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Inflation And Monetary Policy: Bank Indonesia's Role in Suppressing the Inflation Rate of Islamic Economic Objectives

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Abstract

This paper aims to define theories of inflation and photograph the response of Muslim scholars to the phenomenon of inflation itself. This paper aims to capture the role and position of Bank Indonesia (BI) as a monetary policy maker in overcoming the rate of inflation. The author uses descriptive qualitative methods of literature study and philosophical normative approaches. The results of this paper analysis state that Bank Indonesia plays an important role in suppressing the rate of inflation. Bank Indonesia plays a role in establishing and implementing monetary policy, regulating and maintaining a smooth payment system, and regulating and supervising banks. Bank Indonesia conducts open market operations in the rupiah money market, including foreign exchange intervention in order to stabilize the rupiah. BI sets the BI rate as the benchmark interest rate. BI has established a mandatory minimum reserve policy for banks. BI conducts comprehensive analysis and studies in assessing the effectiveness of monetary instruments and monetary policy transmission channels, analyzing and reviewing various information variables, conducting discussions with various parties such as business actors, government agencies, banks, and academics, identifying factors that cause inflationary pressures, and formulating monetary policy exposure.

Keywords: Bank Indonesia, Government, Inflation, Islamic Economics, Monetary Policy.

Abstrak

Paper ini berusaha medefinisikan teori-teori inflasi dan memotret respon para cendikiawan muslim terhadap fenomena inflasi itu sendiri. Paper ini bertujuan untuk memotret peran dan posisi Bank Indonesia selaku pemangku kebijakan moneter dalam menanggulangi laju inflasi. Penulis menggunakan metode kualitatif deskriptif studi pustaka dan pendekatan normative filosofis. Hasil analisa paper ini mengemukakan Bank Indonesia berperan penting dalam menekan laju inflasi. Bank Indonesia berperan dalam menetapkan dan melaksanakan kebijakan moneter, mengatur dan menjaga kelancaran sistem pembayaran, dan mengatur dan mengawasi bank. Bank Indonesia melakukan kebijakan operasi pasar terbuka di pasar uang rupiah, termasuk intervensi valuta asing dalam rangka stabilisasi rupiah. BI menetapakan BI rate sebagai suku bunga acuan. BI menetapakan kebijakan cadangan wajib minimum bagi bank-bank. Bank Indonesia melakukan analisis dan kajian yang komprehensif dalam mengkaji efektivitas instrumen moneter dan jalur transmisi kebijakan moneter, menganalisis dan mengkaji berbagai variabel informasi, melakukan diskusi dengan berbagai pihak seperti pelaku usaha, instansi pemerintah, perbankan, maupun akademisi, *mengidentifikasi faktor-faktor yang menyebabkan tekanan inflasi, dan memformulasikan respon kebijakan moneter.*

Kata kunci: *Bank Indonesia, Ekonomi Islam, Inflasi, Kebijakan Moneter, Pemerintah.*

INTRODUCTION

Many people feel that the price of basic necessities goods and services at this time is more expensive than the price of these goods and services a year or two ago. Even for some people, the increase in the price of daily necessities has become a very heavy burden on life. The protests and public complaints expressed in various demonstrations if the Government planned to increase the price of fuel or basic electricity tariffs, among others, were a form of public dislike of the increase in prices as a result of the plan. The increase in the prices of daily necessities from time to time is due to the existence of what is referred to as inflation (Kewal, 2012). Inflation, the general increase in prices of goods and services, which is high, will be a burden by many parties. With inflation, the purchasing power of a currency becomes lower or decreases (Silitonga, Ishak, & Mukhlis, 2017). With the decline in the purchasing power of the currency, the ability of fixed-income people to buy goods and services for daily necessities will become lower. The unstable inflation rate also makes planning difficult for the business world, does not encourage people to save, and various other negative impacts that are not conducive to the overall economy (Cipta & Laily, 2021).

