MONETARY POLICY: COMPARISON OF MASUDUL ALAM CHAUDHURY AND MILTON FRIEDMAN ECONOMIC THOUGHT

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Abstract

This study aims; 1) to describe Masudul Alam Choudhury and Milton Friedman version of monetary policy, 2) to describe the comparison of Masudul Alam Choudhury and Milton Friedman thoughts on monetary policy, 3) to describe the relevance of Masudul Alam Choudhury and Milton Friedman version of monetary policy to monetary policy in Indonesia. The research method used is a qualitative method with a literature review type. The results showed that; 1) Choudhury put forward the endogenous theory of money in Islam, where the central bank as the monetary authority only facilitates the circulation of the money supply volume so that the amount is accordance with actual spending and not spending demand expectation, 2) Friedman argues that money only affects inflation and does not affect economic growth, therefore monetary policy must be directed only affects at controlling inflation and not directed at influencing real economic activity, 3) The relevance of Choudhury and Friedman economic thinking regarding monetary policy on monetary policy in Indonesia can be seen from the implementation of monetary policy implemented by Bank Indonesia.

Keywords: Monetary Policy, MA Choudhury, M. Friedman.

1. INTRODUCTION

Monetary policy is one of the concepts and theories born from economics problems faced by humans. Monetary policy is a policy carried out to control macroeconomic conditions as desired by regulating the amount of money circulating in the economy. Experience has shown that an out of control money supply can have dire consequences for the economy as a whole. These conditions, among others are the background of the efforts made by the government or the monetary authority of the country in controlling the money supply in the economy. In its implementation, the monetary policy applied by each country is different, adjusted to the objectives and transmission mechanisms that apply to each country the economy concerned. The strategy and transmission chosen are the basis for formulating the operational framework of monetary policy [1].

Frederic S. Mishkin describes that monetary policy is part of macroeconomic policy. The objectives or targets of monetary policy are to help achieve the objectives of macroeconomic policy, namely; 1) expand job opportunities (high employment), 2) increase economic growth, 3) price stability, 4) interest rate stability, 5) money market stability and 6) market stability foreign exchange [2].

Chapra, (1985) suggest that a monetary policy mechanism not only helps regulate the money supply in line with demand for real money but also helps meet the need to finance the governments original deficit and achieve other sosio-economic goals of Islamic society. There are 6 elements of the monetary policy mechanism, among other, 1) Targeted growth in
M and Mo, 2) Public shares to show deposits (demand deposits), 3) Official statutory reserves, 4) Credit limits, 5) Value oriented credit allocation, 6) Another technique (morality).

Currently, many contemporary economists have made contributions to monetary policy in various economic literatures. The contribution of the thoughts of each of these contemporary economist certainly has similarities and differences. The paradigm of thinking of contemporary economist will greatly influence the contribution of thought it produces. Religious value are one of the thing that characterize the paradigm of thinking of contemporary economist. The contribution of contemporary Muslim economist will certainly differ from those of non-Muslim contemporary economist.

Masudul Alam Choudhury (1948) an American economist, an economist in the United States, is one of the many contemporary Muslim economists who have ever existed. Choudhury was born on January 1, 1948 in Calcutta, India. Kholi, (2016) stated that since 1992, Masudul Alam Choudhury is Professor of Economics at The University College of Cape Breton, Sydney Nova Scotia Canada. Choudhury is also a professor of economics and finance at the College of Industrial Management, King Fahd University of Petroleum and Minerals, Dhahran, Saudi Arabia. Badi’, (2017) explained that, a book entitled Money in Islam; A Study in Islamic Political Economy, Routledge, London, 1997 is Choudhury’s first work using epistemological analysis in explaining money and monetary theory from an Islamic perspective.

Furthermore, Milton Friedman, an American economist, is one of the many contemporary non-Muslim economic figures who have ever existed. Friedman was born on July 31, 1912 in Brooklyn, New York, United States and died on November 16, 2006 in San Francisco, California, United States. Milton Friedman was an American economist and educator and one of the main proponents of monetarism in the second half of the 20th century. Friedman was awarded the Nobel Prize in Economics in 1976 [6].

