Impact of Inflation Toward Economic Growth and Income Distribution

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Abstract. This paper delves into the intricate relationship between inflation, income distribution, and economic growth. It discusses how inflation can influence income distribution by affecting the purchasing power of individuals, especially those with fixed or low incomes, and how it can alter the wealth distribution in an economy. The paper also highlights how income distribution can affect economic growth by impacting consumption and production rates. The relationship between inflation and economic growth is complex and can be influenced by various factors. The paper proposes several strategies to mitigate the effects of inflation on income distribution, such as monetary policy, fiscal policy adjustments, financial inclusion initiatives, and evidence-based policymaking. It underscores the importance of income distribution in economic stability, social equity, poverty reduction, and human development. The paper also emphasizes the role of government policies in managing inflation's effects on economic growth and income distribution. It concludes by suggesting potential areas for further research on this topic.

Keywords: Consumption, Economic Growth, Income Distribution, Inflation, Production.

1 Introduction

Inflation is an increase in the cost of goods and services. When the general price level rises, each unit of currency buys fewer products and services, reducing an economy's internal medium of exchange and unit of measure. The annualized percentage change in a broad pricing index, typically the Consumer Price Index, is used to calculate price inflation (Ascari & Sbordone, 2014). Connecting inflation and economic growth and income distribution, the visualization is causal, when the price gone up due to the inflation, the economic activities will adjust to this condition, some may have caused the sales rate to fall, and some may lead increasing sales rate, this often happen to substitute goods, considering the primary goods now cost higher than before. From this condition, it will either cause low consumption or not, which will impact productivity, indirectly impacting the income distribution. This condition will also potentially cause decreased income, in which also reduce consumption, all of this aftermath will lead to slower economic growth (Balcilar et.al, 2018). Economic growth is also affected by inflation in general. Inflation plays quite an important role

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in several ways, in which can be reflected in inflation threshold, as this threshold may imply different outcomes depending on its threshold level. Another important inflation plays on economic growth, is the impact it has toward exchange rate, the shift in economic activities, will trigger exchange rates, as money become one of the most important instruments in economic activities. Hard times cause by inflation, may change the behaviors of many, especially in seeking financial aids, the aftermath of this, is the change in exchange rate and interest rate (Akinsola & Odhiambo, 2017). To economic activities at its optimal level, the need to maintain inflation level has always been the goal of the government, according to empirical research, this can be done through three important steps, which is, first maintain financial development, promoting capital accumulation, enhance trade and capacity utilization, and lastly, is manage well the government expenditures (Eggoh & Khan, 2014). There are two channels, inflation can impact income distribution, which is interest-rate channel, and asset-value channel, interest-rate reflected by the changing state of economic growth which later impact real interest rate, meanwhile, asset-value channel, reflected in changing wage value, and ratio of asset income (Zheng et.al, 2020). Reflecting from this, it can be seen that the effects of inflation are causal, it can be interpreted that inflation may be the sources of slower economic growth, or some economic issue such as unemployment, and low-income jobs.