In reality, inflation in Indonesia, as well as in other developing countries, is not only a monetary phenomenon but also heavily influenced by structural problems on the *supply* side (Utari & Pambudi, 2015). Therefore, efforts to control inflation are not enough only to be carried out with monetary instruments that are generally short-term, but must also be accompanied by improvements in the real sector to eliminate structural barriers that exist in the national economy. Synergy between Bank Indonesia and the Government, both at the central and regional levels, is needed to create low and stable inflation. Given the importance of inflation management to achieve quality development goals, the understanding of inflation in Indonesia by policymakers is very important. With the same understanding, it is hoped that control efforts can be carried out more effectively.

Fluctuations in the prices of goods and services are common in everyday life. For example, hotel rates and airfares increase during the weekend or holiday season. This increase occurred due to the increasing demand for transportation and lodging services. At other times, we experience rice prices rising due to crop failures or otherwise falling due to bountiful harvests. Price fluctuations, especially price increases in a commodity, which occur due to momentary changes in demand and supply do not always have an inflationary impact (Utari & Pambudi, 2015). The phenomenon of inflation was felt during the reign of Muhammad SAW (Mulyani, 2020). The increase in the price of dates caused complaints from friends. Some of the causes of the increase in the price of staples are due to the lack of availability of goods due to drought and war (Syakir, 2015). Maqrizi revealed that inflation does not occur due to natural inflation, but can be caused by human error inflation (Allounce & Maqrīzī, 1994), (Fadilla, 2016). This paper seeks to define theories of inflation and photograph the response of Muslim scholars to the phenomenon of inflation itself. This paper aims to capture the role and position of Bank Indonesia (BI) as a monetary policy maker in overcoming the rate of inflation.

LITERATURE REVIEW

Inflation

In the beginning, inflation was defined as an increase in the money supply or an increase in liquidity in an economy. This definition refers to the general symptoms caused by an increase in the money supply which is suspected to have caused an increase in prices. In the macroeconomic concept, inflation is defined as a general and continuous increase in the price of goods and services. As Suseno and Astiyah (2009) wrote, in this context there are two important meanings that are key in understanding inflation, namely price increases in general and continuously. Only a general increase in prices can be called inflation. Price increases in certain commodities that occur due to seasonal factors, for example in the run-up to big days or due to momentary supply disruptions and do not have a further effect, are not called inflation.

Taqyuddin Ahmad Ibn Al-Maqrizi (1364-1441) in Euis Amalia (2005:17) stated that Inflation occurs when prices in general experience a continuous increase. At that time the supply of goods and services was scarce, while consumers had to spend more money on the same amount of goods and services. So that will result in Inflation (Amalia, 2005). According to Adiwarman Azwar karim (2004:424), the definition of Islamic inflation is no different from conventional inflation. Inflation has the meaning of a symptom of a general and continuous increase in the price of goods (Karim, 2004). Thus, inflation is a symptom that occurs due to the intentional or natural increase in the price of goods and does not only occur in one place, but in all corners of the country and even the world. This price increase lasts continuously or for a long time and may increase if no solution is found to solve the problem that causes the Inflation.

Inflation Theory

The inflation rate in Indonesia is caused by imported inflation triggered by the depreciation of the rupiah exchange rate against foreign currencies against the national economy (Atmadja, 1999).

(1) Quantity Theory. This theory is the oldest theory that discusses inflation, but in its development, it was refined by economists of the University of Chicago, so this theory is also known as the monetarist models. This theory emphasizes the role of

the money supply and people's expectations regarding price increases against inflation.

(2) Keynesian Model. The rationale of Keynes' inflation model, that inflation occurs because society wants to live beyond the limits of its economic capabilities, thus causing people's effective demand for goods (aggregate demand) to exceed the amount of goods available (aggregate supply), as a result of which there will be an inflationary gap. This limitation in the amount of inventory (aggregate supply) occurs because in the short-term production capacity cannot be developed to compensate for the increase in aggregate demand. Therefore, just like the monetarist view, Keynesian models are more widely used to explain the phenomenon of inflation in the short term.

