Inflation: islam and conventional economic systems

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Abstract

A country is seen as successful or not, in solving the economic problems of its own country can be seen from the country's macro and micro economy. Macroeconomics is a study of activities that discuss the economy of a country.[1] One of the macroeconomic indicators used to see / measure a country's economic stability is inflation. Changes in this indicator will have an impact on the dynamics of economic growth. In an economic perspective, inflation is a monetary phenomenon in a country where inflation fluctuations tend to result in economic turmoil.[2] Inflation is a phenomenon where the general price level increases continuously.[3] The price increase of just one or two items cannot be said to be inflation unless the increase extends or results in an increase in prices for other goods. Both the conventional economic system and the Islamic economic system, the roles of both demand and supply are emphasized in pricing. In fact, Islamic scholars are aware of centuries that the importance of demand and supply caused inflation. From the problems above this study uses qualitative methods to describe the related problems and is reinforced with secondary data in the form of journals, books and related articles.

Keyword: Inflation, Islamic Economy, Conventional Economy

JEL Code: D2. D3. E3. E63

A. Background

A number of theories have been developed to explain the symptoms of inflation. In the monetarist view the main cause of inflation is the excess money supply compared to what is demanded by the community. While the non-monetarist group, namely the Keynesian, does not deny the opinion of the monetarist view but adds that without the expansion of money supply, excess aggregate demand can occur if there is an increase in consumption, investment, government expenditure or net exports.

High inflation in a country means that the economy of a country is bad. According to Sukirno economic policy, especially the monetary policy of a country, seeks to keep inflation at the level of inflation creeping. With conditions of inflation that can be controlled it can have a good effect on the economy. Company profits increase and will encourage investment. So that employment and income opportunities increase and encourage economic growth.[4] According to Bick in the Threshold Effect of

[1] Adiwarman Karim, *Ekonomi Makro Islam*, (Jakarta: PT. Raja Grafindo, 2014), p. 1

[2] Engla Desnim Silvia, dkk, ―*Analisis Pertumbuhan Ekonomi, Investasi, dan Inflasi di Indonesia*‖, Jurnal Kajian Ekonomi,Vol. I, No. 02 Januari 2013, p. 224

[3] Muana Nanga, Makro Ekonomi: *teori, masalah dan kebijakan,* (Jakarta: Rajawali Pers, 2005) p. 241.

[4] Sukirno, Sadono, *Makro ekonomi Modern*. (Jakarta: PT. Raja Grafindo Persada, 2000) p. 11

Inflation on Economic Growth in Developing Countries, states that there is a significant relationship between inflation and economic growth.[5]

The main cause of inflation is a predetermined interest rate. Furthermore, financing government debt / deficits through interest payments is also another source of inflation. If, on the other hand, the government finances its debt by Islamic means, that is, payments in debt are based on refunds in productive activities or economic growth rates, the debt results in a decrease in the inflation rate.

B. Literature Review

Research on the effects of inflation and unemployment on economic growth has been widely carried out, but this study emphasizes more on Islamic theory and conventional how the theory is in practice. Ditha Rima Kurniasari (2011), states that the results of the inflation analysis have a positive effect on economic growth. This means that when inflation increases, economic growth remains high.[6] In addition, the study was also conducted by Rovia Nugrahani Pramesthi (2012) which states that Unemployment has a negative effect on the variables of economic growth. This means that when unemployment is high, economic growth will also be low or vice versa.[7]

C. Methodology

In conducting this research so as not to deviate from the existing problems, the authors emphasize the discussion on the analysis of Islamic theory and conventional theory in looking at inflation as an influence of the state of stability and economic growth. The type of data used in writing this study is secondary data. Secondary data is data obtained from records, books, in the form of publication reports, journals and so on.[8] With descriptive qualitative methods.

D. Result

Inflation is an economic condition characterized by rapid price increases that have an impact on decreasing purchasing power. Inflation is often followed by a decrease in the level of savings and / or investment due to increasing public consumption and only a small amount for long-term savings. Meanwhile the notion of inflation is also a tendency of rising prices in general and continuously, in certain times and places. 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.[9]

In theory, the emergence of inflation can be caused by several things. According to Soediyono in Setyawan (2000), from why inflation can arise due to an increase in public demand (demand pull inflation), because of the pressure to increase production costs (costpush), and because of both (mixed infltion). Some of the inflation determinants that enter into demand-pull inflation include: economic liquidity

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[5] Bick, Alexander. 2010. *Threshold Effects of Inflation on Economic Growth in Developing Countries.*

[6] Ditha, Rima Kurniasari. ―*Analisis pengaruh investasi, inflasi, nilai tukar rupiah dan tingkat suku bunga terhadap pertumbuhan ekonomi di Indonesia*‖, (Thesis, 2011).

