either positive or negative. Initially, it may show a surplus due to increased capital inflows if the stabilization program is credible. However, over time, it can turn into a deficit because of the combined effects of both the current and capital accounts, mainly driven by growing uncertainty. When the economy is open to capital movements, the real exchange rate is jointly determined by the interaction between the rate of government spending growth and the rate of devaluation.

The mechanism works as follows: if the rate of devaluation is higher than the rate of government spending growth, government spending decreases in real terms and the real exchange rate increases. If both grow at the same rate, government spending in real terms remains unchanged. However, if the rate of government spending growth is higher than the rate of devaluation, government spending increases in real terms.

Under a stabilization program, any alternative that involves government spending growing faster than the devaluation rate is therefore doomed to fail, as it leads to an increase in the state’s share of the economy, which causes instability. Moreover, programs where the devaluation rate exceeds the rate of government spending growth, although they reduce the state’s share, are unlikely to be sustainable as long as the foreign currency acts as the unit of account.

The only possible alternative that ensures a path toward stability is a program that reduces the size of the state by cutting

government spending. This allows for an exchange rate policy that acts as an anchor, where the devaluation rate is higher than the growth rate of spending, without negatively affecting the balance of payments or the real interest rate.

An increase in real government spending is only possible if the nominal exchange rate does not keep pace with the growth rate of the government's nominal spending. However, if the spending growth rate is such that the exchange rate cannot be stabilized, then a stabilization plan in economies like Argentina—where foreign currency serves as a store of value—is unlikely to be sustainable.

The effect on the real exchange rate will be greater the larger the government's share of GDP and the bigger the difference between the nominal spending growth rate and the devaluation rate.

If the observed inflation rate, measured as the average increase in the prices of a basket of goods and services, falls between the nominal spending growth rate and the devaluation rate, then the greater the appreciation of the real exchange rate, the lower the inflation caused by the increase in government spending. Following Ribas: "... the greater the transfer of real resources to the public sector (...) the greater the inflationary expropriation..."

At the same time, the real interest rate for producers of tradable goods will be higher, the greater the real exchange rate appreciation. Additionally, capital inflows will increase as the interest rate differential rises, which depends on the inflation rate and the expected devaluation rate.

If the devaluation rate decreases without changing the nominal spending growth rate, the real exchange rate appreciates, which negatively affects the current account. Although this can be temporarily offset by a capital account surplus, this situation is not sustainable for the private sector—especially for the tradable goods sector—because the difference between the local and international interest rates pushes the real interest rate away from the economy's natural rate.

As the deterioration of the current account becomes evident, pressure is placed on the capital account in the form of a higher interest rate differential to prevent reserve losses. This pressure increases due to the growing risk of devaluation. According to Ribas: "...the situation created forces a deadly choice between high

interest rates and the bankruptcy of private companies or the loss of reserves..." (Ribas 2024, p. 38).

a) The Interventionist Economy: Public Spending, Monetary Expansion, and Devaluation. An Alternative to Measure Distortion

The real problem of inflation, beyond the mere increase in prices, lies in its effects on the transfer of resources from the productive sector to the unproductive sector, as well as in the distortion of relative prices, thereby affecting the entire productive structure of the economy.¹¹

This problem does not depend solely on the fiscal deficit. The true inflation tax, measured through this transfer of resources, depends on the relationship between the growth rate of government spending and the rate of monetary expansion or devaluation.

The internal imbalance caused by this attempt to transfer resources, when interest rates are free, is reflected in those interest rates rather than in the inflation rate. Similarly, the external imbalance does not necessarily show up as changes in monetary reserves but rather in the interest rate differential.

In other words, this process implies a fundamental shift in the concept of external equilibrium, since it is no longer determined by the overall balance of payments situation—reflected in changes in international reserves—but by the interest rate differential. Thus, Ribas departs from the monetary approach to the balance of payments in his analysis. The greater the gap between the domestic real interest rate and the natural rate, the greater the internal and external imbalances, even if the reserve levels remain unchanged or even increase for a time.

However, unlike Ribas (2024), devaluation is not an effective tool to solve external imbalances in this context, because the foreign currency (the dollar) functions as the unit of account. Therefore, a stabilization plan should include reducing public

¹¹ See Huerta de Soto (2011).

spending—not the deficit per se—to avoid deterioration of the real exchange rate, while the exchange rate anchor stabilizes both the domestic and foreign unit of account. This reduction in the state's share of the economy decreases instability and provides greater predictability for economic calculation by achieving exchange rate stability, where the foreign currency serves as the unit of account.