Hetzel, (2007) explains that, Milton Friedman became one of the most influential intellectuals of the 20th century because of the influence of his ideas in redefining the view of depression and shaping the contemporary view of the great inflation from the mid-1960s to the early 1980s. The Depression was not a failure of the capitalist system but the collapse of the monetary institutions of the United States. Butler, (2019) states that, one of Friedman's works entitled Studies in the Quantity Theory of Money (1956) also contains the idea that the government is responsible for maintaining currency stability. Friedman argues that if the government creates jobs by ignoring rising inflation, it will create inflation and unemployment.

So far, there has been no literature study that comprehensively discusses the comparison of the economic thinking of Masudul Alam Choudhury and Milton Friedman on monetary policy. The purpose of this study is to describe how the economic thinking of Masudul Alam Choudhury and Milton Friedman in relation to monetary policy compares, and its relevance to monetary policy in Indonesia.

2. RESEARCH METHODS

The method used in this study is a qualitative method with the type of literature review (library research). The data needed in this study were obtained from several literatures of books, journals and articles relevant to the contribution of Masudul Alam Choudhury and Milton Friedman's economic thought related to monetary policy. The entire data that has been collected is then carried out descriptive analysis by explaining the contribution of Masudul Alam Choudhury and Milton Friedman's economic thought related to monetary policy. The final step is to conduct a deductive analysis, namely by combining data, examining and researching general data to be concluded in a more specific way.
3. RESULT AND DISCUSSION

3.1. The Contribution of Masudul Alam Choudhury Economic Thought

Choudhury is a devout Muslim and is active in every Islamic development activity in the United States. After the tragedy of the World Trade Center (WTC), Choudhury was considered as one of the supporters of the Islamization agenda in North America. Apart from various positive and negative assessments regarding this matter, it will be possible to see the various contributions of Choudhury's thoughts that are beneficial to the development of the Islamic world, especially in the field of Islamic economics.

Choudhury has explored and documented his research work and thoughts in the form of books, articles in books, journals, reviews and other publications. Around 36 books have been published and forthcoming, 115 academic publications in the form of journals and reference books, 21 book articles, 8 book reviews and other publications that may not be published.


3.2. The Contribution of Milton Friedman Economic Thought

One of Milton Friedman's earliest works was A Theory of the Consumption Function (1957) which articulated the permanent income hypothesis, the idea that household consumption and saving decisions are influenced more by changes in permanent income than by changes in income that household members perceive as temporary. The permanent income hypothesis provides an explanation for some of the conundrums that emerge in the empirical data regarding the relationship between the average and marginal propensity to consume. It also helps explain why, for example, fiscal policy in the form of tax increases, if considered temporary, may not lead to the intended consumption reductions; on the other hand, a tax increase may be financed from savings, so the level of consumption does not change. That's Friedman's new finding: if households don't perceive permanent income as change, they will maintain their established spending patterns.

Friedman's most famous contributions are in the field of monetary economics, where he is considered the founder of monetarism and as one of the successors to the Chicago School's economic tradition. In the 1950s, macroeconomics was dominated by scholars who adhered to the theory put forward by John Maynard Keynes. Keynesians believe in using government policies to counter the business cycle and fiscal policy is more effective than monetary policy in neutralizing for example the effects of a recession. Friedman opposes the Keynesian view that money is not important. Friedman then promoted the theory that changes in the money supply affect real economic activity in the short run and the price level in the long run [10].

In 1963, Friedman published the first of three books he co-authored with Anna J. Schwartz. Combining theoretical and empirical analysis with institutional insights, the volume provides an intricately detailed account of the role money has played in the US economy since the civil war. Most influential is the author's claim that the Great Depression would have been
a typical downturn had it not been for policy errors made by the Federal Reserve. [11].

During his career, Friedman has also been a spokesperson for free markets and free societies in an era when many social scientists underestimated market solutions to social problems. Friedman's collaboration with Anna J. Schwartz remains an important resource for those interested in the monetary history of the United States. Other legacies include Friedman's revival of the monetary approach to macroeconomics and his staunch critique of Keynesian economics.