Income distribution refers to the distribution of national revenue or gross added value among production variables such as labor and capital (business owners). It can also refer to the distribution of the Gross National Income (GNI) among households, regardless of income source or social class. The impacts of this distribution on life satisfaction and job motivation can impact human resource structure and economic outcomes (Bilan et.al, 2020). Income distribution promotes growth. Fluctuations in the family income gap may place low-income households behind the reference group. Due to wealth imbalance, consumption, investment, and social mobility impact economic growth. Financial inclusion and comprehensive insurance enhance inclusive growth and income distribution. With inclusion, pricing and availability of insurance products decrease. This enhances the wealth, investment, and production decisions of disadvantaged households, hence raising their income (Zheng & Su, 2022). There are many factors that could impact income distribution, namely, interpersonal comparison, inequality, and household debt, from these factors, it reflected the need for household to wanting the same needs with other households, however this often cause overconsumption. Income inequality and household debts also cause consumption to decrease, let alone distributing wealth, families with this problem often suffer lack of daily needs (Hake & Poyntner, 2022). Income distribution is an important, and often research on, the importance of income distribution is reflected in many ways such as economic stability, which explain that if wealth are mostly own by only one or two person, it will lead to possible potential of economic instability and social unrest. Further, income distribution will affect customer demand, in a condition where the population has lots of income, they will also have high income. Lastly, income distribution will affect life quality, with higher income, one can afford to buy facility for better lifestyle (Tiku et.al, 2022). Income distribution is a critical aspect of economic policy as it has both short and long-term implications that policymakers must consider when assessing the impact of government policies. income distribution is closely linked to other economic factors such as inflation, poverty, and economic growth (Fakhruddin et.al, 2020). Empirical evidence reflected that income distribution have two ways of outcome, which at the condition where income distribution experience inequality, people consumption will decrease, and thus, reduced happiness rate, further, income distribution inequality will affect the progress of sustainable development (Sitthiyot & Holasut, 2022). This highlights the importance of income distribution, and the aspect that many affect income distribution, such as inflation. There are several connections or relationships between inflation and income distribution, such as (1) Inflation and Real Income: Inflation erodes the purchasing power of money. This means that when inflation is high, the real income (income adjusted for inflation) of individuals falls; (2) Inflation and Wealth Distribution: Inflation can also affect the distribution of wealth in an economy. For example, unexpected inflation can redistribute wealth from lenders to borrowers if the rate of inflation is higher than the interest rate on loans; (3) Inflation and Functional Income Distribution: Changes in the functional distribution of income (the distribution of income between labor and capital) can also affect inflation; and (4) Inflation and Price Effects: Changes in income distribution can also have price effects, which can affect inflation (Onaran & Obst, 2015). When inflation occurs, it can erode the purchasing power of income, particularly for those with fixed incomes, such as retirees or those with fixed wage contracts. The relationship is not always straightforward. For example, if wage increases outpace inflation, workers may actually see an increase in their real income. The impact of inflation on income distribution can also depend on government policies. For instance, governments can implement policies to protect those most vulnerable to inflation, such as adjusting social security payments for inflation or providing subsidies for essential goods and services (Bortz, 2014). According to (Ozdemir, 2020) Inflation can have a significant impact on income distribution, often leading to increased inequality. This is because inflation can negatively affect the purchasing power of individuals, particularly those in lower income brackets. When inflation increases, the real value of income decreases, especially for those with fixed or low incomes. Inflation can also affect income distribution through its impact on government protections and welfare services. The relationship between inflation and income distribution is complex and can be influenced by a variety of factors, including the bargaining power of workers.

After explaining the relationship between inflation and income distribution, this paper also highlights the importance of economic growth in term of inflation, however, the relationship between inflation and economic growth is complex and can vary depending on the specific circumstances of an economy. This relationship indicates most of the monetary policies effectiveness to handle tackle and handle inflation rate, in most conditions it can be seen when the Gross Domestic Product (GDP) rises, inflation also rises, in natural way, when GDP rises, inflation should decrease, so does the opposite (Olu & Idih, 2015). The relationship between the inflation and economic growth is complex and can be influenced by various factors. High inflation rate can reduce the level of investment, which in turn adversely affects economic growth. Inflation can also impact economic growth by affecting other factors such as investment rates, productivity growth, and the ratio of investment to GDP (Svigir et.al, 2017). In this term, the debate primarily revolves around whether inflation is necessary or harmful for economic growth. According to classical economic thought, market forces play a crucial role in stabilizing the price of goods and services, with any surplus or deficit output adjusting the price to maintain stability. while inflation can have both positive and negative impacts on economic growth, the key lies in maintaining a balance and preventing inflation from reaching harmful levels (Wollie, 2018).