Nevertheless, this would only be the first stage of a stabilization plan that properly uses the available tools under the current regimes.

V.

MONEY, INFLATION, AND THE INTEREST RATE AS MANIFESTATIONS OF INSTABILITY: THE MONETARY REGIME

It is difficult to guarantee long-term success without achieving monetary stability. In this regard, it is important to emphasize that a fractional reserve monetary system is inherently unstable. Moreover, it undermines private property by violating the basic principle of any capitalist system.¹²

This situation worsens in economies where the fiat currency imposed by the Central Bank coexists with a currency freely chosen by agents as a store of value and unit of account, for which the monetary authority does not act as the lender of last resort.

If legal tender is not granted to the currency freely demanded by individuals and the exclusive use of the national currency is imposed, the latter—lacking genuine demand as a store of value—structurally leads to a loss of purchasing power, even under conditions of fiscal and monetary discipline. This situation puts pressure on exchange rate and price stability. Furthermore, by failing to function effectively as a store of value, it hinders the development of the capital market, preventing savings from being channeled into productive investment.

On the other hand, the decline in the inflation rate during the initial phase of a stabilization plan may trigger a credit boom

¹² See Huerta de Soto (2011) y Hülsmann (2021).

driven by the financial intermediation inherent in the fractional reserve system. This results in an unsustainable and artificial economic expansion that ultimately undermines the stabilization process.

Moreover, in the initial phase, under a fractional reserve system, the higher the inflation rate, the greater the intermediation margin that allows banks to maintain their profitability levels. While the real interest rate remains negative, inflation itself erodes the cost for borrowers. However, this situation reverses as the stabilization plan succeeds, inflation falls, and the real interest rate turns positive. If policy mismanagement leads to a further increase in the real interest rate, the fractional reserve system exacerbates the problem.¹³ Following Hülsmann: "...it is true that fractional-reserve banking protected by legal tender laws represents a race toward the abyss...() as with every form of inflation, fractional-reserve banking (and credit money), supported by legal tender privileges, entails an illegitimate redistribution of benefits, and since it generates far more inflation than any other institutional arrangement..." (Hülsmann 2021, p. 136 y 137).

VI. CONCLUSIONS

Therefore, a successful stabilization plan cannot be assessed solely by the initial reduction in the inflation rate. For it to be sustainable, a necessary condition is the reduction of the State's involvement in the economy, as it is a primary source of instability. Although every program requires a fiscal adjustment, this does not necessarily imply that stability will be achieved through deficit reduction

¹³ An interesting case is the experience of the Convertibility regime in Argentina during the 1990s. Due to space constraints, which would warrant a more detailed study, I will only mention that the plan can be considered successful in terms of stabilizing inflation in Argentina for a decade. However, it did not prove sustainable, and among the causes often overlooked are the failure to reduce government spending as a source of imbalance and, above all, the existence of a fractional-reserve banking system in an economy that allowed convertibility between its currency and the U.S. dollar but lacked a lender of last resort.

or a balanced budget alone. In this regard, a fiscal policy that increases government spending while contracting the money supply will only lead to the bankruptcy of the private sector due to the expanding role of the State.

Furthermore, programs based on exchange rate policy, using the exchange rate as a nominal anchor, must implement a sufficiently contractionary fiscal adjustment to avoid a real exchange rate appreciation that would deteriorate the current account and require high interest rates to compensate via capital account. If this scenario materializes, the resulting resource transfer from the private to the public sector will make the stabilization program unsustainable.

Programs that also move in the right direction by seeking to reform the monetary regime—granting greater freedom in the use and choice of currency, recognizing that money is the ultimate social institution enabling social cooperation—must address the urgent need to eliminate the fractional reserve banking system.

The fractional reserve system, beyond being a source of instability, guarantees the existence of a central bank and thereby establishes monetary statism, which ultimately undermines the stability of an economy that the stabilization program seeks to correct, while discouraging entrepreneurial function, the primary driver of human progress in society.

Any stabilization plan must not only reduce inflation but also lay the foundations for a process of sustained growth. Such a goal is unlikely to be achieved without unleashing the creative potential that drives entrepreneurial function, within an institutional framework that upholds private property as the principal guarantor of a capitalist system. This—and not another—must be the guiding objective of any stabilization plan.

Conflict of interest

The author declares that he has no conflict of interest.

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