

The Relationship between Inflation and Political Stability

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ARTICLE INFO

Keywords: Relations, Inflation,
Political Stability

Received : 03, February
Revised : 17, February
Accepted: 22, March

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ABSTRACT

This article examines the relationship between inflation and political stability in Indonesia. By using secondary data related to the level of inflation and the political situation from a certain period, this article aims to analyze whether there is a correlation between inflation and political stability in Indonesia, as well as the dynamics of this relationship. Through a statistical analysis approach and literature review, this research finds that the relationship between inflation and political stability in Indonesia tends to be complex and influences each other. Although high inflation rates can create social dissatisfaction and political pressure, there are also situations where political factors such as government stability and economic policy can influence inflation rates. The results of this analysis provide valuable insight for policymakers to design effective strategies for maintaining economic and political stability in Indonesia.

INTRODUCTION

Economic dynamics and development that influence the growth in demand for goods and services with limited economic capacity are one of the causes of inflation. Inflation is a condition of general and continuous increase in the prices of goods and services. What is meant by "general" is that the price increase does not only occur on one type of goods, but the price increase covers the group of goods consumed by the public, and the increase also affects the prices of other goods on the market.

In general, inflation is detrimental for most people. To overcome and anticipate these losses, the public and all other economic actors must be able to read the symptoms and trends of inflation that have occurred previously. By calculating inflation based on previous years, economic policies can be more rational. Political stability is a dynamic condition of politics itself to produce balance, stability, and political stability. Because politics is the formation and distribution of power in society which, among other things, takes the form of a decision-making process, especially in the state, political stability is a dynamic condition of this process.

Political stability means conditions where peace and security are established in a country's political system without any chaos or conflict that threatens stability. Factors that influence political stability include political consensus, social justice, general trust in the government, and resistance to internal and external pressure. Political stability is important because it allows the government to implement its policies effectively, encourage investment and economic growth, and maintain peace in society. In a global context, political stability can also affect interstate relations and regional security.

Uncertainty in the economic and political situation can create an unfavorable environment for domestic and foreign investment. Therefore, political stability influences saving and consumption behavior and hurts the investment decisions of domestic and foreign investors (Ismihan and Ozkan, 2005). This article will explain in more depth the complex relationship between inflation and political stability, and how the interaction of the two affects a country's economic conditions.

LITERATURE REVIEW

According to Abideweli M. Ali (2001), economic growth can be determined by the quality of a country's institutions. Bad institutions disrupt the rate of economic growth because economic actors are fed up with the ruling bureaucracy and tend to fight the system rather than get involved in economic activities. One form of order is politics, politics has an impact on market boundaries and the environment and is a form of control over consumers and companies or producers. In reality, economic policies that go through a political process are not free from interests and attachments but are very strong and close to the interests and attachments of policymakers. Therefore, economic policy is the result of a process that balances conflicts of interest between various political-economic decision-making instruments.

Usually, the reading and interpretation of political stability are by comparing it, namely political instability which is just a framework for reading the social and political-economic situation of a country, namely political stability through instruments that are a combination of social, political, cultural, and economic factors. Political stability can significantly influence economic performance, as can political instability. Political stability can have a quite serious impact on economic growth because it can increase uncertainty about the situation and economic policies in the future, Carmignani (2003). Uncertainty in the economic and political situation can create an unfavorable environment for domestic and foreign investment.

METHODOLOGY

The method we use applies a qualitative approach in answering questions proposed research. This approach uses literature studies from various academic journals, following social science research methods. The research provides a detailed description of methods used in dealing with problems and methods of analysis.