3.3. Masudul Alam Choudhury's Version of Monetary Policy

Choudhury's philosophy in thinking is to place ethics and economics as well as political and economic issues as interrelated and inseparable. His book, entitled, Money in Islam; A Study in Islamic Political Economy, describes how he cares about the economic system, especially in terms of the use of money, where money can be designed so that it is in accordance with Islamic ethics and values. In Choudhury's view, money, organizations and markets are always related to moral and ethical issues in society [12].

Starting from the awareness of the wrong treatment of money in which economic transactions are always based on interest rates so that interest controls economic activity in the global economy. Without placing moral and ethical values regarding the real meaning and function of money. The speculative motive has denied the use of money to serve real transactions. Whereas Islam introduces the main function of money as a medium of exchange. Money is treated as a means of valuing or measuring goods. Because the position of money is very important in an economy, the injustice of measuring instruments due to the instability of the exchange rate can cause the economy to run in a balanced manner, making it difficult to realize social and economic justice.

Choudhury's perspective on the nature and function of money is based on an Islamic political economy theoretical perspective approach. The use of money should be designed and adapted to Islamic ethics and values. Money and its associated institutions should not step outside the circle of morals and ethics. The birth of an awareness of morals and ethics can arise through the process of absorbing knowledge, not from the coercion of laws or regulations. This knowledge is a reflection of the perception of the truth of a particular problem. [13].

The point of view of Islamic political economy is a benchmark for Choudhury in describing the function of money epistemologically. Standards for evaluating various real business activities are understood as the function and meaning of money. The balance of money supply growth with output growth will occur if the valuation function can be achieved with the right amount of money. In the end, price stability will also be achieved by changing the productivity of the growth [14].

Choudhury explained that the endogeneity of money refers to the Prophet's recommendation regarding the use of precious metals as a transaction tool. With an Islamic political economy approach, the use of precious metals as a transaction tool must be for the purpose of assessing prices from actual market transactions. Money cannot be used as stock held by the monetary authority or as an intermediary for transactions when the intertemporal flow of resources and capitalization of assets cannot be carried out using de facto money. If two goods are valued in the same monetary unit of the precious metal used, the exchange of those goods, regardless of whether they are the same or different, must reflect the value of the same precious metal. [15].

The existence of money is basically integrated in the prevailing socio-economic system. This means that the value and the amount of money are not independent variables. The integration of money in a complex system makes
money not independent or not an exogenous variable. In the exogenous theory of money, interest rates play a role in bringing together the functions of the demand for money and the supply of money. In the endogenous theory of money, the instrument used to reconcile the two functions is a variable that is able to reflect the real conditions of an economy. The better and the prospects for the real sector, this variable will move up. The variable is the average rate of profit for all mudharabah and musharakah investments. This variable is able to reflect the level of economic development in the real sector [12].

In the endogenous theory of money, the development of the monetary sector is only a representation of changes in the real sector. Policies in Islamic economics, both monetary and fiscal, are always oriented towards the allocation of resources to achieve productive transactions and investments. The speculative motive in the demand for money will result in misallocation of funds and inefficiency in the demand for money which does not generate added value in the real sector (imaginary money demand). The demand for money with speculative motives occurs due to the practice of borrowing and borrowing money with an interest system by some people. Interesting money is an illegal activity so that the interest variable is not accommodated as a policy variable. In the Islamic endogenous theory, the central bank is not fully able to control the amount of this money supply stock. The role of the central bank is to facilitate the circulation of the money supply volume so that the amount is in accordance with actual spending rather than expected spending demand. It can be concluded that in this endogenous concept there is no centralization of monetary authority at the central bank, with the notion that empowerment is given to the community and they themselves determine the future money supply. In addition, the effect of inflation due to an increase in money supply can be reduced by using the knowledge induced system and the ummah system. The increase in income will be greater than the increase in the supply or demand for money because of empowerment which is fully held by the community.