[7] Rovia Nugrahani Pramesthi, Hendry Cahyono. ―Pengaruh pengangguran dan inflasi terhaadap pertumbuhan ekonomi di Kabupaten Trenggalek‖, Jurnal Pendidikan Ekonomi (JUPE), vol 1, Mo 3,(2013).

[8] Sujarweni, V. Wiratna, Metodologi Penelitian, (Yogyakarta: Pustaka Baru Press, 2014), p. 74a

[9] Nopirin, *Ekonomi Moneter,* Yogyakarta: BPFE,1997), Cet ke- V, p. 67.

characterized by increasing money supply, crude oil prices, the appreciation of the rupiah exchange rate, productivity, and the type of inflation from seasonal demand (traditional holidays, new year)) While the causes of cost-push inflation are: depreciation of the rupiah, volatile food inflation, increase in provincial minimum wages by the government (UMP), and other inflation determinants of administered inflation such as: fuel price increases, electricity tariffs, prices cigarettes and import duties on raw materials.

Inflation is an economic condition characterized by rapid price increases that have an impact on decreasing purchasing power. Inflation is often followed by a decrease in the level of savings and / or investment due to increasing public consumption and only a small amount for long-term savings. Inflation can be classified in several ways. The first way, inflation can be classified according to magnitude. Budiono[10] classify the input into four:

a) Mild inflation (inflation below 10% per year), b) Moderate inflation (between 10% -30%), c) Heavy inflation (between 30% -100%), and d) Hyper inflation (above 100% per year). Samuelson and Nordhaus in Djohanputro categorize inflation into three:

1. Low inflation, also called single digit inflation, which is inflection below 10%. This infection is still considered normal. In this information range, people still believe in money and still want to hold money.

2. Galloping infltion or double digit even triple digit inflation, which is defined as between 20% -200% per year. Inflation like this occurs because of weak governance, war, revolution, or other events that cause goods not available, 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 believe in money. It's better to spend money and save in goods rather than save money. Why? Because most items such as gold, land, buildings, experience an equivalent (even higher) price increase from inflation.[11]

Inflation Theory

a. Conventional Inflation Theory

In general, inflation means an increase in the general price level of commodity goods and services for a certain period of time. Inflation can be regarded as a monetary phenomenon because of the decline in the value of a monetary calculation unit for a commodity. The definition of inflation by modern economists is a comprehensive increase in the amount of money that must be paid (the value of the monetary calculation unit) for goods / commodities and services.[12] Conversely, if what happens is a decrease in the value of the unit of monetary calculation of goods / commodities and services is defined as deflation (deflation). Inflation is measured by the rate of inflation (rate on inflation), which is the level of change in the price level in general.

In both the conventional economic system and the Islamic economic system, the role of both demand and supply is emphasized in pricing. In fact, Islamic scholars are aware of centuries that the importance of demand and

[10] Budiono, Ekonomi Moneter. (Yogyakarta: Penerbit BPFE UGM, 2009) p. 167

[11] Adiwarman A. Karim, *Ekonomi Makro Islam,* Jakarta: Raja Grafido Persada, 2010), Cet ke- I, p. 138.

[12] Adiwarman Karim, Ekonomi Makro Islam, (Jakarta: PT. Raja Grafindo, 2014), p. 135

supply caused inflation. Al-Jahiz (d.869), Taymiyyah (d. 1328) and Ibn Khaldun (died 1406) explain one way or another how the movement of demand and supply causes the price level to rise and fall, see Chapra (2008) for a more detailed explanation.[13]

b. Islamic Inflation Theory

According to Al-Maqrizi, the inflation event is a natural phenomenon that afflicts people's lives throughout the world since the past until now. Inflation, according to him, happens to type prices in general experience an increase and take place continuously. At present, the supply of goods and services is scarce and consumers, because they really need it, must spend more money on the same number of goods and services.[14] In the following description, Al-Maqrizi discussed the issue of inflation in more detail. He clarified inflation based on its causal factors into two things, namely inflation caused by natural factors and inflation caused by human error.

