Riba and Inflation

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The argument of inflation is often advocated to compensate for the "*loss of value*" or the "*depreciation in money*", and therefore any consideration to offset this damage may well be justified. This approach may find its way fast in conventional organism, and to incorporate such computations may not be a problem in a mere profit driven interest based system rather it can be looked upon as another risk calculating element. However, it can't and shall not go unchecked without proper evaluation for its Islamic permissibility; a viewpoint is required to be established off topic.

Although, the same sense has traveled to many of Islamic minds as well except with a question mark, it equates to similar asking that an extra "*equivalent to inflation*" if charged by the lender will be considered as "***Riba***" or not?

Here the problem is double, there is a well-known confusion on the subject of inflation in Western economies and when coupled with the prevailing confusion on the subject of "***Riba***" in Islamic World – it becomes horrendous!

At least there is a common settled perception that inflation is some sort of phenomenon related to the upward trend in prices, but there is no unanimous agreement on the definition or **what causes inflation**. A wide variety of somewhat segmented classifications is provided from different schools of thoughts and work groups, like:

1. **Demand Pull Inflation** (Demand Supply Phenomenon)
2. **Cost Push Inflation** (Due to increase in the cost of production/supply)
3. **Built-in Inflation** (Result of past events experienced now)
4. **Hyperinflation** (Inflation getting out of control), etc.

You may find different variants of definition in English dictionaries, and few are generous enough to accommodate even sentimental statement within definition like "in inflation everything gets more valuable except money" but the acuity is matching all across.

In dynamic societies / economies, when some happening or any phenomenon is observed influencing the economy or society then to keep the system ongoing, the management drive also institutes and enforces controlling mechanisms. Since the exact and agreed upon cause(s) of inflation are not identified, therefore the subject is also handled segment-wise to a certain extent. A proof for this partial handling is the formation of different indexes like:

1. Consumer Price Index (**CPI**)
2. Producer Price Index (**PPI**)
3. Employer Cost Index (**ECI**)
4. Purchasing Power (**PP**), etc. etc.

There are many drawbacks connected naturally to indicators thus established from these indexes mainly because of the reason that these indexes do not cover every aspect but a weighted average of select group and therefore can not be reputed "**as convincing as it demands**" to deal with the problem.

In addition to the statistics and analysis based on selected groups, there is an interesting circle that further deteriorates the credibility of these pointers, that is:

1. Use previous Price, Cost, and Purchasing Power etc. as reference.
2. Calculate Inflation from present Price, Cost and PP.
3. Prepare Reflection for the next.
4. Remember we are talking about inflation – the upward trend, now go to #1.

It is common and easy to understand that demand of certain things go high during some specific period or time or event, say for example "dates" are high-in-demand in the month of Ramadan, therefore prices are inflated. Shortage of products and commodities is certain in the times of wars thus prices are blown-up.

What is difficult to understand is the situation where say, I am on my place for long; my city is calm, negligible change in habitants, increase in demand if any is met with the increase in supply, wages are not increased since last year, lifestyle of the city people cannot change overnight.

No reflective change in anything, no specific period or event is around, but prices are increasing in a regular pattern, a BIG WHY? This big why is regularized and justified with the contraption of "Inflation".

What inflation is? - Answer "**7.2%**"
How calculated? - "**from CPI which is .....**"
What causes inflation? - "**may be blab bla bla!**"

Figures work simple as that, it works because mostly people are interested in figures, so even if nobody knows "what causes inflation" - it will not make a difference or just very little difference – at least the inflation figure is known, isn't it interesting?

What causes Inflation?

An adequate amount of literature on different explanations is there available on book-shelves and Internet; inflation is explained as a result of "*excess money supply*", a result of "*paper money*", an outcome of "*increase in demand*", a burden derived from "*over expenditure of government in the form of taxes*" etc.

Central banks seem more convinced with the cause of "*excess money supply*" (or may be because it is their jurisdiction and they can control it easily), anyway what ever is the reason of their persuasive cause, the adjustment they normally do is to squeeze money supply by increasing "*interest rates*" to fight "*so-called inflation*". The monetary contraction and expansion policies are well known styles of central banks to address inflation and deflation respectively.