(3) Model Mark-up. In this theory, the rationale of the inflation model is determined by two components, namely the cost of production and profit margin. The relationship between the change of these two components and the price change can be formulated as follows (Price = Cost + Profit Margin) Because the amount of profit margin is usually determined as a certain percentage of the amount of cost of production, the formula can be described as (Price = Cost + (a% x Cost)) Thus, if there is an increase in price in the components that make up the cost of production and or an increase in profit margin will cause an increase in the selling price of commodities in the market.

(4) Structural Theory: A Model of Inflation in Developing Countries. Many studies on inflation in developing countries show that inflation is not only a monetary phenomenon, but also a structural phenomenon or cost push inflation. This is due to the economic structure of developing countries in general which is still agrarian in style. Thus, domestic economic shocks, such as crop failures (due to external factors of too fast seasonal changes, natural disasters, and so on), or things related to foreign relations, such as deteriorating terms of trade, foreign debt, and foreign exchange rates, can cause price fluctuations in the domestic market. Structural phenomena caused by structural gaps or constraints in economies in developing countries (Atmadja, 1999). These cases are often referred to as structural bottlenecks.

Causes and Types of Inflation

Montiel (1989) said that inflation in developing countries can come from several factors, including the government budget deficit (Montiel, 1989). The government's budget deficit increases the money supply, as also discussed by Sargent and Wallace (1981). The government's budget deficit can also cause problems in the balance of payments and further encourage currency depreciation (Livitian and Piterman, 1986). The study of the relationship between the government budget deficit and the rate of inflation is also discussed in various studies, including in Razin and Sadka (1987) and Brunno and Fischer (1990). Another source of causes of inflation in developing countries, on the demand side, is economic inequality because it is spurred beyond the available capacity (output gap). This, for example, occurs in

13 Asian countries as discussed by Coe and McDermot (1997). On the other hand, inflation can also be caused by supply factors as discussed by Ball and Mankiw (1995). They stated that changes in the prices of certain goods (for example, the price of fuel oil-fuel) could result in a soaring rate of inflation. In addition to demand and supply factors, inflation can also be caused by expectations. Gordon (1997) explained the determinants of inflation from the three sides, namely demand, supply and expectations. The importance of expectations in influencing inflation was also stated earlier by Chopra (1985). All the factors that cause inflation mentioned above will be used as an analytical tool to explain the main factors that cause inflations in Indonesia (Suseno & Astiyah, 2009).

Inflation in terms of its origin is divided into two types, namely domestic and imported inflation. Domestic inflation, which is inflation that is entirely caused by mismanagement of the economy both in the real sector and in the monetary sector in the country by economic actors and society. Imported inflation, which is inflation caused by an increase in commodity prices abroad (in a foreign country that has trade relations with the country concerned). This inflation can only occur in countries that adhere to an open economy system. The phenomenon of inflation can be transmitted both through the price of imported goods and the price of exported goods (Atmadja, 1999).

Monetary Policy

Central banks have an important role in controlling inflation, and in general central banks will try to control inflation at a reasonable level (Ananda, 2021). Inflation control in Indonesia under monetary policy has been carried out since the early 1950s, especially since the enactment of the law on Bank Indonesia in 1953. With this law, Bank Indonesia is officially mandated to control the inflation rate (Astuti & Eddyono, 2021). Inflation control, formally implemented through monetary policy, has undergone changes and developments over time in line with changes in economic conditions in the relevant period.

Monetary policy, which was initially carried out directly by controlling interest rates or bank loans, has gradually changed to a more *market-based* monetary policy (Wijoyo, 2017). In implementing monetary policy directly, from 1974 to June 1983, Bank Indonesia as the monetary authority directly controlled both interest rates (loans and deposits) and credit expansion in the banking industry. Since deregulation in the financial and banking sectors in 1983, Bank Indonesia has gradually implemented monetary policy indirectly, or what is often referred to as a more market-oriented monetary policy (Haryono, Nugroho, & Pratomo, 2019). These policies are among others carried out by using and developing indirect monetary instruments, for example, by introducing Bank Indonesia Certificates (SBI) and money market securities (SBPU) (Suseno & Astiyah, 2009).

