

## TOWARD A RIBA-FREE MACROECONOMIC FRAMEWORK: RETHINKING INFLATION AND ECONOMIC BALANCE

*Menuju Kerangka Makroekonomi Bebas Riba: Menata Ulang Pemahaman tentang Inflasi dan Keseimbangan Ekonomi*

نحو إطار للاقتصاد الكلي الحالي من الربا: إعادة التفكير في التضخم والتوازن الاقتصادي

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### **Abstrak**

Artikel ini mengkaji keterbatasan kebijakan moneter berbasis suku bunga dalam mengendalikan inflasi dan menjaga keseimbangan ekonomi. Meskipun kerangka makroekonomi konvensional sangat bergantung pada penyesuaian suku bunga sebagai instrumen utama stabilisasi, pendekatan semacam itu kerap tidak memadai dalam mengatasi gangguan struktural, kendala sisi penawaran, serta dinamika perilaku dalam perekonomian. Dengan bertolak dari prinsip-prinsip ekonomi Islam, kajian ini mengajukan suatu kerangka makroekonomi bebas riba yang menekankan keterkaitan dengan sektor riil, mekanisme keuangan berbasis bagi hasil dan berbagi risiko, serta penyelarasan strategis antar pelaku ekonomi. Melalui integrasi unsur-unsur tersebut, artikel ini menawarkan perspektif alternatif bahwa stabilitas ekonomi dapat dicapai melalui desain struktural dan kelembagaan, bukan melalui ketergantungan pada instrumen berbasis suku bunga. Temuan kajian ini menunjukkan bahwa sistem bebas riba tidak hanya menyediakan landasan normatif, tetapi juga menawarkan pendekatan yang secara konseptual koheren dalam mengendalikan inflasi dan mendorong keseimbangan ekonomi yang berkelanjutan.

**Kata Kunci:** Kerangka Makroekonomi Bebas Riba; Inflasi; Keseimbangan Ekonomi; Ekonomi Islam; Mekanisme Keuangan Berbagi Risiko

### **Abstract**

*This paper examines the limitations of interest-based monetary policy in managing inflation and maintaining economic balance. While conventional macroeconomic frameworks rely heavily on interest rate adjustments as the primary stabilization tool, such approaches are often insufficient in addressing structural disruptions, supply-side constraints, and behavioural dynamics within the economy. Drawing on Islamic economic principles, this study proposes a riba-free macroeconomic framework that emphasizes real-sector anchoring, risk-sharing financial mechanisms, and strategic alignment among economic agents. By integrating these elements, the paper offers an alternative perspective in which economic stability is achieved through structural and institutional design rather than reliance on interest-based instruments. The findings suggest that a riba-free system provides not only a normative foundation but also a conceptually coherent approach to managing inflation and promoting sustainable economic balance.*

**Keywords:** *Riba-Free Macroeconomic Framework; Inflation; Economic Balance; Islamic Economics; Risk-Sharing Financial Mechanisms*

### الملخص

تتناول هذه الورقة البحثية حدودَ فاعلية السياسة النقدية القائمة على سعر الفائدة في ضبط التضخم والحفاظ على التوازن الاقتصادي. ومع أن الأطر الاقتصادية الكليّة التقليدية تعتمد اعتمادًا كبيرًا على تعديل أسعار الفائدة بوصفه الأداة الرئيسة للاستقرار الاقتصادي، فإنّ هذه المقاربات كثيرًا ما تكون غير كافية في معالجة الاضطرابات الهيكلية، والقيود المرتبطة بجانب العرض، والديناميكيات السلوكية داخل الاقتصاد. وانطلاقًا من مبادئ الاقتصاد الإسلامي، تقترح هذه الدراسة إطارًا للاقتصاد الكلي خاليًا من الربا، يقوم على الارتباط بالقطاع الحقيقي، وآليات التمويل القائمة على تقاسم المخاطر والمشاركة، والمواءمة الاستراتيجية بين الفاعلين الاقتصاديين. ومن خلال دمج هذه العناصر، تقدّم الورقة منظورًا بديلًا مفاده أن الاستقرار الاقتصادي يتحقق من خلال التصميم الهيكلي والمؤسسي، لا من خلال الاعتماد على الأدوات القائمة على سعر الفائدة. وتشير النتائج إلى أن النظام الخالي من الربا لا يوقر أساسًا معياريًا فحسب، بل يقدم أيضًا مقارنةً متماسكةً من الناحية المفاهيمية لضبط التضخم وتعزيز توازن اقتصادي مستدام.

