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Literature Review

The Role of Fundamental Strategies in Overcoming the Inflation

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ABSTRACT

High inflation rates are a complex economic challenge and have far-reaching impacts. To deal with these problems, an effective strategy involving a series of policy instruments and a deep understanding of the root problems that cause inflation is needed. This research aims to analyze strategies to overcome inflation and offer fundamental strategies. This research uses a qualitative with a descriptive-analytical method. The research data is obtained through a literature review: the relevant information from previous research results or official publications. The research results show that it is more supply-side based on analyzing the government's strategy for overcoming inflation. Based on examining the existing situation, this strategy must be complemented by a demand side: providing energy subsidies, increasing national production capacity, and moral education. Based on an in-depth study of inflation, this research provides recommendations for a more fundamental strategy in integrating financial technology (fintech) with precious metals (gold-fintech). This condition means gold-based fintech. It means realizing practical transactions using fintech, which is flexible, practical, and cashless, but the standard is using gold, not fiat money. Also, Islam views gold and silver as suitable for currency use. Apart from internal factors and conformity between nominal and intrinsic value, the uses of gold and silver are based on the sharia. Gold and silver are strong enough to withstand inflation, something that paper money-based currencies do not have. Hence, researchers suggest further research regarding the technical transition mechanism from fiat money-based to precious gold and metal-based fintech.

1. INTRODUCTION

Inflation is an economic phenomenon of significant concern to policymakers and economists. Inflation is a persistent condition characterized by continuous increases in the prices of goods and services over an extended period (Emeru, 2020). In addition, inflation refers to a general increase in the prices of goods, commodities, and services over a specified period, indicating a rise in the overall level of prices (Fauziyah, 2016). In Islam, there is no different from conventional inflation (Dwihapsari et al., 2021).

In general, inflation is caused by an increase in people's purchasing power for a particular item. When the demand for an item rises due to increased purchasing power, but the supply of the item remains limited, its price tends to increase (Nila Atikah et al., 2023). Meanwhile, rising production costs, stemming from escalations in raw material prices and employee salaries, will also contribute to inflation. Consequently, inflation poses a significant challenge to the economy of every country. Also, uncontrolled inflation will seriously impact financial stability, eroding people's purchasing power and worsening the distribution of wealth. It is essential to control inflation to maintain economic balance and sustainable growth (Putra et al., 2023).

Inflation occurs when the prices of goods and services generally increase (Gamaliy et al., 2018). During that period, there was a shortage of goods and services, leading consumers to spend more money for the same amount of goods and services. On the other hand, inflation can occur due to internal or external factors (Abdullaev et al., 2023). Internally, inflation is generally caused by increased production costs due to demands for increases in labour wages, raw material prices and energy costs (Su et al., 2020). Additionally, supply disruptions due to transportation and climate factors cause inflation. Moreover, the government policies that impact increasing inflation are monetary and fiscal expansion (Marlina et al., 2019).

Meanwhile, external inflation can be triggered by the depreciation of the local currency against foreign currencies, which impacts the prices of imported commodities (Juliana, 2017; Vera, 2017). The situation will become even more difficult for countries highly dependent on imported commodities because the export-import supply chain will be disrupted by conflict. Based on World Bank publications, the Russia-Ukraine conflict has increased energy prices by 50% and global food prices by 20% (Yudianto & Supriyadi, 2023). The impact on Indonesia caused inflation to reach 4% (Khairizka in Reeves, 2023)

On the other hand, the world's reality is currently faced with dramatic changes at high speed on various fronts (Soto-Acosta, 2020). The development of digital technology, like artificial intelligence (AI), has caused economic and business disruption. Consequently, humans are in Volatility, Uncertainty, Complexity and Ambiguity (VUCA) (Kaivo-oja & Lauraeus, 2018). Some jobs previously done by humans are quickly being taken over by technology. This fact certainly makes the problem of inflation even more complicated.

However, the general strategy offered by economists and commonly adopted by policymakers in various countries to control the inflation rate is to pursue tight monetary and fiscal policies, market intervention and economic structure reform (Mahlstedt & Zagst, 2016; Öztürk et al., 2014; Pardo Pardo & Clavijo Cortés, 2018)

The various policies adopted have proven ineffective in reducing the inflation rate. This case has been proven in various countries experiencing hyperinflation even though they have implemented a series of recipes to antidote inflation, as happened in Zimbabwe (Maune et al., 2020), Venezuela (Vera, 2017), and Argentina (Guindon et al., 2018). The same condition occurs in Indonesia. Based on publications by the Central Statistics Agency (BPS), even though inflation in Indonesia is controlled, Indonesia's economy is very vulnerable to shocks when the world economy is shaken.