RESEARCH METHODE

The author uses qualitative description methods. The author combines this method with studying the literature with a philosophical approach. Data collection is done through various inflation and central bank journals. The author provides a descriptive analysis of various national and international journals. The author tries to defend the theory of inflation and the central bank's position in controlling the rate of inflation.

RESULT AND DISCUSSION

Inflation on perspective Al Maqrizy

Al-Maqrizi's full name is Taqiyuddin Abu Al-Abbas Ammad bin Ali bin Abdul Qadir Al-Husaini. He was born in the village of Barjuwam, Cairo, in 766 A.D. (1364-1365 A.D.). His family is from Maqarizah, a village located in the city of Ba'labak. Therefore, he tends to be known Al-Maqrizi. Al-Maqrizi is in the second phase in the history of Islamic economic thought, a phase that is beginning to see signs of slowing down of innovative intellectual activities in the Islamic world (Bauden, 2014). Al-Maqrizi's life background as neither a Sufi nor a philosopher and relatively dominated by his activities as a Muslim historian greatly influenced the complexion of his thinking about economics. He always looks at the problem with *flash back* and tries to take pictures of what it is about a country's economic phenomenon by focusing his attention on some things that affect the rise and fall of a government. This means that Al-Maqrizi's economic thoughts tend to be positive, a unique and interesting thing in the second phase that is actually dominated by normative thinking. In that regard, Al-Maqrizi is an Islamic economic thinker who conducts special studies on money and inflation (Saputra, 2021). The focus of Al-Maqrizi's attention on the two aspects that during the reign of the Prophet and Al-Khulafa AlRasyidun did not cause this problem, apparently motivated by the increasing number of deviations in Islamic values, especially in these two aspects, carried out by the heads of government of the Umayyads and beyond.

During his lifetime, Al-Maqrizi was known as a critic of the monetary policies implemented by the Bani Mamluk Burji government which was considered a source of doom that devastated the economy of the Egyptian state and society. The behavior of the Burji Mamluk rulers who deviated from religious and moral teachings has resulted in a very severe economic crisis dominated by inflationary tendencies that were further exacerbated by the outbreak of infectious diseases that plagued Egypt for some time. One of his criticisms of the policy of using mixed dirham money and the spread of *fulus*. Al-Maqrizi revealed that inflation does not actually occur due to *natural factors (natural* inflation), but can be caused by human *error inflation* (Rizqon, Prasetya, Ramadhan, & Habibah, 2022).

Natural inflation is caused by various natural factors that cannot be avoided by mankind. According to Al-Maqrizi when a natural disaster occurs, various foodstuffs and other produce experience a very drastic decline and there is a scarcity (Allounce

& Maqrīzī, 1994). On the other hand, due to its very significant nature in life, the demand for various goods has increased. The soaring prices far exceeded the purchasing power of the people. This has great implications for the increase in prices of various other goods and services. As a result, economic transactions are congested, even stopped altogether, which ultimately leads to famines, plagues, and deaths among the people. Meanwhile, human error inflation can occur due to human error (Allounce & Maqrīzī, 1994). Maqrizi identified three things that both singly and collectively led to this inflation. There were three factors underlined by al Maqrizy at the time, namely; corrupt government and bad administration, excessive taxation and increased currency circulation (Rustandi, Asrofi, & Jamil, 2021). The government plays an important role in suppressing the rate of inflation in a natural and human error. One of the roles of the government is monetary policy issued by the central bank (Nugraha, et. al, 2019).