**الكلمات الدالة:** الإطار الاقتصادي الكلي الخالي من الربا؛ التضخم؛ التوازن الاقتصادي؛ الاقتصاد الإسلامي؛ آليات التمويل القائمة على تقاسم المخاطر

## BACKGROUND

In modern macroeconomic policy, interest rates are widely regarded as the primary instrument for managing inflation and stabilizing economic growth. Central banks across the globe, particularly in developed economies such as the United States, rely on monetary tightening to curb inflationary pressures. The conventional framework assumes that raising interest rates reduces aggregate demand, thereby stabilizing prices (Mankiw, 2021).

From an Islamic economic perspective, the reliance on interest rates presents a fundamental issue, as *riba* (الربا) (*al-ribā*)—commonly associated with interest but more broadly defined as unjustified excess or predetermined gain—is strictly prohibited. This prohibition is not merely a legal or theological constraint but reflects a broader economic philosophy that emphasizes fairness, risk-sharing, and the linkage between financial activities and real economic production.

In contrast to interest-based systems, which allow for guaranteed returns regardless of economic outcomes, Islamic economic principles advocate for profit-and-loss sharing mechanisms that align incentives between capital providers and entrepreneurs. Consequently, the dependence on interest rate adjustments as a primary tool of macroeconomic stabilization raises critical concerns, as it may encourage financial practices detached from the real sector and contribute to structural imbalances. This perspective invites a reconsideration of conventional monetary frameworks and opens the possibility for alternative approaches to managing inflation and economic stability that are more consistent with Islamic values.

In this regard, the Qur'an provides a clear normative foundation by explicitly prohibiting *riba* and distinguishing it from lawful trade:

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَٰلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَى فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَٰئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ

“Those who consume interest cannot stand [on the Day of Judgment] except as one stand who is being beaten by Satan into insanity. That is because they say, “Trade is just like interest.” But Allah has permitted trade and has forbidden interest. So, whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns [to dealing in interest]—those are the companions of the Fire; they will abide eternally therein. (Surah Al-Baqarah 2:275)”

However, this dominant paradigm (interest-based policy) has not gone unchallenged. In recent years, alternative perspectives have emerged, questioning the effectiveness and fairness of interest-based monetary policy. Notably, policymakers in countries such as Turkey and Indonesia have expressed concerns that high interest rates may suppress real economic activity and hinder productive investment.

Criticism toward interest-based monetary policy is not only theoretical but also reflected in the views of contemporary policymakers. For instance, Turkish Ex-Prime Minister and Current President (2003–Recent) Recep Tayyip Erdoğan has consistently opposed high interest rates, arguing that they are fundamentally harmful to economic stability. In one of his public speeches, he explicitly stated that “*interest rates are the mother and father of all evil*”, linking high interest rates directly to inflation and broader economic problems. This perspective challenges conventional macroeconomic theory, which typically views interest rates as a primary tool for controlling inflation. Instead, Erdoğan’s stance reflects a belief that interest itself may be a structural cause of economic imbalance rather than a solution to it.

A similar concern can be observed in the views of Jusuf Kalla, who has repeatedly criticized high-interest rate regimes in Indonesia. He argued that “*with high interest rates, people prefer to earn from interest and become less motivated to undertake productive business activities*”<sup>2</sup>, highlighting the distortionary effects of interest on real-sector development. In another statement, he emphasized that raising interest rates is not an effective way to control inflation, noting that such policies can burden economic actors and hinder investment. These views reinforce the argument that excessive reliance on interest-based policy may undermine productive economic activity and long-term growth.

This paper therefore seeks to critically examine both conventional and alternative perspectives, and to propose a riba-free macroeconomic framework that is not only theoretically grounded but also aligned with the principles of Islamic economics and contemporary policy realities.

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<sup>1</sup> Reuters (2018) *Turkey’s Erdogan calls interest rates “mother of all evil”, lira slides*. Available at: Business Standard: Turkey’s Erdogan calls interest rates ‘mother of all evil’; lira slides. (cited on March 2026)

<sup>2</sup> ANTARA News (2016) *Wapres bilang bunga tinggi jadikan orang malas usaha*. Available at: [www.antaranews.com](http://www.antaranews.com) : Wapres bilang bunga tinggi jadikan orang malas usaha - ANTARA News

## **Problem Findings**

Despite the widespread reliance on interest rate adjustments as the primary tool for controlling inflation, this approach is not universally effective, particularly in addressing supply-side disruptions and structural inefficiencies. Conventional monetary frameworks tend to treat inflation as a homogeneous phenomenon, thereby overlooking its diverse causes and the limitations of interest-based policy responses.

From an Islamic economic perspective, the issue is more fundamental, as the reliance on interest rate mechanisms conflicts with the prohibition of *riba* (الربا), which extends beyond the notion of interest to include unjustified and predetermined gains detached from real economic activity. This creates a conceptual gap between conventional policy tools and Islamic economic principles.