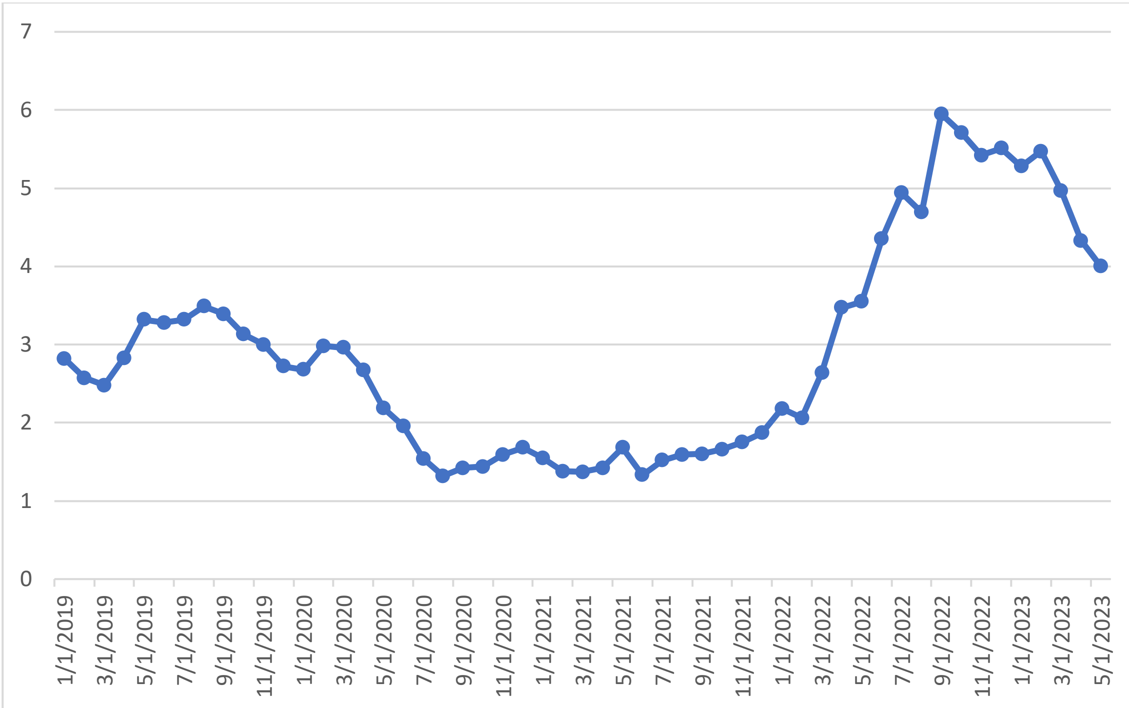

Figure 1. Indonesia's inflation over time (Source: BPS, 2023)

Therefore, evaluating or updating existing inflation-taming strategies is required. However, more fundamental strategic steps are needed to overcome inflation challenges in an ever-changing economic context. However, to face dramatic changes that mean the world today is no longer the same as the world of the past. In a changing world, it is necessary to prepare new strategies rather than old ones that may no longer be relevant. At this point, a new, more relevant strategy is needed.