3.4. Milton Friedman’s Version of Monetary Policy

In 1950, Friedman adopted two working hypotheses that guided all of his ideas on monetary matters. First, the central bank is responsible for inflation, deflation and the great recession. Second, the price system works well for allocating resources and maintaining macroeconomic stability [7].

Friedman is known as the originator of the monetarist group, with his modern quantity theory of money. Friedman views that inflation, wherever and whenever it occurs, is always a monetary phenomenon. This view is in line with Irving Fisher's Quantity Theory of Money (1911) which explains that there is a direct relationship between the growth in the money supply and the increase in general prices (inflation) and the growth in the money supply is the main cause of inflation. [16].

Monetary policy is needed but its implementation must refer to the position where an economy is in the business cycle. The monetary policy applied to an economy experiencing a boom must be different from the monetary policy applied to an economy experiencing a recession. The central bank can shorten the recession period by implementing an expansionary monetary policy so that the economy can recover. On the other hand, in a warming economy, the central bank can avoid this by implementing a contractionary monetary policy. This means that monetary policy is very necessary and its implementation must take into account the cycle of the business world and policy makers must be active, especially when the economy is in recession [10].

There are 3 basic things in the quantity theory of money that are the views of traditional
and modern classical economists, among others:

1) The assumption of full employment in the long term
Friedman explained that a shift or price rigidity is likely to affect the achievement of full employment balance in the long term. However, the imperfection of the mechanism in the price system will not cause the prevailing market mechanism to result in unemployment.

2) Price rigidity in the short term
Friedman explained that the quantity theory of money states that changes in the money supply will cause the price variable to change proportionally and changes in the money supply will not affect real variables.

3) Absolute liquidity trend
Friedman views that there is a direct relationship between the money supply and rising prices (inflation) through the balance sheet and changes in interest rates. An increase in the money supply will cause a reaction in the community’s efforts to be able to restore the balance of the balance to a normal level. Changes in the money supply will cause asset prices to increase and interest rates to decrease. As a result, it will stimulate spending both to produce assets and for other expenses such as purchasing services, paying debts and others. Through the mortgage effect, changes in the balance sheet will be transformed in the level of income and expenditure.

3.5. Comparison of Choudhury's Version of Monetary Policy with Friedman

Talking about the comparison of thoughts between two particular experts, it is correlated with the thinking paradigm of the two experts. Paradigm is a basic concept or foundation of thinking that is used as a model or pattern by scientists to rely on for study. Paradigm is a framework of basic concepts and postulations that become the reference for the research process. The paradigm will give birth to a perspective that has an impact on all aspects of human life, both economic, social, political and scientific.

As explained earlier, Choudhury and Friedman are two contemporary economists who have made major contributions to the development of the world economy. This is evidenced by the various works they produce and become a reference for other economists. Talking about monetary policy, it will be seen a comparison of the thoughts of the two contemporary economists. The difference in thinking paradigm between the two becomes a differentiator for the contribution of economic thought related to monetary policy.

Choudhury, who has a Muslim background, certainly has a paradigm of thinking based on Islamic ethics and values as expressed in the Qur’an and Sunnah. In relation to monetary policy, Choudhury put forward the endogenous theory of money in Islam, where the central bank is not fully able to control the amount of the money supply stock. The role of the central bank is only to facilitate the circulation of the money supply volume so that the amount is in accordance with actual spending and not expected spending demand. In this endogenous concept, there is no centralization of monetary authority in the central bank, with the notion that empowerment is given to the community and they themselves determine the future money supply. In addition, the effect of inflation due to an increase in money supply can be reduced by using the knowledge induced system and the ummah system. The increase in income will be greater than the increase in the supply or demand for money because of empowerment which is fully held by the community. The balance between the growth in the volume of money and the growth in the volume of the economy in the real sector is the source of inspiration for the endogenous theory of money.
Meanwhile, Friedman, who adheres to the quantity theory of money, makes the money supply target a target for monetary policy in controlling prices in the goods market. Adherents of quantity theory (monetarists) make the money supply as an action variable (fine tuning). Friedman and the monetarist group argue that money only has an effect on the inflation rate and has no effect on economic growth, therefore monetary policy should be directed only to control inflation and not be directed to affect real economic activity.

