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THE EFFECT OF INFLATION ON ECONOMIC STABILITY IN ISLAMIC PERSPECTIVE

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Abstract

This paper explores the issue of inflation, its causes and impacts, particularly on economic stability from an Islamic perspective. The author highlights the significant burdens arising from rising prices of basic goods and services, which are often attributed to inflation, as well as its effects that encourage protests against government plans that may worsen the situation. The paper reviews the definition and recognition of inflation in economic discourse, highlights its historical significance, and its negative consequences on purchasing power and public welfare. The author emphasizes the importance of controlling inflation to maintain economic stability, recognizing the government's challenge in striking a balance, as inflation rates that are too low or high can be detrimental. The text also presents insights from Islamic economists, such as Monzer Kahf, who oppose the fallacy of blaming interest rates for inflation, and claim that inflation is related to a surplus of means of payment or a shortage of general supply. The paper concludes by outlining the impact of inflation on economic stability from an Islamic perspective and details strategies to control inflation, involving government policies and individual practices.

Keywords: *inflation; economic stability; Islamic economics*

A. INTRODUCTION

Many people feel that the prices of basic goods and services are currently more expensive than the prices of these goods and services one or two years ago. In fact, for some people, the increase in prices of daily necessities has become a very heavy burden on their lives (Nugraha, Janwari, Athoillah, & Mulyawan, 2023). Public protests and complaints expressed in various demonstrations if the Government plans to raise fuel prices or basic electricity tariffs, among others, are a form of public dislike for the increase in prices due to these plans. The increase in prices of daily necessities over time is caused by what is referred to as inflation (Kewal, 2012).

Inflation is probably one of the most recognizable words in economics. Inflation has plunged many countries into prolonged economic instability. Central bankers often aspire to be known as "inflation hawks". Even politicians who have won elections often promise to fight inflation, just to gain power. Inflation was even declared Public Enemy No. 1 in the United States by President Gerald Ford in 1974. So, what is inflation, and why is it so important? Inflation is the rate of increase in prices over a period of time. Inflation is usually a broad measure, such as an overall rise in prices or a rise in the cost of living in a country. However, inflation can also be calculated more narrowly-for specific goods, such as food, or for services, such as haircuts, for example. Whatever the context, inflation indicates how expensive relevant goods and/or services are over a certain period, usually a one-year period (Oner, 2020).

Inflation is not new in the world of economics, where inflation is a discussion that often arises, especially when talking about the scope of Islamic macroeconomics. Inflation in the economic world has a negative impact on purchasing power and the level of public welfare, both in a country and in the world. This is caused by weak economic efficiency and productivity, rising capital costs, investment, and unclear income (Siregar & Abdul Majid, 2022). Understanding the dynamics of inflation requires an understanding of the underlying concepts and how to measure it (Höflmayr, 2022).

Inflation is an economic condition that is always interesting to discuss because it is related to its widespread impact on the economy in aggregate or macro, which is related to economic growth, economic stability, competitiveness, interest rates, and even income distribution (Masriani, 2022). A zero percent inflation rate is not the main goal of government policy because it is very difficult to achieve and can lead to deflation. The main thing is how to control the inflation rate to keep it low. Normal inflation is low inflation, which is between 0-4 percent, some limit it to single-digit inflation (Ardiansyah, 2021).

If a country wants to control a low inflation rate, the government must control price increases. Efforts to control prices can be made by suppressing the rate of increase in the money supply, for example by limiting lending or by increasing lending interest rates (tight money policy). However, the impact will be sluggish investment and rising unemployment which will ultimately reduce national income. We need to remember that an inflation rate that is too low will also be very dangerous if it reaches deflation. In economics, deflation is the opposite of inflation, which is a situation where prices generally fall and the value of money increases. Inflation that is too low will greatly affect entrepreneurs. Entrepreneurs lose money and cause the economy to be sluggish, so there are many layoffs everywhere and finally people's income decreases (Ardiansyah, 2021).

A sluggish economy will cause a country's economic growth to decline. A normal inflation rate is in line with a country's economic growth rate. In developing countries, inflation is considered normal if it is at 3%-4% annually with a deviation tolerance of 1%-2%. But for developed countries like the US, UK, and Japan, the central bank usually targets inflation at 2%. If hyperinflation occurs, it indicates that a country is experiencing an economic crisis (recession) (Ardiansyah, 2021).