There are several studies related to this topic. The first comes from Nila Atikah et al. (2023), who was exploring the Islamic economic position as a breakfast to reduce the inflation. The researchers used a descriptive-analytic qualitative with a literature review as the data collection. The results show that the Islamic economic in overcoming the inflation consisted of printing low/minimal amounts of money, executing the Dues Idle fund strategy, and implementing fiscal policy. The second comes from Saadillah et al. (2019), who was analyzing the impact of inflation, interest rate, and industrial production index (IPI) on the amount of zakat in central Baznas. The researcher was focusing on phenomena start from Januray 2011 – December 2017. The data collection was taken from website of Bank Indonesia, the website of the Badan Pusat Statistik (BPS), and the website of the Central BAZNAS. The VECM test results indicated that, in the short term, both inflation and interest rates exhibit a negative and statistically insignificant impact on zakat amounts. At the same time, the IPI showed a positive but insignificant effect. However, inflation significantly decreased zakat receipts in the long run, whereas interest rates negatively affected zakat amounts, with statistical significance. Additionally, the IPI demonstrates a significant favourable influence on zakat amounts. The third comes from Dikiy et al. (2019), who was assessing the influence of inflation volatility on an enterprise's innovation strategy. The study highlights that increasing inflation correlates with a decline in the stationary level of potential output and a reduction in the economic growth rate during the transition to a stationary state. A formula was proposed to compute the overall effect of inflation on enterprise output levels. Furthermore, the study revealed a negative impact of inflation rates on the welfare of economic agents, leading to a decrease in their equilibrium consumption levels. Interestingly, higher-income countries were more adversely affected by high inflation than poorer nations. These findings were rigorously verified through econometric modelling, employing various methods and models for panel data analysis, including fixed effects models, random effects models, and the generalized method of moments. Additionally, the empirical results demonstrated stability across equation specification and estimation method changes. The fourth comes from Kočenda & Varga (2018) , the analysis delved into the impact of price-stability-oriented monetary strategies on inflation persistence, employing a time-varying coefficients framework across a panel of sixty-eight countries spanning 1993–2013. The study demonstrated the efficacy of inflation targeting (IT), even amidst and following the financial crisis, with explicit IT showing a more substantial capacity to mitigate inflation persistence than implicit IT strategies. Moreover, it reveals that exchange regimes anchored to the euro as a reserve currency exhibit greater effectiveness than those tied to the U.S. dollar. Conversely, U.S. inflation persistence displays a notably diminished influence on the persistence of other countries' inflation compared to its German counterpart.

Different from previous studies, this research incorporates the fundamental strategies and Islamic ways of overcoming inflation. This article attempts to answer the need for new steps to reduce inflation and create a stable and sustainable economy. Apart from that, this article also continues to examine strategies to reduce ongoing inflation. More than that, this article proposes the Islamic strategy for overcoming inflation using gold and silver. Gold and silver are strong enough to withstand inflation, something that paper money-based currencies do not have. Hence, this study provides an alternative for countries or regions to overcome inflation.

2. METHODS

This research uses a descriptive-analytical approach. Descriptive analysis is collecting, compiling, or classifying data and analyzing and interpreting it (Beal et al., 2003). The descriptive method aims to describe systematically, accurately, and factually using literature studies to identify the occurring factors. The data used in this research is secondary data. Secondary data is not obtained directly by the researcher; the data is obtained through other parties, such as documents, official publications, or popular mass media (Sugiyono, 2018). Through a literature review, researchers will focus on analyzing the leading root causes of the crisis. Once the root of the problem is identified, the next step is to offer a solution to the inflation that continues to haunt people.

3. RESULTS AND DISCUSSIONS

3.1 The Cause of Inflation

Inflation is an increase in liquidity or the amount of money circulating in an economy. This definition refers to the general phenomenon of an increase in the money supply, which is thought to have caused an increase in prices. In its development, inflation is interpreted as a price increase expected in an economy that continues continuously (Zainuddin, 2015).

Furthermore, world economic experts define inflation in their versions. Friedman (1993), for example, states that inflation is a monetary process that generally increases prices. Keynes defined inflation as a general and continuous price increase, so money generally loses its purchasing power (Teupe, 2020). Meanwhile, Paul Samuelson defines it as a phenomenon when the supply of money exceeds the growth of actual economic output, thus causing an increase in general prices (Puttaswamaiah, 2019). The Nobel Prize-winning economist Stiglitz called Inflation excessive monetary growth, which can disrupt economic stability and reduce the purchasing power of money (Stiglitz & Regmi, 2023). In general, the weakening of the value of money is caused by several things:

First, scarcity of goods and services due to high demand (Demand Pull Inflation). Inflation caused by demand arises due to an increase in the money supply. The increase in the money supply causes interest rates to decrease so that the overall amount of consumption and investment increases. An increase in demand automatically leads to an increase in prices due to a supply shortage of goods and services (Guerrieri et al., 2022; Jain et al., 2022; Kaldor, 1970; Urmetzer & Pyka, 2017)

Second, inflation occurs due to supply-side inflation. Supply-side inflation occurs generally due to cost push inflation. Increases in production costs can originate from increases in input prices, such as increases in minimum wages, increases in raw material prices, increases in energy fuel prices, and others (Batsinda & Shukla, 2019; Dasgupta & Chowdhury, 2023; Jain et al., 2022)

Third, inflation is caused by an increase in the prices of imported goods (Imported Inflation); the more critical the role of imported goods in every production activity, the more serious the impact of inflation will be (De Mendonça & Trigo, 2023; Kamel & Mhamed, 2021).

