CHARACTERISTICS AND LESSONS OF INFLATION IN HISTORICAL-ECONOMIC PARALLELS

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Abstract. This article explores the impact of inflation and the rising prices of consumer goods through a series of historical parallels. The author draws extensively from the works of the Austrian School of Economics to investigate measures for regulating inflation. The article analyzes the inflation of historical currencies such as the denarius and dirham, and presents a correlation between urban development and inflation.

The research methodology combines empirical analysis with comprehensive document review. The findings underscore the significant consequences of inflationary crises on urban households, including diminished purchasing power, financial instability, and overall well-being. The article emphasizes the importance of understanding inflation to mitigate its adverse effects on households.

Sound financial forecasting and knowledge of key economic indicators are identified as crucial for households to make informed decisions regarding their financial future. Historical-economic parallels highlight the necessity of proactive measures before the onset of an inflationary crisis. Key strategies proposed for households include investing in business assets prior to economic downturns, structuring business operations to endure crises, and diversifying income streams to counteract the negative effects of inflation. The article contributes to a foundation for developing household strategies to counteract inflation, informed by historical precedents and economic theory.

Keywords: households, inflation, consumer basket, standard of living, megacity.

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INTRODUCTION

The expansion of the money supply can have various effects on an economy, including stimulating economic growth, influencing interest rates, and potentially leading to inflationary pressures. Monitoring and analyzing these trends in the money supply is crucial for understanding the broader economic dynamics and formulating appropriate monetary policies to maintain stability and mitigate inflationary risks.

REVIEW OF RELEVANT THEMATIC RESEARCH

The work of Beshears, Choi, Laibson, and Madrian (2018), in 2 parts, summarizes key facts regarding household financial behavior, emphasizing empirical regularities that are inconsistent with the standard classical economic model and discussing extensions of the classical model and explanations grounded in behavioral economics that can account for the observed patterns.

Hodgson (1974) in "The Venture of Islam: Conscience and History in a World Civilization" discusses the historical context of Islam and its impact on societies. Hourani (2013) provides a comprehensive "History of the Arab Peoples" that sheds light on the cultural and economic transformations brought about by Islam. Kennedy (2006) explores "The Great Arab Conquests" and their profound influence on the world.

Marinakis and White (2022) present a study on hyperinflation potential in commodity-currency trading systems, offering insights into the implications for sustainable development. Beshears et al. (2018) contribute to the field of behavioral economics and household finance, examining the behavioral aspects of financial decision-making.

D'Alessio and Lezzi (2013) discuss "Household Over-Indebtedness" and provide a framework for defining and measuring over-indebtedness using Italian data. Zainal (2020) delves into the lessons from inflation as highlighted in the works of Al-Maqrīzī. Mattingly (2004) offers insights into the dynamics of Britain as an imperial possession in the Roman Empire.

Banaji (2007) presents a critical analysis of the rise of capitalism in relation to Islam and the Mediterranean. Von Mises' (1912) influential work, "Theory of Money and Credit," provides a foundational understanding of money and credit in economic systems.

MATERIALS AND METHODS

<u>Literature review:</u> A thorough review of relevant literature was conducted, including scholarly articles, books, and reports, to establish a theoretical framework and identify key concepts related to inflation in urban households.

<u>Discussions and observations:</u> Discussions with experts in the field of economics, policymakers, and individuals from urban households were conducted to gather qualitative insights and understand the lived experiences of inflation in urban settings. Direct observations of household behaviors and economic activities were also made to enhance the understanding of inflation's effects.

1. The Austrian economic school and the inflation

In his work "Theory of Money and Credit," the distinguished economist Ludwig von Mises, among other things, presented an analysis of the consequences of inflation. Mises identified its role in wealth redistribution from one economic group to another, studied its impact on deferred payments, and explained how inflationary policies (primarily in the form of credit expansion) generate the mechanism of alternating artificial booms and destructive crises (known as the economic cycle)." Thus, it is clear that the increase in consumer basket prices is closely related to inflation, and at the same time, this interconnection results in imbalances in the global economy, namely the alternation of consumption booms and crises. If we observe an "escalation" of consumer basket price growth over at least several years, it is highly likely that the outcome of this process will be an economic crisis and a decline in consumption levels as a result of macroeconomic equilibrium disruptions. It is possible that the greater the "acceleration" of consumer basket price growth in the short to medium term, that is, the higher the average dynamics of this growth, the greater the imbalance it will cause and the more pronounced the shifts in equilibrium will be, leading to more abrupt reactions from market participants, including households, and thus, one can expect a more devastating collapse. In this context, Mises, in particular, stated: "The great inflation of our age is not an act of God. It is not a catastrophe of the elements or a disease that comes like the plague. It is a man-made and government-made phenomenon. It is the offshoot of doctrines that ascribe to governments the magic power of creating wealth out of nothing and of making people happy by raising the 'national income.'" Mises understands that the central bank can increase the money supply, and this can cause inflation. He believes that the central bank should determine the demand for money, and this should not be underestimated. As demand increases, the inflationary impact can have a reverse effect on the value of money.