The relationship between this three variables is complex, while most people expect positive relationship between variable, inflation doesn't always needs to positively influence, the relationship of this variable were supposed neglect each other, such as GDP, which when GDP rises inflation should be decreasing, however, on other note, income distribution may have positive influence on inflation, for example, equal income distribution contribute toward individual and household purchasing power and consumption level, with the high amount of income, one can buy their needs, and provide themselves with better quality of item, and thus bring better quality of life. Further, the consumption rate also affects production rate, when the demands are high, production process also increases, which indicates that inflation are indirectly affect economic growth through consumption. These complex relationships are very interesting to research on, which are to explore and illustrate the relationship between inflation toward income distribution and economic growth.

2 Methodology

This paper serves the purposes to explore and illustrate the relationship between inflation toward income distribution and economic growth. In order to achieve this, this paper utilizes deductive reasoning to achieve the objective of this paper. This paper uses empirical evidence and data to its advantage, the empirical research used in this paper are assured to be relevant to its main topic, which are crucial for its authenticity. The result of this paper will be formulated from the main sources of data which is an accumulation of empirical research and data, the conclusion will also be formulated from the result and discussion, further, the result of this paper will also highlight possible implications, and possible improvement for future research under the same topic and theme. The illustration of this research process can be seen below:

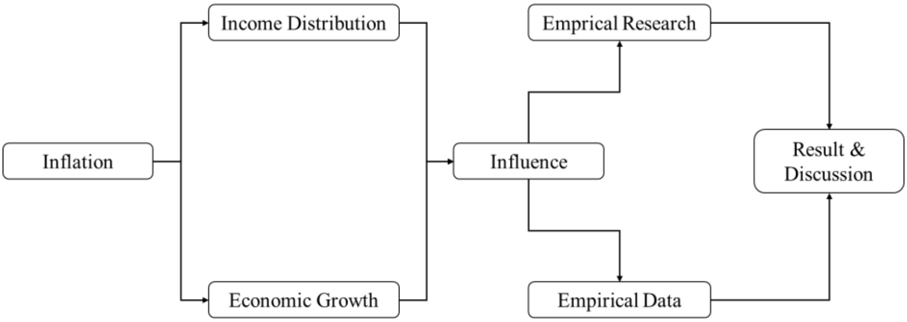

Fig. 1. Research Conceptual Framework

3 Result and Discussion

Inflation are common conditions and a never-ending issue in the context of economic so far, in economic activity, inflation will emerge sooner or later, the price of the goods and services will increase at one point, mostly due to the decreasing number of primary sources of production material, other than that, the low income rate in public, cause a huge fallout on consumption ability could also be the origins of inflation. Inflation could also impact many of the economic components, such as income distribution and economic growth. This impact however could have causal relationship or indirect effects toward one another, such as inflation that impacts economic growth through consumption rate.

3.1 Inflation and Income Distribution

Inflation is considered an aspect of income distribution due to its potential to exacerbate income inequality. Inflation can disproportionately affect different income groups, during periods of high inflation, those with fixed or low incomes may find their purchasing power significantly reduced, while those with higher incomes or wealth may be better able to absorb the impact of rising prices (Agnello & Sousa, 2014). Similar findings states that the rise in inflation has been found to have a positive and significant impact on crime, which is often linked to income inequality, those with fixed incomes or low incomes may be hit harder by inflation as the cost of living increases, while those with higher incomes or assets that can appreciate in value (like property or stocks) may be better protected or even benefit from inflation (Ahad, 2016). The impact of inflation on income distribution is multifaceted. Theoretically, an increase in inflation could increase income inequality by lowering the purchasing power of the poor and reducing the real value of government aid that is usually not indexed to inflation. This is because inflation erodes the purchasing power of money, and those with lower incomes may find it harder to keep up with rising prices. However, inflation could also potentially lower income inequality. This could occur if inflation raises nominal income, leading to higher income tax payable by the rich. In this scenario, the increased tax burden on the wealthy could help to redistribute wealth and reduce income inequality (Law & Soon, 2020).