1) Natural inflation

As the name implies, inflation is caused by various natural factors that humanity cannot avoid. According to Al-Maqrizi, when a natural disaster occurs, various foodstuffs and other agricultural products experience crop failures, so that the inventory of these goods has decreased dramatically and there is scarcity. When there is an automatic scarcity of prices, prices soar. As a result, economic transactions experience congestion, even stop altogether, which in turn leads to famine, epidemics and deaths among the people. The worsening situation forced the people to pressure the government to immediately pay attention to their situation. For

tackling the disaster, the government issued a large amount of funds which resulted in a dramatic decline in the state treasury because, on the other hand, the government did not receive significant income. In other words, the government suffers from a budget deficit and the state, both politically, economically and socially, becomes unstable which then causes the collapse of a government.[15] *Natural Inflation* can be distinguished based on the cause into two groups, namely as follows:

a) Too much money coming from abroad, where the value of exports (X) goes up while the import value (M) decreases, so the net export value is very large, resulting in an increase in Aggregate Demand (AD).

b) As a result of the decline in the level of production (US) due to famine, war, or embargo and boycott. Graphically, this can be graphed as follows:

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[13] Chapra, M. (2008), *"Ekonomi Islam: Apa Adanya dan Cara Mengembangkannya"*, EH. Ensiklopedia Bersih, diedit oleh Robert Whaples, 16 Maret 2008. Tersedia di <URL: http://eh.net/encyclopedia/article/chapra.islamic >, Diakses pada: 08-10-2017

[14] Adiwarman, Karim. *Sejarah Pemikiran Ekonomi Islam.* Cetakan pertama(Jakarta: PT. RajaGrafindo Persada, 2004) p. 390

[15] Pandangan Al-Maqrizi ini sangat jelas terlihat ketika ia menguraikan sebab-sebab berbagai bencana kelaparan yang menimpa Mesir sejak masa Mesir Kuno hingga masa pemerintahan Sultan Mamluk Bahri, Al-*Ashraf Sha'ban* (767-778 H/1363-1376 M). Lihat—ibid., pp. 27-49.

2) Inflation due to Human Errors In addition to natural factors, Al-Maqrizi also stated that inflation can occur due to human error. He has identified three things that both individually and together lead to this inflation. These three things are corruption and poor administration, excessive taxation and increased circulation of currency money.

If we see that in principle not all inflation has a negative impact on the economy. Especially if there is mild inflation, which is inflation below 10% with the existence of mild inflation this can encourage economic growth. This is what motivates entrepreneurs to further increase their production by opening new jobs. With the inflation, the increase in the inflation rate indicates an economic growth, but in the long run the high inflation rate has a very bad impact.[16] Under Islamic law, there are theories that can reduce inflation including having a supply of labor (must be productive), ownership of land (productive land), use of cash, distribution of zakat and sustainable capital.

E. Comment

Kia (2006) explained that inflation can be influenced by both internal and internal external factors. Internal factors include government deficits, debt financing, monetary policy, institutional economy (shirk, opportunism, economic freedom, risk, etc.) and structural regime changes (revolution, political regime changes, policy boundaries, etc.). External factors include the terms of trade and foreign interest rates and attitude of the rest of the world (sanctions, risk-generating activities, war, etc.) against the state. Channels where government deficits and debt financing affect inflation include capital formation (crowding out effect), debt monetization and wealth debt effects By reducing the cost of information, institutional economics can also reduce inflation in a country.

Inflation is defined as a state of continuous price increase which results in a decline in the purchasing power of a country's currency. This situation is caused by an increase in the money supply, excess demand, an increase in people's living costs and labor market behavior and changes in costs. In a journal written by Amir Kia entitled Inflation: Islamic and Conventional Economic Systems, explaining how Islamic and conventional economic systems treat inflation has similarities but in the journal does not explain in detail about monetary and fiscal policies in the view of Islamic economics that can be the solution to the increase in inflation, the absence of a graph / curve that explains demand and supply that influences inflation.

F. Conclusion

Inflation arises because of pressure from the supply side (cost push inflation), from the demand side (demand pull inflation), and from inflation expectations. The factors of cost push inflation can be caused by exchange rate depreciation, the impact of foreign inflation, especially countries of trading partners, increases in administered prices, and negative supply shocks due to natural disasters and disruption of distribution. The Islamic economic system, similar to conventional economic systems, totally disapproves of sharp price fluctuations.

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[16] Saparuddin Siregar . *Politik Ekonomi Islam Dalam Pengendalian Inflasi.* Dosen FEBI UIN Sumatera Utara saparuddinss@yahoo.com

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