Indonesia experienced the highest inflation in 1998 of 77.6% (Nugroho & Utomo, 2022). One of the causes of inflation that occurred at that time was the depreciation of the rupiah exchange rate, the economic crisis, and high inflation expectations. Previously, Indonesia had experienced hyper inflation in 1966 when the old order ended. So psychologically, inflation is a crisis for Indonesians. The way to control Inflation is by implementing monetary policy. The Monetary Authority conducts monetary policy by influencing monetary variables, money supply, SBI interest rates and exchange rates. CPI is one of the indicators used to measure the level of Inflation. Changes in the CPI over time reflect the rate of increase (inflation) or the rate of decrease (deflation) of goods and services.

Based on data from Bank Indonesia, the inflation rate in 2022 was 4.20%. While as of April 2023 Indonesia's average inflation rate was 4.92% (Bank Indonesia, 2023), this is due to the month of Ramadan that Muslims in Indonesia have just passed and also Eid al-Fitr 1444 H. The government must suppress price increases if a country wants to maintain a low inflation rate. This can be done by reducing the increase in money supply, for example by limiting credit or by raising interest rates (tight money policy). However, this will result in sluggish investment and rising unemployment, which in turn will reduce National Income.

If many views in Islamic economics blame the interest rate as one of the causes of inflation, this contradicts the view of Islamic economist Monzer Kahf. In his view, Monzer Kahf argues that inflation is caused by a surplus of means of payment (including the amount of money in society) or a shortage of general supply. In other words, it is related to supply and demand but in a general sense that touches all goods and services in the economy. Kahf also emphasized that there is no link between inflation and interest rates or vice versa. This can happen in a society that deals with usury transactions, and at the same time it can happen in an interest-free society. Monzer Kahf's research exposure is also supported by Bawono's research which reveals that inflation is closely related to the amount of money in circulation and has no effect on interest rates (Bawono, 2019).

The religion of Islam has a specialty that distinguishes it from other religions, namely providing perfect guidance for every individual human being in every era and in every problem of life. Islam has provided a complete system for the economic aspects of human life which is the guarantor of solutions to economic problems in every era. Inflation is one of the most serious problems in the country. It has a devastating impact on the entire economy, law and order and economic development of the country (Saleem, et al., 2021). Based on the brief description above, this paper will try to outline the effect of inflation on economic stability in an Islamic perspective.

B. LITERATURE REVIEW

1. Inflation

Inflation occurs when prices generally increase continuously (Amin & Chong, 2007). At that time, the supply of goods and services is scarce, while consumers have to spend more money for the same amount of goods and services. So this will cause Inflation (Yulianti & Khairuna, 2019).

In Islamic economics, the causes of inflation are as follows (Yulianti & Khairuna, 2019):

a. Natural Inflation

Natural Inflation is inflation that occurs naturally, where humans are unable to prevent it. This inflation occurs due to a decrease in aggregate supply or an increase in aggregate demand. Natural inflation, for example, is when there is a natural disaster, where something happens outside the development plan/prediction that causes an increased need for goods.

b. Human Error Inflation

Human Error Inflation is inflation caused by human error, such errors include:

1) Corruption and poor administration, due to the appointment of bribed officials and nepotism, officials will abuse their positions to gain personal interests, both for economic needs and the luxury of life. Widespread corruption will cause state revenues to decline. This will cause a country's economy to collapse. The spirit of corruption has spread to high-ranking officials down to the village level.
2) High taxes Because many officials are corrupt, this will cause state spending to increase. So that the government finally sets a very high tax fee, which is very burdensome for the community, especially the small community. This tax increase will lead to an increase in production costs so that the goods produced will experience price increases.
3) Printing money excessively, when there is a budget deficit due to economic congestion or corruptors who spend state money, the government ends up printing money in large quantities. Too much money printed will cause the price level to rise and the value of the currency to fall.

In addition, inflation can also be caused by the following:

a. An increase in the price of imported goods;
b. An excessive increase in the amount of money in circulation without being matched by an increase in production or supply of goods.
c. A chaotic political and economic system due to irresponsible government.