Indonesia's Inflation in Islamic Economy Perspective

Inflation in Indonesia, in general, can be caused by a combination of various factors both from the demand, supply, and expectations sides (Suseno & Astiyah, 2009). The contribution of each of these factors affecting inflation is not always the same over time. In other words, the main factors affecting inflation can differ over time. In the early 1960s to the mid-1960s, the increase in the inflation rate was more due to the demand side related to the government's budget deficit policy (Wijoyo, 2017). At that time, the government carried out a budget deficit policy so as to increase the money supply and in turn encourage a high rate of inflation. The rate of inflation caused by the increasing money supply also occurred in the early 1970s. However, the increase in the money supply in this period was not caused by the budget deficit policy, but was related to the increase in oil prices on the world market. In the early 1970s world oil prices increased so that government revenues from oil increased high. The increase in government revenue from oil increased the money supply, pushing inflation to rise sharply in 1973 - 1974 (Atmadja, 1999). Factors affecting the rate of inflation in Indonesia can also be caused by the depreciation of the domestic currency. For example, when the government still adheres to the fixed exchange rate system, every government devaluation (for example, in 1978, 1983, and 1986), it is always followed by a higher inflation rate. The impact of the exchange rate on inflation in Indonesia is greater through cost pressures (direct passthrough) than through the output gap (indirect passthrough). Rupiah depreciation further increased inflationary pressures in Indonesia (Appa, 2014).

Inflation in Indonesia can also be caused from the supply side (Suttawijaya, 2012). Supply inflation is an increase in inflation due to increased cost *push inflation*. Apart from rising costs, supply inflation can also be caused by government policies on administered prices and supply stock. Supply inflation, in addition to being caused by increasing input costs, can also be caused by rising wage costs. Price increases in terms of costs are an important factor that causes inflation in Indonesia. Another factor that affects the supply side is policies taken by other agencies outside Bank Indonesia, for example, the policy of eliminating government subsidies or tax increase policies that result in an increase in the price of these goods (administered prices). For example, the very high increase in inflation in 2005 (and also in 2008) was mainly related to the policy of increasing fuel prices. Inflation can also be caused by supply disruptions, for example if there is a dry season that results in crop failure, natural disasters, distribution disruptions so that distribution is not smooth and social unrest results in cuts in supply from outside the region (Prastowo, Yanuarti, & Depari, 2007). Such disruption will affect the quantity of goods offered will result in an increase in the price level of these goods in general and will ultimately increase the rate of inflation.

In Islamic economics perspective, there are two causes of inflation in Indonesia, namely; Natural inflation is caused by various natural factors that cannot be avoided by mankind when a natural disaster occurs, various foodstuffs and other produce experience a very drastic decline and scarcity occurs. On the other hand, due to its very significant nature in life, the demand for various goods has increased. The next cause of inflation is human error inflation (Allounce & Maqrīzī, 1994). This happened due to the corrupt government and poor administration of the country, excessive taxation and increased circulation of the currency.

Bank Indonesia's Monetary Policy to Control Inflation

Central banks have an important role in controlling inflation, and in general central banks will try to control inflation at a reasonable level (Ananda, 2021). Inflation control in Indonesia under monetary policy has been carried out since the early 1950s, especially since the enactment of the law on Bank Indonesia in 1953. With this law, Bank Indonesia is officially mandated to control the inflation rate (Astuti & Eddyono, 2021). Inflation control, formally implemented through monetary policy, has undergone changes and developments over time in line with changes in economic conditions in the relevant period.

Monetary policy, which was initially carried out directly by controlling interest rates or bank loans, has gradually changed to a more *market-based* monetary policy (Wijoyo, 2017). In implementing monetary policy directly, from 1974 to June 1983, Bank Indonesia as the monetary authority directly controlled both interest rates (loans and deposits) and credit expansion in the banking industry. Since deregulation in the financial and banking sectors in 1983, Bank Indonesia has gradually implemented monetary policy indirectly, or what is often referred to as a more market-oriented monetary policy (Haryono, Nugroho, & Pratomo, 2019). These policies are among others carried out by using and developing indirect monetary instruments, for example, by introducing Bank Indonesia Certificates (SBI) and money market securities (SBPU) (Suseno & Astiyah, 2009).