RESULTS AND DISCUSSION

Inflation at the Beginning of Independence

The cause of inflation at the beginning of independence was the amount of money in circulation that exceeded the needs of the country and its people. This is a phenomenon in the economic field because this incident rarely occurs in other parts of the world. Apart from that, the cause of inflation at the beginning of independence was because the amount of money circulating was more than needed. Other factors influenced the economic situation in Indonesia, one of which was the Dutch decision to block trade access to Indonesia so that people's cost of living increased drastically, namely up to 100% in 1950. Then from 1963 to 1965, Indonesia experienced hyperinflation, namely the phenomenon of inflation. can no longer be controlled. The following condition occurs when the price of goods rises very quickly while the value of money decreases drastically. The total inflation rate in that period reached more than 600%. Starting in 1960 when Indonesia was still reaching 20%, this became a sign that the country's financial condition was unstable. This continued in 1962 when the inflation rate had reached 156% and increased again in 1965, reaching 592%. However, in 1998, once again the cause of inflation at the beginning of independence was repeated, namely the monetary crisis, increasing by 77%. The proclamation of the President of the Republic of Indonesia on October 3 1945 determined that the De Javasche Bank, De Japansche Regeering, and Dai Nippon and Dai Nippon Teikoku currencies were legal to be used as a means of transactions on Indonesian soil.

At the beginning of independence, Indonesia did not have a stable economic situation, especially when it came to issuing its currency, because conditions after the war meant that Indonesia was still shaky in its footing in the economic realm while making its currency, the country experienced a shortage of human resources and production facilities. Therefore, the implementation of 3 types of currency is considered a solution to the difficulties experienced, although, in the future process, it turns out that it creates new problems in the economic sector, namely inflation.

The above causes of inflation at the beginning of independence had a major impact on the increase in prices of goods such as food and wages for employees and laborers which were not balanced with their daily needs. One of the parties most affected was farmers because they owned the most Japanese currency at a time when the country was transitioning since the war crisis. Apart from that, farmers' financial conditions were also worsened by the naval blockade by the Dutch so Indonesian export products had difficulty entering the international trade market and import activities could not meet their needs. Related to this, there were several efforts made by the government to overcome inflation at the beginning of independence, namely by making national loans with the approval of the Central Indonesian National Committee Working Body (BPKNIP). The following National Loans were carried out with the support of the people of Java and Madura in 1946 to the Postal Savings Bank and pawnshops. And the following steps succeeded in raising 500 million.

Furthermore, another effort made by the government to overcome inflation at the beginning of independence was to produce the Oeang Repoeblik Indonesia (ORI) currency in 1946 to replace Japanese cash. Over time, the government also formed Bank Negara Indonesia (BNI) as a coordinating institution in the economic and financial fields. The main task of Bank Negara Indonesia is to regulate the ORI exchange rate in foreign currencies in Indonesia. Not just one, but at that time several things were factors that triggered inflation. Even to the point that the government is overwhelmed in handling it.

Inflation in the Present

In the current era, many interesting events have occurred and have greatly influenced the economy in our country, Indonesia, which of course is not far from the involvement of political policies from the government in its involvement in overcoming economic growth in times such as the Covid-19 pandemic last year which caused Global economic growth has plummeted and several countries have lost money, and this has now been exacerbated by the impact of the Russia-Ukraine war. This war triggered an increase in world energy and food prices which caused high inflation in several regions and of course also greatly affected the economic situation in Indonesia itself.

Inflation occurs due to a lack of energy supply which is needed in the production and distribution process. When energy prices soar, production and distribution costs also rise. This type of inflation is called cost-push inflation, namely inflation that is triggered by an increase in production costs which then

has an impact on rising prices. So rising prices of goods can cause sales of goods to decrease so that the company's income also decreases. As a result, this condition could trigger a wave of layoffs. Cost-push inflation often leads the economy towards stagflation, namely low economic growth accompanied by inflation and high unemployment rates.

Global Economic Conditions

Global economic conditions will greatly influence the economic conditions of developed countries, especially developing countries such as Indonesia, which is now a tough test, especially for developing countries which are still vulnerable. In July 2022, several developing countries will already experience suffocating inflation, for example, Iran at 42.9%, Argentina at 83%, Sri Lanka at 60.8%, and Turkey at 83.5%. Prices of goods, especially food and energy, in these countries have simultaneously soared. Sharply rising inflation will threaten a country's political stability. People became angry with the ruling regime because they were seen as unable to control prices. As a result, it is difficult to avoid a wave of protests and demonstrations. Public pressure pressured the regime to adopt policies to reduce prices. If people's expectations are not met, political turmoil will continue to hit a country. For example, Sri Lanka became the first victim of high inflation this year. In fact, since January 2022, inflation in Sri Lanka has been above 10%. The Russian and Ukrainian war saw inflation in Sri Lanka soar above 20% in March until toppling the ruling government in July when inflation reached 60.82%. The decline of the old regime has not made inflation tame, in fact in September inflation still crept to 69.8%.