2. Economic Stability

Economic stability means that people have the resources essential for a healthy life. Factors that affect economic stability include affordable housing; jobs that pay a living wage; things that support employment, such as worker protections, paid sick leave, and childcare; and access to reliable transportation. Economic stability refers to a situation where all of a country's essential economic resources are available to its citizens, and no economic changes disrupt their daily lives. This helps achieve macroeconomic goals such as reducing unemployment, balancing payments, price stability, and sustainable economic growth (Vaidya, 2022).

Economic stability is an important factor that affects people's lives.

Economic stability shows indicators of a healthy economy, and is free from disturbances. Economic fluctuations can be financial, political, social, legal, or technological. Therefore, a country must prepare itself to minimize vulnerability to economic problems. Maintaining stability in the economy is essential as it creates confidence and certainty in the minds of investors who wish to invest in human resources and technological resources. In addition, the government can identify stable economic indicators and control them. Stabilization measures, such as fiscal or monetary policies, help keep the economy on track. Thus, the government can adopt easy or tight monetary policy according to financial needs (Hopkins, 2006).

The inflation rate is perhaps a more reliable indicator of economic stability. Mild inflation is necessary for an economy, but a high inflation rate can harm the economy. In addition, high inflation may discourage or stop investment from other countries as money and assets lose value (Tumin, Koryakov, & Nikiforova, 2013).

C. METHOD

The completion of this case study uses a qualitative method with a literature study approach with secondary data sources. The data used comes from books, previous research results, journals and websites that are trusted and relevant to the existing problems.

D. RESULT AND DISCUSSION

Inflation is an economic condition characterized by a general and rapid increase in prices that results in a decline in people's purchasing power. Inflation is often followed by a decline in the level of savings and or investment due to increased public consumption and only a little for long-term savings. Meanwhile, the definition of inflation is also a tendency for prices to rise generally and continuously, in a certain time and place. Its existence is often interpreted as one of the main problems in the country's economy, in addition to unemployment and balance of payments imbalances (Ayub & Pusparini, 2022).

Inflation has an impact on both developed and developing countries. Individuals with the lowest incomes are affected the most. Inflation will not last long, as long as the supply chain functions unimpeded, according to the IMF. Inflation is always followed by price increases, although the price level fluctuates, it still shows a tendency for prices to rise not only in one product, but in all commodities. There are several macroeconomic indicators that can be used to measure inflation, such as the Consumer Price Index (CPI), Producer Price Index (PPI), and GDP Deflator (Yulianto, 2018).

Inflation is an economic condition characterized by a general and rapid increase in prices that has an impact on the decline in people's purchasing power (Putra, 2019). Inflation is often followed by a decline in savings and/or investment rates as public consumption increases and little is used for long-term savings (Iqbal & Nawaz, 2009). Inflation can be classified in several ways. In the first way, inflation can be classified according to its magnitude. Budiono classifies it into four (Budiono, 2009):

1. Mild inflation (inflation below 10% per year);
2. Moderate inflation (between 10%-30%);
3. Severe inflation (between 30%-100%); and
4. Hyper inflation (above 100% per year).

Samuelson and Nordhaus in Djohanputro categorize inflation into three (Karim, 2010):

1. Low inflation, also called single-digit inflation, which is inflation below 10%. This inflation is still considered normal. In this range of information, people still believe in money and still want to hold money.
2. Galloping inflation or double-digit or even triple-digit inflation, which is defined as inflation between 20%-200% per year. This kind of inflation occurs due to weak government, war, revolution, or other events that cause goods to be unavailable, while money is abundant so people do not believe in money.
3. Hyper inflation, which is inflation above 200% per year. In this situation, people do not trust money. It is better to spend money and save in kind than to save money. Why? Because most goods such as gold, land, buildings, experience price increases equal to (even higher) than inflation.

In general, monetary policy and fiscal policy are used to reduce inflation. Monetary policy oriented towards reducing the inflation rate, strong real sector growth, low unemployment, stable financial situation, trade deficit control, and a stable exchange rate are some of the goals of achieving economic prosperity and stability. Monetary policy is a solution taken by the Indonesian government to overcome high inflation, this policy regulates the amount of money circulating in society (Kartini, 2019).