The selection of inflation as the final target is in line with the latest development trend of central banks in the world, when many central banks are turning to focus more on the ultimate goal of monetary policy is to achieve a relatively low inflation rate (Wijoyo, 2017). The reasons underlying the change include the following. *First*, empirical evidence suggests that in the long run monetary policy can only affect the inflation rate, monetary policy cannot affect real variables, such as output growth or the unemployment rate. *Second*, achieving low inflation is a prerequisite for achieving other macroeconomic targets, such as growth at full employment and the provision of the widest possible employment opportunities. *Third,* the establishment of a low inflation rate as the ultimate goal of monetary policy will be the nominal anchor of various economic activities. The inflation target used is CPI inflation. There are several reasons underlying the choice of CPI inflation as the central bank's target. First, CPI is the most appropriate measuring tool in measuring the level of public welfare because CPI measures the consumer's cost of living index (Suseno & Astiyah, 2009).

As is the case with other countries, institutions in charge of collecting statistical data always focus most of their resources on producing reliable CPI data compared to other price indices, so that the results of CPI measurements are always of good quality and are always available on time. Second, CPI inflation is relatively more popular in the public. However, with the selection of CPI inflation as the final target for monetary policy, there are many factors that cannot be controlled by monetary policy. As previously discussed, the CPI inflation component consists of core inflation and non-core inflation. Non-core inflation is influenced by inflation of *administered* prices and *volatile prices* (Utami & Suryaningsih, 2011). Inflation, which comes from administered prices and volatile prices, is beyond the control of monetary policy, only core inflation can be controlled by monetary policy.

Bank Indonesia as the Central Bank of the Republic of Indonesia is a state institution that by law is tasked with maintaining and maintaining the stability of the Rupiah currency (Sinaga, Nasution, & Siregar, 2013). Bank Indonesia as the central bank is an institution tasked with maintaining the inflation rate at a low and stable level. To achieve this goal, Bank Indonesia has three main tasks, namely; establish and implement monetary policy, regulate and maintain the smooth running of the payment system, and regulate and supervise banks. The three main tasks seem to be three different things, but in their implementation, they are three closely related tasks to achieve the effectiveness of monetary policy.

Bank Indonesia may implement policies, among others, by operating the open market in the rupiah money market, including foreign exchange intervention in order to stabilize the rupiah. Bi sets the BI rate as the benchmark interest rate. BI establishes a minimum mandatory reserve policy for banks. The implementation of monetary control is not only carried out through the activities of banks operating conventionally, but also through the activities of banks operating under sharia. Bank Indonesia also conducts comprehensive analysis and studies such as assessing the effectiveness of monetary instruments and monetary policy transmission channels, analyzing and reviewing various information variables, conducting discussions with various parties such as business actors, government agencies, banks, and academics, comprehensively identifying the factors that cause inflationary pressures, and formulating monetary policy exposure. Bank Indonesia as the central bank has an important role in suppressing and controlling the inflation rate in Indonesia.

CONCLUSION

The government plays an important role in suppressing the rate of inflation. Bank Indonesia as the Central Bank of the Republic of Indonesia is a state institution that by law is tasked with maintaining and maintaining the stability of the Rupiah currency. Bank Indonesia plays a role in establishing and implementing monetary policy, regulating and maintaining a smooth payment system, and regulating and supervising banks. Bank Indonesia conducts open market operations in the rupiah money market, including foreign exchange intervention in order to stabilize the rupiah. Bi sets the BI rate as the benchmark interest rate. Bank Indonesia has established a mandatory minimum reserve policy for banks. The implementation of monetary control is not only carried out through the activities of banks operating conventionally, but also through the activities of banks operating under sharia. Bank Indonesia conducts comprehensive analysis and studies in assessing the effectiveness of monetary instruments and monetary policy transmission channels, analyzing and reviewing various information variables, conducting discussions with various parties such as business actors, government agencies, banks, and academics, comprehensively identifying factors that cause inflationary pressures, and formulating monetary policy exposure.

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