Fourth, inflation is caused by economic expectations in the future (expected inflation). Community behaviour, in general, is forward-looking; if the community considers that in the future, economic conditions will get better, this can cause demand-pull inflation and cost-push inflation (Duffee, 2018; Xu et al., 2019).

3.2 Strategy of Bank Indonesia and the Government to Overcome the Rate of Inflation

Bank Indonesia and the Government are always committed to achieving the inflation target through consistent policy coordination. Based on Bank Indonesia press release law number 25/44/DKom, the Government and Bank Indonesia agreed on five strategic steps to consistently maintain Consumer Price Index (CPI) inflation within the target range of 3.0% ± 1% in 2023 (Haryono, 2023), namely:

a. Strengthen policy coordination to maintain macroeconomic stability and encourage national economic growth.
b. Maintain inflation of the Volatile Food (VF) component, especially during National Religious Holidays (HBKN), so it is in the range of 3.0% - 5.0%.
c. Strengthening domestic food security through: (i) accelerating the implementation of the food barn program and (ii) expanding inter-regional cooperation.
d. Strengthening the availability of food data to support the formulation of inflation control policies.
e. Strengthening communication synergy to support the management of people's inflation expectations.

These five government strategies continue the previous year's strategy, which also launched five strategies with slight differences. If previously there was a strategy mitigating the impact of upside risks due to increases in world commodity prices. In 2023, there is a strategy to strengthen domestic food security through (i) accelerating the implementation of the food barn program and (ii) expanding inter-regional cooperation. The strategy of strengthening food security is a necessary strategy to restrain the rate of inflation. Weakening food security will result in low levels of community nutrition, especially for people categorized as poor. Hence, food security policies must be implemented to maintain national economic stability, increase farmer incomes, and develop the rural economy. An increasing fertilizer subsidy policy accompanied this policy during the Jokowi era.

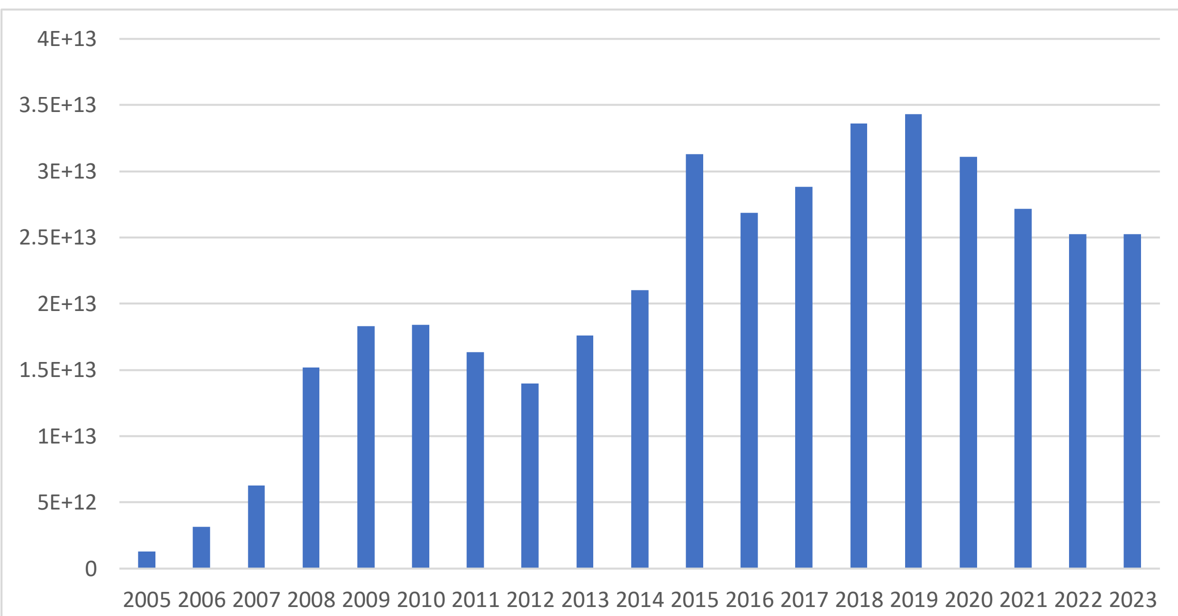

Figure 2. Fertilizer Subdivision from the Kemasa Period
(Source: Katadata, 2023)

However, this policy is only from the supply side and not from the demand side. The five government and BI strategies have yet to see the strategies for dealing with inflation from the demand side (demand pull). Furthermore, this article will offer a strategy to overcome inflation from the demand side (demand-pull inflation).