Inflation control is just one of the problems faced by governments that want to promote rapid economic development and maintain economic stability. Eradication of illiteracy, reform of bureaucratic practices, construction of basic sanitation facilities for the eradication of endemic diseases, substitution of competitive trade practices for monopoly, encouragement of widespread entrepreneurial spirit, and creation of adequate amounts of social capital, may be important prerequisites for rapid growth. However, attacks on economic problems will more quickly destabilize the atmosphere of financial stability: rapid inflation will make the failure of such attacks more likely (International Monetary Fund (IMF), 1963).

Inflation control should be one of the main objectives of economic policy in developing countries. It is true that rapid economic development tends to trigger inflationary pressures. Therefore, one of the issues that requires high priority from the authorities in rapidly developing economies is inflation control.

Inflation reduces the volume of resources available for domestic investment. Public savings are reduced, and most of these savings are channeled into foreign rather than domestic investment, while capital flows from abroad are discouraged. A large part of the reduced flow of resources for domestic investment is diverted to uses that are not of the highest social priority. Large inventory accumulation is encouraged. The diversion of savings away from capital markets, where investment decisions are more subject to long-term economic criteria, is exemplified by the diversion of investment from productive uses for the whole society to the construction of self-occupied housing for the relatively wealthy few. The apparent profitability of certain short-term investments leads to distortions in the productive structure that make the economy less adaptable. Balance of payments difficulties are a symptom of underlying pressures. To reduce the foreign deficit, the authorities were almost forced to resort to controls, which in many cases protected uneconomic production. Political pressure led to further restrictions which, in the final analysis, created further distortions. Economic activity becomes increasingly distorted (International Monetary Fund (IMF), 1963). There is no doubt that the process of economic stabilization is a difficult one. But difficult or not, it is a prerequisite for rapid economic growth (International Monetary Fund (IMF), 1963).

Nowadays most economists prefer low or stable inflation (Boschen & Weise, 2003). However, researchers are striving to have a system that puts inflation at zero. The rise of the Islamic Financial System (IFS) gives them hope. IFS is not only growing in Islamic countries but also in developed countries such as the US and UK. The resistance to the current crisis and the consistent growth of IFS during the uprooting has led to the conclusion that IFS can be a viable solution to the current financial ills (Shahzad, Ahmed, & Rehman, 2012).

Unlike conventional economics, Islamic economics initially did not recognize inflation. This is because Islam makes a stable element as currency. The element is gold contained in dinar and silver contained in dirham. Inflation arose in the midst of Islamic civilization as a result of the printing and circulation of unstable dinar and dirham currencies (fulus). Whereas the scholars of the madhhab, Imam Shafi'i, has forbidden the government to print impure dirhams because it can damage the value of the currency, can raise prices to the detriment of others, and cause damage. This is in line with Ibn Taymiyyah's theory about the quality of good money is bad money in circulation. This means that if it continues to be printed and circulated, counterfeit money can eliminate dinars and dirhams from circulation (Rozalinda, 2014). The Western world only recognized this concept in 1858 in Gresham's law which reads "Bad money drives out good". Islamic inflation theory was presented by Taqiyuddin Ahmad ibn Al-Maqrizi, a student of Ibn Khaldun (Rohmana & Utami, 2023).

According to Islamic economists, inflation is very bad for the economy because (Wulan & Nurfaiza, 2014):

1. Potential disruption of the function of money, especially the savings function, the prepayment function, and the function of the unit of calculation.
2. Weakening the spirit of saving and people's attitude towards saving.
3. Increased tendency to spend, especially on goods that are not primary and luxury.
4. Directing investment in unproductive things, accumulation of wealth such as land, buildings, precious metals, foreign currencies at the expense of investment in productive directions such as: agriculture, industry, trade, transportation, and others.

Inflation is inevitable. However, some steps can be taken to reduce inflation to a low level. Al-Maqrizi offered an important idea about inflation. Al-Maqrizi's idea is divided into two parts, natural inflation and inflation due to human error, as explained earlier. It is difficult for humans to resist natural inflation. Al-Maqrizi asserted that a variety of food and other products not harvested after a natural disaster would cause a sharp drop in the availability of goods and scarcity. While factors related to human error, such as corruption, poor governance, high taxes, and better money circulation, also contribute to inflation. Therefore, inflation can be suppressed by correcting elements of human error such as corruption and money circulation (JUB). Al-Maqrizi argues that inflation occurs when prices, in general, increase and continue. Meanwhile, supplies of goods become scarce, and people have to spend more money to get the same goods (Janwari, 2016).