3.6. The Relevance of Choudhury's and Friedman's Version of Monetary Policy on Monetary Policy in Indonesia

Theoretically, the implementation of monetary policy can be operated using two approaches, namely the quantity approach and the price base approach. In the quantity approach, Bank Indonesia focuses on controlling or controlling the money supply in the hope that interest rates will also change. Dual-target monetary policy is operated with a quantity approach. In the price approach, Bank Indonesia focuses on controlling or controlling interest rates in the hope that the money supply will also change or be affected. A single-target monetary policy is implemented with a price approach [18].

A Bank Indonesia study documented that there was structural instability in the Indonesian economy as seen in several indicators, including, 1) income velocity, demand form money and money multiplier tended to be less stable, 2) Bank Indonesia could not fully control the Mo. Approximately 70% of the Mo component is quarterly money which is the community's need for payment instruments, 3) M1 monetary aggregates are relatively stable compared to M2. From the results of this study, Bank Indonesia as the monetary authority in Indonesia considers to leave or replace its monetary control from the quantity approach to the price approach since July 2005. The implementation of the price approach is an integral part of Bank Indonesia's efforts to implement the full-fledge inflation targeting framework in July 2004 in accordance with the mandate of Law no. 3/2004 concerning Bank Indonesia [1].

In this case, Choudhury's thoughts on the real nature and role of money in the economy can become an important discourse to be considered and studied and even further implemented in Indonesia. Choudhury's theory is actually an emphasis on the function of money in its original nature as a medium of exchange, where money is only a representation of goods or services in the real sector. This means that the monetary authorities in Indonesia must act freely and actively, namely in controlling the amount of money supply and demand, not by adding or withdrawing money circulation directly, but rather on how to facilitate the circulation of the money supply volume so that the amount is in accordance with actual spending.

The community actually holds the power to determine how money supply and money demand they need. In addition, in making policies, it is very important to prioritize transparency and consistency. Because the absolute requirement to allow the formation of a natural equilibrium point between money supply and demand, not by adding or withdrawing money circulation directly, but rather on how to facilitate the circulation of the money supply volume so that the amount is in accordance with actual spending.

The idea of restructuring the real sector or restructuring the business world side by side with the restructuring of the banking and financial sector is also in line with Choudhury's idea that development programs and plans should
focus more on how to reduce the amount of wealth, in this case unproductive money, by channeling and increasing micro-enterprises at the local level grassroots.

4. CONCLUSION
This study describes a comparison of Masudul Alam Choudhury and Milton Friedman's economic thoughts on monetary policy. Masudul Alam Choudhury and Milton Friedman were among the most influential intellectuals of the twentieth century because of the influence of their ideas on shaping contemporary views of monetary policy.

Choudhury with a Muslim background has a paradigm of thinking based on Islamic ethics and values as expressed in the Qur'an and Sunnah. In relation to monetary policy, Choudhury put forward the endogenous theory of money in Islam, where the central bank is not fully able to control the amount of the money supply stock. The role of the central bank is only to facilitate the circulation of the money supply volume so that the amount is in accordance with actual spending and not expected spending demand. In this endogenous concept, there is no centralization of monetary authority in the central bank, with the notion that empowerment is given to the community and they themselves determine the future money supply.

Friedman, who adheres to the quantity theory of money, makes the target money supply the target of monetary policy in controlling prices in the goods market. Adherents of quantity theory (monetarists) make the money supply as an action variable (fine tunning). Friedman and the monetarist group argue that money only has an effect on the inflation rate and has no effect on economic growth, therefore monetary policy should be directed only to control inflation and not be directed to affect real economic activity.

The relevance of Choudhury and Friedman's economic thinking regarding monetary policy to monetary policy in Indonesia can be seen from the implementation of monetary policy implemented by Bank Indonesia. Prior to July 2005, Bank Indonesia used a quantity base approach in implementing monetary policy. This quantity approach was developed by Friedman and the monetarist school. After July 2005, Bank Indonesia used a price base approach in implementing monetary policy. This quantity approach was developed by the Keyness school.

5. REFERENCE
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