3.3 Demand pull inflation strategy

Demand-side inflation pulls inflation, which occurs due to excess demand. The phenomenon of excess demand occurs due to a reduction in the amount of production or an increase in demand in a situation of total employment. Reduced production quantities can occur due to factors increasing production costs, including energy, labor, and raw material costs. The increase in consumption occurs due to lifestyle. Hence, the strategy to overcome inflation from the demand side can be done in several ways, namely:

a. Energy Subsidies. Providing energy is one antidote to inflation that the government can take, apart from the fact that this policy is known to be populist. Looking closely at the energy subsidy allocation data in the budget in brief (APBN), it can be seen that this policy has experienced quite significant reductions during President Jokowi's administration. Removing fuel subsidies will increase production and transportation costs. Fuel is the lifeblood of the economy. If prices rise, it will cause inflation.

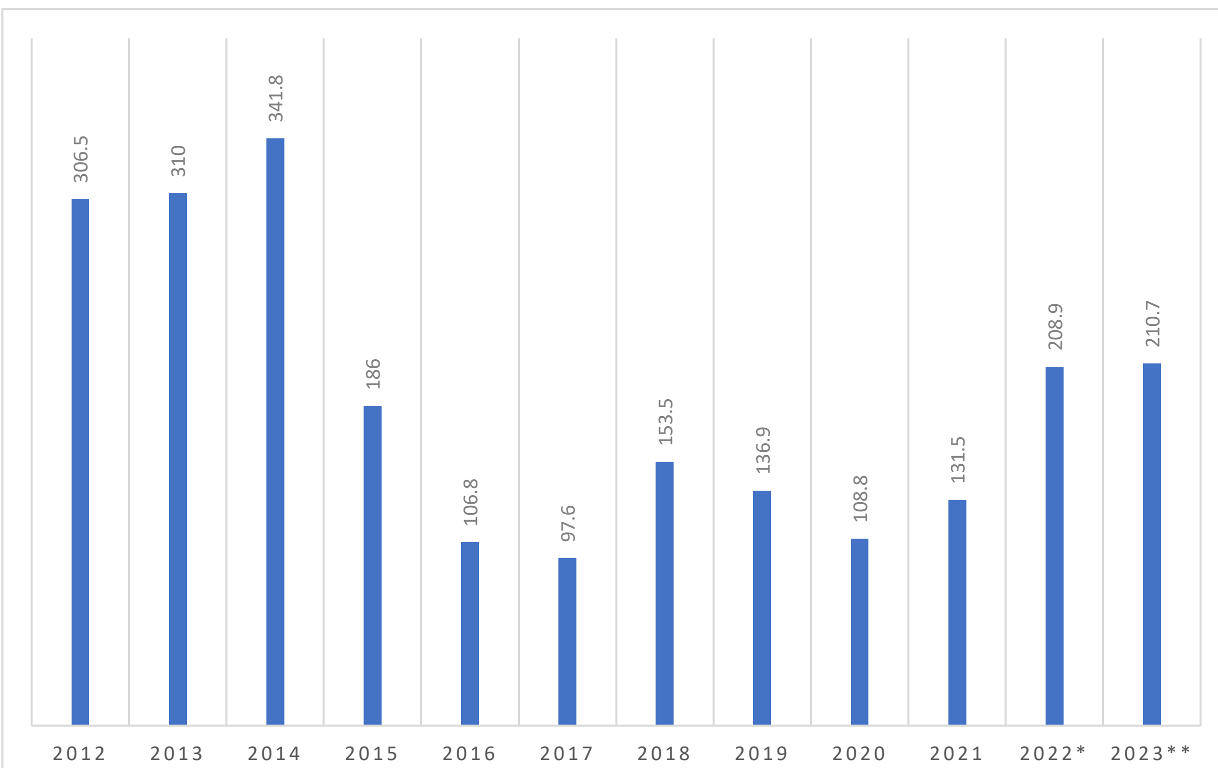

Figure 3. Energy Subsidy Policy from Time to Time
(Source: Ministry of Finance, 2023)

b. Enhancement production capacity. Increasing production aims to increase the availability of national goods and services. To be able to realize this goal, many things must be considered, including production efficiency, technological innovation, improving the quality of human resources, optimizing supply chains from upstream to downstream, building national road infrastructure that reaches all regions so that goods and products are distributed in sufficient quantities throughout the region.