Britain became the first victim of high inflation in Europe. Britain's political stability is shaken by calls for former Prime Minister Liz Truss to step down. Even though she had only been in power for 45 days, Truss was forced to step down due to the economic crisis that continued after she came to power and errors in the formulation of fiscal policy. Rishi Sunak, who is of Indian descent, has now replaced Truss. It is not impossible that political stability in other European countries will also be disrupted and even violently shaken due to high inflation.

Political Transition and the Relationship between the Inflation Rate and Political Policy

Based on the amount of inflation, Boediono (1985) divided the types of inflation into light inflation (< 10%), moderate inflation (10-30%), heavy inflation (30-100%), and very heavy inflation (> 100%). Moderate inflation is quite dangerous and reduces the level of social welfare. Economic chaos begins usually when inflation is above 30%. In the opinion column in the Wall Street Journal in October 2021, Holman W. Jenkins said "Inflation is the mother of Big Political Change". If inflation has risen sharply, then whoever the regime is in power will be pressured to take bold policies. It could be short-term mainstream policies with larger figures. Or, non-populist long-term structural

policies. Like it or not, policies in this phase will hurt the status quo so that the regime can gain the trust of the people.

High inflation and political instability have a reciprocal relationship. High inflation causes political instability, and vice versa, political instability can cause high inflation. Palman (1987) found a strong relationship between inflation and political instability in eight Latin American countries during the period 1946-83. A weak civilian regime with high inflation is easily couped by a military regime. Palman even gave precision that double-digit inflation could reduce support to the government by 3-7%. Aisen and Vega (2007) took a sample of 160 countries during the period 1960-1999. Countries with high inflation volatility tend to have high inflation too. This high inflation volatility is caused by political and institutional factors. A Central Bank that is not independent and has low economic freedom will create high inflation volatility. Cabinet changes or (reshuffle) can also increase inflation. Frequent cabinet reshuffles tend to make inflation even more volatile. This is because the public has the perception that cabinet reshuffles often indicate political instability.

If inflation is still difficult to control with high political turmoil, an "abnormal" political transition will usually occur. As a result, the ruling regime was forced to step down before the end of the period. In history, abnormal political transitions have often been accompanied by waves of protests, social unrest, political divisions, and even bloodshed. Indonesia also experienced a similar condition in 1998 when inflation soared to around 60%, forcing Suharto to step down. Now the attack of high inflation is difficult for all countries to avoid. The integrated global economy means that all regions are affected by this high inflation, especially in the energy and food sectors. The economic resilience of every country is now being severely tested. If a country cannot tame high inflation then political stability is at stake.

CONCLUSIONS AND RECOMMENDATIONS

Inflation and political stability are two important aspects of the economic dynamics of a country. As has been discussed, inflation is a general increase in prices that occurs continuously and can become a serious problem for the economy and society. On the other hand, political stability has a crucial role in shaping economic conditions that are conducive or not. By understanding the interrelated relationship between inflation and political stability, we can feel its impact directly in everyday life. For example, such as increases in the prices of goods and services, and uncertainty in economic and investment policies, can be caused by the dynamics of inflation and political stability. A deeper analysis of this relationship will help governments and policymakers formulate appropriate measures to maintain overall economic and political stability. In this way, it is hoped that readers will gain a better understanding of the importance of maintaining political stability to overcome inflation challenges that may arise.

FURTHER STUDY

The results of the literature study are still in the form of conjectural conclusions collected from the literature. It is hoped that this research can be further investigated regarding the practices and impact of political policies on inflation.

ACKNOWLEDGMENT

Thank you to the Semarang State University lecturer majoring in Political Science for allowing me to write this article. Thank you to my teammates who have collaborated in writing this article.

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