In the record of public officials in the Mamluk Government in Egypt, they privatized power and transformed state authority into personal superiority (Lapidus, 1984). In addition, the salaries of the Emirs and their household equipment are very much different compared to the income of the workers. Second, taxes are exceeded, a condition in which the government conducts tax collection conditions to cover the operational needs of the state. Various conditions occurred in Egypt in 736H/1336 AD, such as the ease of selling wheat by the government in the hope of large profits. Thus, forcing farmers to produce more, but what happened was increased imports from Syria and northern Egypt. Meanwhile, the government imposed a flat tax on wheat of 30 dirhams/irdabb. This was an increase of about 20 times compared to the actual tax rate. This tax increase was used for dam/drainage maintenance. Meanwhile, the landowners raised the rent, which resulted in the high cost of agricultural production. Third, the excessive circulation of currency; Al-Maqrizi noticed a condition where too much currency was circulating in society. Government-imposed currency printing was to meet operational needs and demand. Meanwhile, the large amount of money in society led to price increases.

Meanwhile, according to Ibn Khaldun, inflation can also be caused by production failure; in his mind, crop failure causes delays in the supply of goods, leading to scarcity and price increases. Ibn Khaldun also argued that taxes are very influential on inflation. He said that the state needs more administrative management if taxes are too low. Conversely, if the government raises tax benefits, there will be fiscal pressure, decreased profits for traders and producers, and a tendency for prices to rise and wage policies to become tight.

Ibn Khaldun believed that inflation occurs when a corresponding increase in productivity is not accompanied by an increase in the money supply. This problem causes the prices of goods and services to rise, leading to inflation. According to Ibn Khaldun, an increase in money that is not matched by an increase in production can occur due to unproductive trading activities. For example, trading activities that only aim to make a profit by taking advantage of rising prices. In addition, Ibn Khaldun also stated that inflation can occur due to unnecessary spending, such as waste and corruption. This problem can cause money to circulate in society, but is not followed by a comparable increase in production. According to Ibn Khaldun's theory, inflation can be controlled by increasing production and reducing unproductive trade activities. In addition, unnecessary spending also needs to be reduced, such as waste and corruption. Although Ibn Khaldun's theory is more than 600 years old, it is still relevant and can be applied to overcome inflation in Indonesia today. Increasing production and reducing unproductive trade activities are expected to help stabilize prices and reduce inflation in Indonesia (Alwa & Wahyudi, 2022).

Suppressing inflation for the sake of economic stability requires government reliability and cooperation from various economic households. Islam actually has a strategy to control economic activities in terms of wealth consumption to reduce inflation and maintain economic stability. In economic terms, wealth consumption means spending one's resources to obtain goods and services that directly satisfy one's needs. For example, food, clothing, shelter, medicine, education, entertainment, and others (Saleem, et al., 2021). Some of the Islamic recommendations that can be made for consumer households include:

1. Spend halal and good property;
2. Prohibition of waste;
3. The law of moderation in spending;
4. Regulating spending on neighbors and relatives (social).

In addition, other efforts that can be made by producer households include:

1. Avoiding haram and suspicious sources in production;
2. Prohibition of monopoly;
3. Exercise strict control over business activities;
4. Prohibition of exploitation of consumers;
5. End monopolistic activities.

E. CONCLUSION

In summary, the text explores the pervasive issue of inflation, its causes, and its consequences, with a particular focus on its impact on economic stability in an Islamic perspective. The author contends that rising prices of basic goods and services over time, often attributed to inflation, pose a significant burden on individuals, prompting protests against government plans that may exacerbate the situation. The paper delves into the definition and recognition of inflation in economic discourse, highlighting its historical significance and the negative repercussions it has on purchasing power and public welfare. The author emphasizes the importance of controlling inflation to maintain economic stability, acknowledging the challenges governments face in achieving a balance, as both excessively low and high inflation rates can be detrimental. The text also provides insights from Islamic economists, such as Monzer Kahf, who argue against blaming interest rates for inflation, asserting that it is linked to a surplus of means of payment or a shortage of general supply. The paper concludes by outlining the impact of inflation on economic stability from an Islamic perspective and proposes strategies to control inflation, involving both government policies and individual practices.

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