c. Moral education. An in-depth look at all forms of economic transactions will lead to human behavior (Yusanto & Karebet, 2002). If people have good morals, then their behavior will be good and thus the economic results will be felt well. Guided by this principle, the occurrence of various economic distortions will undoubtedly have a contribution from human error. Moral education for economic actors in a capitalistic context is a very important matter. The capitalist spirit based on economic freedom often makes economic actors exceed moral and ethical boundaries (Munafaroh & Masyhuri, 2019). This behavior often has a significant impact on the economy, including inflation. Like the behavior of speculators in the stock market with the aim of getting the maximum gain. Corrupt behavior in all its forms and complicated bureaucracy should be made simple. Therefore, morals and economics are a single currency that cannot be separated to create an economy that is just, prosperous, and evenly distributed.

3.4 Fundamentals Strategy to Overcome the Rate of Inflation

Referring to the understanding of world economic experts and a review of various literature on inflation, the essence of inflation is the weakening of the value of money. If prices increase in an economy, it is not because people are getting richer. However, because the value of money is decreasing, more units of money are needed to pay for each unit of the same item. The amount of money in the present has a lower value than the same amount in the past, and the amount in the present has a higher value than the same amount in the future.

With this basic understanding, a currency solution resistant to inflation is fundamentally needed. The currency resistant to inflation is commodity money (Eden & Kay, 2019). Commodity money known worldwide is precious metals (gold and silver). Gold currency does not require regulatory support from anywhere to make it valuable. Its intrinsic value makes gold stable throughout time (Rothbard, 2005).

There are doubts about the gold standard as a currency due to limited supply. Gold currency differs from fiat money, which can be printed anytime, creating inflation problems. The limited supply of gold is part of the strength of its value that cannot be weakened by printing as many units as possible. Even though the supply is limited, gold products have been valuable throughout history. This differs from fiat money, whose value is limited to a specific period. Money printed 20 years ago may no longer be valid. Gold has remained in effect since humans first knew about it until now and in the future. Gold also differs from other mining products, such as petroleum, which can become extinct, or iron, which can rust. Gold never becomes extinct or rusts. Its existence passes from one hand to another, from one place to another. Gold mining is believed to have been discovered by humans' tens of thousands of years before Christ (Bernstein, 2012). However, until now, humans have continued mining gold. This means that there are no problems related to a shortage of gold supply. Indonesia itself is currently the country with the world's 6th gold reserves.