What are the results of all these efforts taken in the context of "***inflation***"? I don't know any but confusion. The every time successful strategy worked again, i.e., if you can't answer or can't do anything about a problem – try to confuse. But the monkey (if you know the story) was not succeeded in confusing the complainant by jumping from one tree to another (exerting efforts) in order to solve the problem of plaintiff. There are people in the society not satisfied with efforts or means undertaken to tackle inflation issue and the projections of its causes.

What causes inflation is still not answered to their satisfaction. Although, the mentioning of "*interest*" as a relative of "*inflation*" is seen, but "*Riba or Interest*" is not labeled as the main cause of producing inflation which in my view is the "true story". How and why?

"Riba or Interest" AS THE "Cause of Inflation"

In order to explain how "*Riba or Interest*" becomes the main cause of Inflation, it is mandatory to further elaborate my point of view about "*Riba*" that revolves around the "*non-existence*" of the extra-liability created in a transaction.

At a given time of transaction when a lender and a borrower are going to agree on interest based loan contract, there is an owner of each penny of capital available in the economy.

Is there a contract executed at that moment with similar time span in the economy to bring about the "*change of ownership of capital*" equivalent to the "*Riba or Interest*" in favour of borrower? Because of the deficit he is in now due to the just concluded agreement.

No need of such a simultaneous contract, might be argued in a case where the borrower already owns equivalent to that extra he has committed in terms of "*Riba or Interest*" and is able to discharge his total liability. Any problem now, **YES!** Still there is.

Whatsoever is the case, the borrower owns that much or not, his commitment or promise is reflected in accounting books of lender in "*receivable*" column and "*balance sheet projection with increase of profit*". Is there any manifestation of the contract on the part of borrower? Yes, of course there will be.

The books of borrower will be adjusted for an increased liability, the assets side will be re-evaluated to balance or to gain profit (profit is the motive every where, means and rules are subjective), a check on options available to the borrower to match the increased liability will sound only to adjust the saleable assets prices upward.

If "*Riba or Interest*" was not there in the contract; absolutely there was no requirement to adjust accounting books, and therefore no forced increase in the prices of saleable assets (inventory). From this single case in point, one can expand the canvas to every type of financial contract incorporating "*Riba or Interest*", the "*receivable*" of lender is always reflected as increased liability on accounting books of the borrower (an industrialist, trader, service provider, individual etc.), accounting adjustment of that "*increased liability*" is only possible by upward price adjustment of products and services. It can happen at the start of the business, in midway or whenever "*Riba or Interest*" is recorded in books.

Here, the whole economy is run like this, lending is taking place on regular basis incorporating "*Riba or Interest*", prices are increased with each cycle of lending, there is a continuous trend of increase in prices, study CPI and other bunch of indexes, regard it as empirical evidence but please don't call it a phenomenon of "*Riba or Interest*" but "*Inflation*".

It looks simple; true as well "the route cause of inflation is the practice of incorporating Riba or Interest in lending". This is totally opposite to the belief (or mistaken belief) posed by central banks. When central banks adopt the policy of "*increasing interest rates*", it gives an impression that by increasing interest rates, the inflation is reduced or at least capped from further increase in it, you heard this and kept in mind, but you can't be convinced because there is no logic told. Who is hiding what and why? Try to guess it.

Beyond Inflation

There are few points that require your attention in above context.

1. One should not be confused when some one quotes that "look! the price of computer has gone down considerably, so what inflation or the affect of interest are you talking about, how this industry is saved from this phenomenon?" No, it is not like this, the above asserted cause of inflation is equally influencing this industry as well, but the reason for decrease in prices is the advancement in technology. The technology has a role in pricing.

2. Price is relative, depends on many factors, price shapes itself on natural conditions, different situations. It may change without a difference of time period, a sudden unforeseen, disaster, war, market conditions, geographic displacement, flood or any such event. Comparing prices with a reference which is also changing in its value can never produce equitable results for all. Therefore, to best equate the value of any commodity/currency in different ages, situations and opportunities – is the same commodity or currency itself, nothing else.

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