2. Inflation, urbanization, and the development of large states

The relationship between inflation, urbanization, and the development of large states is notable throughout the history. The expansion of Roman currency, as well as the silver dirham, accompanied inflation. Increased mining activities resulted in more silver and gold, leading to an increased number of coins to meet the growing needs of expanding empires. This expansion also led to the establishment of more cities, a common practice among imperial states where the currency was the dirham.

It appears that the purchasing power of this currency gradually declined because the actual GDP did not correspond to the volume of money in circulation. At some point, the money supply became excessive, and empires minted new coins to cover expenses related to expansion and, overall, improve living standards. More cities meant higher inflation. To understand the correlation, one should examine the share of money supply in circulation in hypothetical "villages" compared to hypothetical "cities."

Even from the perspective of storage (warehousing goods), trade economy, intermediation, and security, cities had more money. Defensive monasteries, including those owned by military orders, could also be considered wealthy. Villages always had poorer positions in terms of storing goods, security, and interregional trade advantages. Therefore, inflation accompanies the growth of cities. Even in the USSR, the ruble's inflation became noticeable in the early 1980s (alongside economic crises and accumulated external debts in the country), when there was another wave of housing construction and the quality of life improvement for the urban population, primarily employees of large enterprises.

Thus, it is worth acknowledging the fact that periods of rapid urban development and progress towards improving the well-being of the general population are invariably accompanied by inflation. This is because many expenses do not yield short-term effects for profit generators but have a "social nature." Therefore, governments are often tempted to engage in "quantitative easing" by producing additional payment equivalents and increasing the money supply to cover current expenditures, partially hoping that the overheated "prosperity economy" will not significantly notice these "infusions of money." Let us recall that in 1990, the USSR decided to seize people's wealth by limiting the circulation of certain banknotes "overnight" and presenting an official explanation that this was a measure to combat the excess money in circulation within the informal sector "held by the population." Similarly, the 1961 reform in the USSR aimed to reduce "illicit" money held by the population and curb the inflation that had rapidly increased during the two World Wars.

However, how did inflation end in the empires we are familiar with? Often, since valuable metals served as the equivalent of value at the time, their proportion in the payment equivalent decreased. Thus, the hypothetical "new denarius" cost less in silver equivalent than the "old" one. In the end, we know that tampering with the money supply is not advisable because we also observe that empires eventually ceased to exist.

3. The Roman empire and inflation of the denarius

The inflationary policy of the Roman Empire led to the constant debasement of the denarius, the primary currency used in the empire. Currency depreciation created a vicious cycle in which the government issued more coins with less silver content, resulting in price increases. Thus, more coins were issued to finance government expenditures, further exacerbating inflationary pressure.

As a result of inflation, the Roman Empire experienced rising prices and a decline in purchasing power, leading to social and economic instability. The wealthy and influential individuals could shield themselves from the worst consequences of inflation by investing in land, art, and other tangible assets. However, the poor and working-class citizens suffered the most from inflation, witnessing a rapid decline in the value of their wages and savings.

Inflation in the Roman Empire ultimately contributed to its decline, weakening the economy and destabilizing society. The lesson learned from the Roman experience is that unchecked inflationary policies can have serious consequences for the overall health of the economy and society. Interestingly, the factor that caused inflation of its currency (the denarius) was the reduction in the silver content of coins, which began in the second half of the 3rd century. It can be said that the decrease in the value of assets that guarantee the value of the currency would have appeared similarly today. In 211 AD, the weight of the denarius was 3.41 grams of silver, and by 270 AD, it had decreased to 2.57 grams, and in 274 AD, it further declined to 1.94 grams. The reduction of silver in the denarius occurred due to the complex economic and financial situation in the Roman Empire, including a silver shortage and increased expenditures on the military, construction, and infrastructure.

Ultimately, the inflation of the denarius led to currency depreciation and, consequently, a general economic crisis in the Roman Empire. As a result, rising prices and a decrease in the purchasing power of the denarius worsened living conditions for the population and reduced economic activity, leading to a decline in income within the state. The inflation of the denarius, therefore, increased social inequality within the empire. Wars and political crises also contributed to a decreased trust in the denarius, with people sometimes preferring barter or currencies of other countries for exchange.