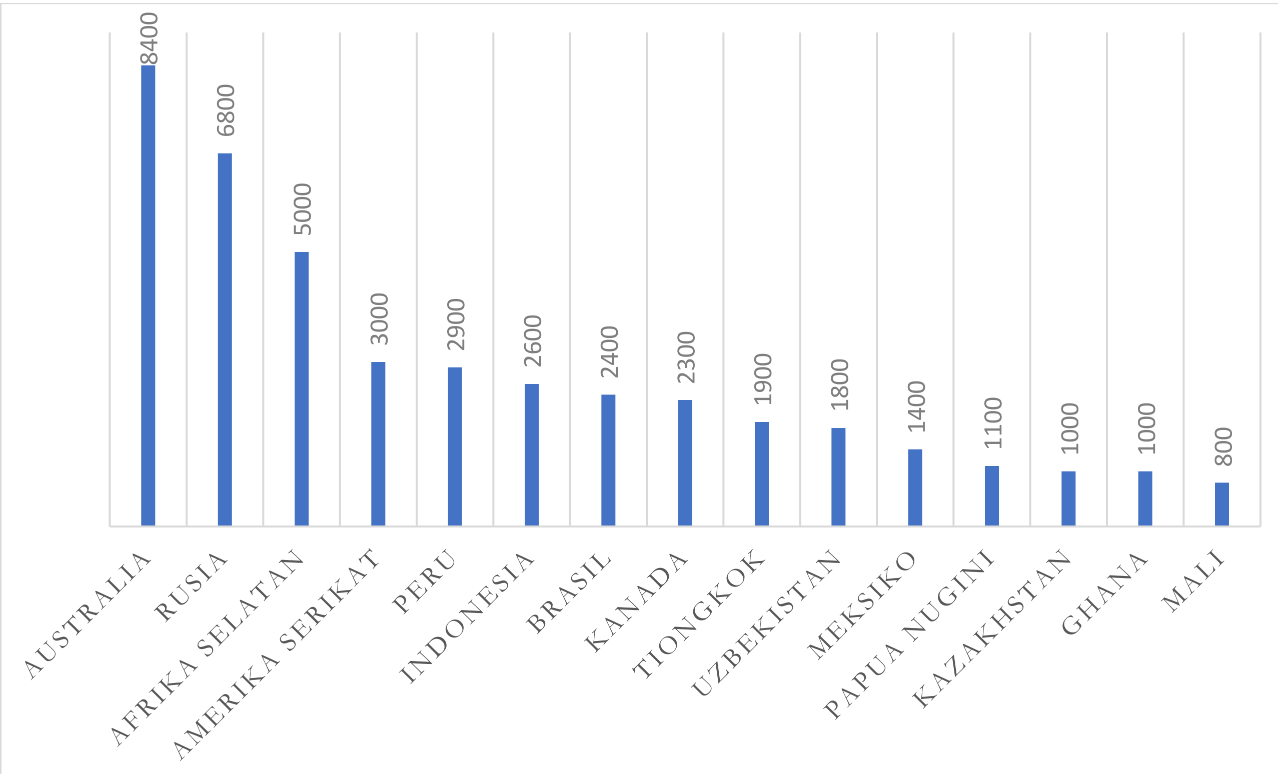

Figure 4. Several countries with the world's largest gold reserves
(Source: Katadata, 2023)

Another doubt from experts regarding the precious metals standard as a currency standard relates to flexibility. Stiglitz, for example, supports commodity currency standards because of their stable value but still needs to be determined regarding their flexibility, which makes it difficult to adjust to changing economic situations (Stiglitz, 2010).

The answer to this doubt is the use of financial technology. The world is now familiar with financial technology (fintech), which is technically sound for cashless transactions, increasing the number of transactions and the efficiency and effectiveness of transactions. The existence of fintech will only be able to hold back the rate of inflation if fintech is still based on fiat money. Hence, what can overcome inflation or even eliminate it is precious metal currency (Arifin et al., 2022; Krichene & Ghassan, 2019; Mahlstedt & Zagst, 2016; Peie et al., 2017; Pujiyono, 2004; Utomo et al., 2023; Zahara, 2020).

Considering its sizeable digital market, Indonesia certainly has the potential to do this. Based on a press release from the coordinating minister for the economy, Indonesia's digital economy is the highest in Southeast Asia; its economic value in 2021 was recorded at around USD 70 billion and is estimated to reach USD 146 billion in 2025 (Liu et al., 2021).

Based on this explanation, the fundamental strategy proposed in this article is the integration of fintech with precious metal currencies (gold-fintech). Fintech functions in terms of transactions in the real world, which are very flexible, cashless, effective, and efficient. Meanwhile, gold acts as a guardian of the stability of currency values.

3.5 Gold and Silver Money in the View of Islamic Economics

The derivative function of money causes money to become a commodity object and a store of wealth that can be bought, sold, and hoarded. One of the effects of this derivative function is the accumulation of gold (Juliana, 2017). Even though hoarding money is a form of prohibition for a Muslim, this follows Allah's words in the Koran, Surah Taubah, verse 34. This verse means that the threat of painful punishment for people who hoard gold and silver is a qarinah (indication), which shows that the prohibition is firm (jazim).

Thus, hoarding gold and silver is haram. Prohibition is definite and general. For this reason, the article indirectly invites a return to the proper function of money, which has been carried out in the Islamic concept as a means of exchange and a unit of value, not as a store of wealth. It must be realized that money is only an intermediary to convert one item into another (Juliana, 2017).

Gold and silver are the shariah money. Islamic Monetary Economics challenges the notion of money as a tool for policy manipulation (Krichene & Ghassan, 2019). Within this framework, fully convertible paper currency aligns with Shariah principles. Shariah dictates that a just government must prioritize balanced budgets and the restoration of gold and silver as lawful currency. Meanwhile, gold and silver, originally natural commodities, evolved into currency through a market-driven process. Gold producers operated like any other profit-oriented entity, devoid of subsidies; average profit margins solely drove their production of gold and silver. If production costs exceeded profits, their production was halted. Gold producers entered the market much like car manufacturers, subject to the laws of value governing gold and automobiles. In contrast, the issuer of paper money does not contribute tangible goods to the market. Instead, they exchange their printed currency for goods such as cars, food, and houses.