Inflation can have significant implications for income distribution, inflation rates can vary across different income groups, leading to what is known as inflation inequality. This inequality arises from the fact that households with different incomes consume different goods and services, and these differences in consumption bundles can lead to varying inflation rates, if not properly managed, inflation can lead to increased income inequality, with lower-income households bearing the brunt of higher inflation rates. This can have far-reaching implications for economic policy and the overall health of the economy (Jaravel, 2021). To handle inflation, income distribution may be affected in one way or another, but according to (Shakeel et.al, 2020) there are several potential strategies to handle inflation which is (1) Monetary Policy: Central banks could use monetary policy tools such as interest rates to control inflation; (2) Fiscal Policy: Governments could use fiscal policy measures such as taxation and government spending to control inflation; (3) Supply-Side Policies: These involve measures to increase the efficiency and productivity of the economy, which can help to reduce inflationary pressures; (4) Income Policies: These involve measures to control wage and price increases; and (5) Exchange Rate Policy: By maintaining a stable exchange rate, governments can help to reduce inflation. Aligning with this strategy, there are several more strategy that can be implemented to handle inflation effect on income distribution, which is (1) Targeted Monetary Policy: Central banks could consider the distributional effects of their monetary policy decisions; (2) Fiscal Policy Adjustments: Governments could use fiscal policy tools, such as tax policy and government spending, to redistribute income and offset the effects of inflation on income distribution; (3) Financial Inclusion Initiatives: Governments and financial institutions could promote financial inclusion to help lower-income households better manage inflation; (4) Inflation Hedging for Lower-Income Households: Governments could provide support to lower-income households to hedge against inflation; (5) Income Policies: Governments could implement income policies, such as minimum wage adjustments, to protect the income of lower-income households from inflation; and (6) Evidence-Based Policy Making: Policymakers should base their strategies on rigorous research (Herradi et.al, 2023).

Income distribution is an important aspect in economic, therefore its important to pay attention toward its utilization, and how it can be balanced, several importance of the income distribution can be reflected in (1) Economic Stability: A balanced income distribution contributes to economic stability. It ensures that all sections of society have sufficient income to meet their basic needs, which in turn stimulates demand and promotes economic growth; (2) Social Equity: Income distribution is a measure of social equity. A more equal income distribution implies a fairer society where resources are shared more evenly. This can lead to improved social cohesion and reduced social unrest; (3) Poverty Reduction: Effective income distribution strategies can help in reducing poverty and improving living standards. By ensuring that income is not concentrated in the hands of a few, more people can benefit from economic growth; and (4) Human Development: A balanced income distribution can lead to better human development outcomes, as more people will have access to education, healthcare, and other essential services (Shabnum & Malik, 2023). Stable income distribution can have several benefits. It can contribute to social stability, as large income disparities can lead to social unrest and conflict. Stable income distribution can also promote economic growth, as it ensures that a larger proportion of the population has the purchasing power to consume goods and services, thereby stimulating demand and economic activity. Furthermore, it can enhance social cohesion and trust, as it reduces the perception of inequality and unfairness in society. In the context of inflation, stable income distribution can help mitigate the adverse effects of inflation on households. For instance, households with stable incomes that are indexed to inflation can maintain their purchasing power even when prices rise. This is particularly important for vulnerable groups such as retirees and fixed salary contractors, who are more susceptible to the erosion of real income due to inflation (Dovonou & Xie, 2023). This reflects the importance of income distribution and its stable state, other than that, inflation stability also contributes toward this matter, as in common sense, the high price of goods and services if not associated with higher household income, it may lead to lack of purchasing power, thus increasing the ability to consume, further this phenomenon could lead to low productivity due to the lack of demand.