4. The Umayyad Caliphate inflation of the dirham

One of the main causes of its inflation the dirham, the currency of the Umayyad Caliphate, was the increase in the price of silver, which led to a decrease in the actual silver content of the dirham. As the value of silver rose, the amount of silver in each dirham decreased to maintain its nominal value, resulting in a decline in the currency's purchasing power. To combat inflation, the Caliphate implemented price controls and strict regulations on the money supply but, these measures were partially effective as the underlying causes of inflation persisted.

The collapse of the Caliphate and the inflation of the dirham were interconnected in several ways. One of the factors that caused the inflation of the dirham was the expansion of the economy of the Caliphate, which increased the demand for money. As the money supply grew, inflationary pressures also increased. The Caliphate financed its military campaigns, public works, etc by issuing a larger quantity of money, which also contributed to inflation.

However, the growth of the economy and the increase in the money supply were unstable and ultimately led to economic instability, resulting in the collapse of the Caliphate. With the weakness of the Caliphate's economy, the value of its currency depreciated. The inflation of the dirham, combined with other economic and political problems, undermined the authority of the Caliphate and contributed to its ultimate demise.

In other words, the collapse of the Caliphate had a significant impact on the value of the dirham. With the fragmentation of the Islamic world into separate states, the dirham lost its status as a widely accepted currency. As a result, the value of the dirham decreased, and it became increasingly difficult to use it as a medium of exchange. Thus, the inflation of the dirham was a symptom of the economic and political problems that contributed to the collapse of the Caliphate. Conversely, the collapse of the Caliphate had a profound impact on the value and acceptance of the dirham as a currency.

RESULTS

At the household level, it is appropriate to formulate a series of recommendations for household-investors in the phase of the economic cycle characterized by the anticipation of a decline in savings and an increase in the cost of the consumer basket:

Cease investing in "luxuries" during times of prosperity. It is better to invest in business assets 4-5 years before the onset of a crisis.

Structure your business assets in a way that allows you to raise prices for your product without significantly affecting demand during a crisis.

Maintain a reserve of operational funds in different equivalents that can assist you during times when currency exchange rates are devalued.

Have operational funds that will allow you to sustain yourself during the turnover cycle of your other (currency) assets aimed at earning additional margin during inflation to compensate for your losses.

Think ahead 2-3 years in terms of key economic indicators, including your investments, savings, sector of your business or employment, and specifically consider the changing market landscape in your economic subsector.

Prior to a crisis, seek new directions to channel your efforts and investments, so that you have an effective launch or development plan for these alternative businesses at the beginning of the crisis.

Actively engage in strategic stockpiling of consumer goods. By purchasing essential items in large quantities at advantageous prices, the household can benefit from cost savings and ensure a stable supply of goods. This approach will provide a sense of security during times of scarcity or price fluctuations, as the household will have a substantial stock of necessary items readily available.

Rid yourself of expensive and especially consumer loans early on in the anticipated inflation and crisis phase. If the crisis is sudden, it is uncertain whether your employment sector/business will stay afloat, and in that case, loans will simply erode your past profits. At the same time, explore opportunities to obtain business-oriented credit lines at reasonable interest rates to activate your "crisis" business directions, which may require a larger amount of circulating funds.

SUMMARY AND CONCLUDING REMARKS:

This study examined the characteristics and lessons of inflation in urban households, drawing historical-economic parallels to provide valuable insights into the phenomenon. Through an analysis of various factors and indicators, we have shed light on the impact of inflation on households and identified key lessons that can be learned from past experiences:

Inflationary crises have significant consequences for urban households, affecting their purchasing power, financial stability, and well-being. Understanding inflation is crucial for households to mitigate its adverse effects.

Sound financial forecasting and understanding key economic indicators are essential for households to make informed decisions regarding their financial prospects. By monitoring inflationary trends, interest rates, and macroeconomic conditions, households can better anticipate and respond to inflationary pressures.

Building a buffer of operational funds and prudent planning can provide households with a safety net during inflationary crises. Having sufficient reserves to cover essential expenses for several months can help households weather the financial challenges associated with inflation.

Historical-economic parallels emphasize the importance of proactive measures before an inflationary crisis emerges. Investing in business assets ahead of an economic downturn, structuring business activities to withstand crises, and diversifying income streams are key strategies for households to mitigate the negative effects of inflation.

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