Gold and silver are precious metals, scarce and produced by only a handful of countries. This scarcity, unlike paper currency, is a fundamental attribute that renders them suitable as forms of money. Unlike wood, stones, gravel, and coal, which can be produced in vast quantities, gold and silver cannot be mass-produced. If people desired an inflationary commodity, they would not have selected gold or silver. Their stable stocks make gold and silver reliable measures of value (Matiushin, 2019). An inflationary commodity cannot effectively measure value, just as a shrinking rod cannot accurately measure length or distance.

On the other hand, gold and silver provide price stability and prevent drastic fluctuations (Meltzer & Robinson, 1989). Durability is a crucial characteristic of currency, essential for facilitating exchange, saving, and capital formation. Money must retain its value until it is utilized in trade. A medium of exchange must be durable and capable of preserving value, as there is often a period between transactions. Workers, for instance, save part of their income to purchase assets like homes in the future.

Furthermore, gold and silver possess durability, remain unaltered over time, maintain stable, and predictable values (Krichene & Ghassan, 2019). They can be securely stored, even underground, without degradation. Historical discoveries of gold in sunken ships, preserved without erosion for decades or centuries, attest to their durability. Refined metals such as gold, silver, copper, and nickel have historically been favoured as money due to their exceptional durability.

An Nabhani stated that Islam has given people the freedom to make exchanges using whatever they like. However, the exchange of goods for specific units of money has been demonstrated by Islam as a monetary system (Abdullah, 2016). Moreover, Islam has assigned Muslims certain types, namely gold and silver. This conclusion is based on the following reasons (An-Nabhani, 1990):

a. Islam prohibits hoarding (al kanz) gold and silver. The prohibition in the Al-Quran surah At-Taubah verse 34 is directed at hoarding gold and silver, as gold and silver, as currency and a medium of exchange.
b. Islam has linked gold and silver with standard laws, such as the diyat for murder amounting to 1000 dinars and the limit for amputation of hands for theft of property up to ¼ dinar.
c. Rasulullah SAW (May Allah honor him and grant him peace) has established gold and silver as currency and made only gold and silver the standard of money where the standards of goods and services will be returned to these standards.
d. When Allah SWT (May He be praised and exalted) requires zakat on money, Allah SWT (May He be praised and exalted) has required zakat on gold and silver, then Allah SWT (May He be praised and exalted) determines the niṣâb of zakat with the niṣâb of gold and silver.
e. When Islam established the law of money exchange (Sharf), Islam stipulated money in the form of gold and silver. Sharf is exchanging or buying money for money, either of the same type, such as buying gold for gold or silver for silver, or between different types, such as buying gold for silver.

4. CONCLUSION

The government's strategy for dealing with inflation in 2023 consists of five strategies, which are continuations of the previous year's strategy. Analysis of this strategy is more supply-side in nature. For a strategy to successfully reduce the inflation rate, it must be complemented by a demand side by providing energy subsidies, increasing national production capacity, and moral education.

Based on an in-depth study of inflation, this research provides recommendations for a more fundamental strategy in integrating financial technology (fintech) with precious metals (gold-fintech). This means fintech is based on gold and silver. Realizing practical transactions using fintech, which is flexible, practical, and cashless, the standard uses gold and silver, not fiat money.

Realizing this strategy's fundamentals certainly requires a more mature concept and support from various aspects. At least several challenges need to be overcome, for example, related to our digital sovereignty, which is still fragile, the digital literacy of society, which is still lacking, and the digital technology ecosystem, which needs to be strengthened. Therefore, researchers recommend further studies in various fields. Researchers also suggest researching the technical transition mechanism from fiat money-based fintech to precious metal-based fintech.

Regarding the mechanism for using precious metals: gold and silver, Islamic economics views that gold and silver are very suitable to be used as currency, apart from internal factors, namely the existence of conformity between nominal value and intrinsic value, the use of gold and silver is following sharia. As explained in the paper, Sharia arguments demand the use of gold and silver as currency. Apart from that, gold and silver have proven strong enough to withstand inflation, something that paper money-based currencies do not have.

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