3.2 Inflation and Economic Growth

Inflation rates can promote economic growth by encouraging investment and providing returns to savers. This is because inflation can increase the potential return on investments, making them more attractive and thus stimulating economic activity. High inflation can create uncertainty, which can negatively impact consumption, savings, and investment decisions, this can lead to a decrease in economic activity and slow down economic growth. The relationship between inflation and economic growth is complex and can vary depending on a range of factors, including the rate of inflation and the specific economic context (Madurapperuma, 2016). Inflation, which is the persistent and continuous rise in the overall price level of a country, can be both a determinant and a hindrance to economic growth, certain level of inflation is essential for economic growth. This is because moderate inflation can stimulate economic activity and growth by encouraging spending and investment, however, in other side, inflation can be detrimental to economic growth. High levels of inflation can create uncertainty and disturb economic performance, leading to slower growth or even contraction (Karki et.al, 2020). Small fiscal deficits and low inflation rates are not mandatory for good growth even over long runs. However, high inflation is not consistent with continued economic growth, one of the empirical studies in Pakistan stated that between 2010 and 2018, GDP growth increased at a constant rate of 1.6 percent to 5.8 percent, while inflation decreased from 12.9 percent to 5.08 percent, this reflect that inflation and growth were supposed to have negative correlation, in which when inflation rises, it can hinder growth and the opposite (Ahmad, 2022). While low levels of inflation can be beneficial for economic growth, high levels of inflation can be detrimental. Therefore, it is crucial for policymakers to manage inflation levels effectively to promote sustained economic growth.

At low levels, inflation can stimulate economic growth. It can "grease the wheels" of the economy by making it easier to adjust prices and wages, and it can signal that the economy is overheating, which can encourage investment and spending. However, high levels of inflation can be harmful to economic growth. High inflation can create uncertainty, which can discourage investment and spending. It can also erode the value of money, which can reduce people's purchasing power and lower their standard of living (Nyenyi et.al, 2017). One of the key components of inflation is the interest rate, inflation affects economic growth positively, and therefore, a sustainable inflation rate that guarantees the desired economic growth for member countries should be complemented with a moderate interest rate. Another important component of inflation is its impact on employment, anything that adversely affects productivity, such as inflation, will also affect employment generation. Exchange rate volatility is another crucial component of inflation, one of the empirical research stated that exchange rate volatility pass-through inflation in 33 emerging and advanced economies and concluded that a decrease in the exchange rate pass-through in emerging economies is a function of reduced inflation (Olamide et.al, 2022). Inflation is often a result of several factors, including an increase in food supply, an increase in transportation capacity, crop failure due to irregular weather, and an increase in the cost of products and services. Another contributing factor to inflation, for example in Indonesia, is the rise in global oil prices, which leads to an increase in the price of raw materials and subsequently, an increase in a company's operational costs (Azaluddin & Hanafi, 2021).

High inflation can increase financial market frictions, reducing efficiency and economic growth. High and variable unforeseen inflation uncertainty affects capital and investment returns. The accumulation or investment effect of inflation on growth influences other growth factors including human capital and R&D. In the efficiency channel, inflation lowers total factor productivity, worsening market economies' long-term macroeconomic performance (Yabu & Kessy, 2015). Full employment causes long-term inflation. After equilibrium, aggregate demand raises the price level. Increasing investment and money supply increases aggregate demand, production, and employment proportionally in the near run, which is considered to be related with underemployment and resource underutilization. Demand side variables like fiscal or monetary policy, expectations, and labor market shifts affect pricing and output in the near run (Saungweme & Odhiambo, 2021). Inflation affects the purchasing power of consumers and can lead to economic uncertainty; as a result, consumer expectations and inflation uncertainty grew, resulting in a high percentage of precautionary savings. In the case of cost-push inflation, a sudden rise in inflation might lead to a decline in output levels. This type of inflation is characterized by a rise in the prices of goods and services and a decline in output levels (Atigala et.al, 2022).

Inflation can affect economic growth in many ways, therefore, economic conditions and consumer behavior often adapt toward the change or fluctuation of inflation, one of the strategies to maintain inflation levels below a certain threshold can have a positive effect on GDP, can be achieved through effective monetary policies and fiscal discipline. Furthermore, the government can put practical price controls on the consumer price index to maintain price levels constant. This can be achieved by setting maximum and minimum price levels on consumer goods and services which are used daily (Sekwati & Dagume, 2023). Encouraging growth in productivity and level of output can also help to mitigate the negative effects of inflation on economic growth, which can be achieved through policies that promote innovation, investment in infrastructure, and human capital development. Other perspective stated that an increase in the education costs incurred by households in a context of high inflation may have more serious effects on economic growth. Thus, controlling education costs can also contribute to minimizing the impact of inflation on economic growth (Sequeira, 2021). Empirical sources stated that low and stable inflation can contribute to economic growth by creating an optimal environment for investment. However, high inflation rates are associated with uncertainty and can have a negative impact on economic growth and societal welfare by reducing the purchasing power of households, affecting decision-making on investment and consumption, and increasing the gap between income groups. Therefore, to make inflation less impactful on economic growth, it is crucial to maintain inflation rates at a low and stable level. This can be achieved through effective monetary policy measures, such as controlling the money supply and interest rates, and fiscal policy measures, such as government spending and taxation (Ezako, 2023).

The strategies to handle the effects of inflation include prudent implementation of fiscal and monetary policies, maintaining a regulation of interest rates, the extended money supply, and real exchange rates. Inflation targeting should also be emphasized by improving the central bank's communication, transparency, and accountability to avoid inflation volatility and stimulate economic growth. This can be achieved by declaring an explicit inflation target and implementing financial strategies to sustain economic price permanence. Further research should also be conducted to understand other factors that influence inflation pressure, such as government spending, investment, and trade openness (Sanga et.al, 2022). The government plays a crucial role in managing the effects of inflation on economic growth. The government should fine-tune policy instruments and create a conducive business atmosphere to achieve sustainable output growth. Furthermore, the government's role in managing public expenditure is crucial, as it can have a robustly positive long-run growth effect. However, it's important to note that irresponsible frequent monetization of government deficits can lead to nominal, not real, economic growth, which is incapable of addressing unemployment, inflation, and other welfare indicators. Therefore, responsible and strategic government intervention is key in managing the effects of inflation on economic growth (Niken et.al, 2023).

4 Conclusion

Inflation has a significant impact on economic growth and income distribution. High inflation rates can reduce the level of investment, which in turn adversely affects economic growth. Inflation can also impact income distribution, often leading to increased inequality, especially for those with fixed or low incomes. This paper also suggests that the government plays a crucial role in managing the effects of inflation on economic growth through the implementation of fiscal and monetary policies, regulation of interest rates, and managing public expenditure. Further research is suggested to understand other factors that influence inflation pressure, such as government spending, investment, and trade openness.

The potential implications of this paper are numerous. Firstly, it highlights the significant impact of inflation on economic growth and income distribution, suggesting that policymakers need to pay close attention to inflation rates. This could lead to changes in fiscal and monetary policies to better manage inflation and its effects. Secondly, the paper suggests that high inflation rates can lead to increased inequality, particularly for those with fixed or low incomes. This could prompt governments to implement policies to protect these vulnerable groups, such as adjusting social security payments or implementing wage increases that outpace inflation. Thirdly, the paper implies that further research is needed to understand other factors that influence inflation pressure, such as government spending, investment, and trade openness. This could lead to new research directions and a deeper understanding of the complex dynamics of inflation. Lastly, the paper's findings could have implications for businesses and investors. For example, understanding the impact of inflation on economic growth and income distribution could inform investment decisions and business strategies.

The potential improvements from this paper for future research could include. (1) A more detailed examination of the relationship between inflation and income distribution, particularly in different economic contexts and across different income groups; (2) Further exploration of the impact of government policies on inflation, income distribution, and economic growth. This could include an analysis of different policy approaches in different countries or regions; (3) Investigation of other factors that influence inflation pressure, such as government spending, investment, and trade openness; (4) A deeper analysis of the impact of inflation on businesses and investors, which could inform investment decisions and business strategies; (5) More comprehensive research on the effects of high inflation rates on economic inequality and the potential policies to protect vulnerable groups; (6) A longitudinal study to track the long-term effects of inflation on economic growth and income distribution.

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