Furthermore, existing approaches often neglect the role of strategic interaction among economic agents in shaping inflation dynamics. Therefore, this paper identifies the need for a more integrated framework that moves beyond interest-based policy and incorporates Islamic economic principles alongside a strategic understanding of economic behaviour.

## **Research Questions**

To address the identified research gap, this study formulates the following research questions. This study is guided by the following research question: *“How can a riba-free macroeconomic framework effectively manage inflation and maintain economic balance without relying on interest-based monetary instruments?”*

To further elaborate this inquiry, the study addresses the following supporting questions:

1. What are the limitations of interest rate-based policies in addressing diverse sources of inflation, particularly those arising from structural and supply-side factors?
2. How do Islamic economic principles provide alternative mechanisms for achieving price stability and sustainable economic growth?

## **Literature Review**

The conventional approach to inflation management is predominantly grounded in the use of interest rate adjustments as a primary monetary policy tool. Standard macroeconomic theory suggests that increasing interest rates reduces aggregate demand, thereby mitigating inflationary pressures (Mankiw, 2021; Blanchard, 2017). This framework is further supported by policy rules such as the Taylor Rule, which formalizes the relationship between inflation, output gaps, and interest rate responses (Taylor, 1993). Within this paradigm, inflation is largely perceived as a demand-driven phenomenon that can be effectively controlled through monetary tightening.

However, a growing body of literature has challenged the universality of this approach. Inflation is increasingly recognized as a multi-dimensional phenomenon that may arise from supply-side disruptions, structural inefficiencies, and external shocks, rather than solely from excessive demand (Stiglitz, 2019). In such contexts, interest rate adjustments may prove insufficient or even counterproductive, as they fail to address the root causes of price instability and may suppress productive investment and economic growth. This critique highlights the limitations of a one-size-fits-all monetary policy framework.

From an Islamic economic perspective, the reliance on interest-based policies presents a more fundamental concern. The prohibition of *riba* (الربا), which extends beyond the notion of interest to encompass unjustified and predetermined gains, necessitates the development of alternative financial and macroeconomic instruments. Islamic economics emphasizes principles such as risk-sharing, asset-backed financing, and the integration of financial activities with the real sector (Chapra, 2000; Iqbal and Mirakhor, 2011). These principles aim to promote economic justice and stability while avoiding the distortions associated with interest-based systems.

Classical Islamic scholars have long articulated the importance of justice and balance in economic life. Ibn Khaldun, for instance, emphasized the relationship between production, governance, and economic prosperity, highlighting the adverse effects of excessive burdens on economic activity. Similarly, Al-Ghazali underscored the ethical dimensions of economic behaviour, advocating for fairness and moderation in market transactions. These foundational insights remain relevant in contemporary discussions on sustainable and equitable economic systems.

Tabel 1. Research on Conventional View

No	Author(s)	Year	Title	Method	Key Findings
1	Bernanke, B.S.	2022	<i>21st Century Monetary Policy</i>	Conceptual / Historical	Interest-based policy remains central in controlling inflation, especially through demand management.
2	Clarida, R., Galí, J., & Gertler, M.	2021	<i>Monetary policy rules in practice</i>	Empirical	Central banks effectively stabilize inflation using interest rate rules such as Taylor Rule.
3	International Monetary Fund	2023	<i>World Economic Outlook</i>	Global macro analysis	Monetary tightening reduces inflation but may slow growth, especially in emerging markets.
4	World Bank	2022	<i>Global Economic Prospects</i>	Policy analysis	Inflation increasingly driven by supply shocks, limiting effectiveness of interest-based policy.

The studies presented in Table-1 consistently demonstrate that interest rate adjustments remain the dominant policy instrument in conventional macroeconomic frameworks for controlling inflation. While these approaches are generally effective in managing demand-driven inflation, they also reveal important limitations, particularly in addressing supply-side shocks and structural disruptions. Moreover, the reliance on monetary tightening often introduces trade-offs between price stability and economic growth, especially in developing and emerging economies. This suggests that the conventional framework, while robust in certain contexts, may not provide a comprehensive solution to the increasingly complex nature of inflation dynamics.

To fully comprehend on what is the Islamic scholar has researched before, we have to look at previous studies conducted in Islamic study perspectives.

Tabel 2. Islamic Perspectives on Issue

No	Author(s)	Year	Title	Method	Key Findings
1	Chapra, M.U.	2000	<i>The Future of Economics: An Islamic Perspective</i>	Conceptual	Advocates a riba-free system emphasizing justice, equity, and real-sector development.
2	Iqbal, Z. & Mirakhor, A.	2011	<i>An Introduction to Islamic Finance</i>	Conceptual	Risk-sharing mechanisms provide a viable alternative to interest-based systems.
3	Dusuki, A.W. & Abdullah, N.I.	2021	Maqasid al-Shariah & CSR	Conceptual / qualitative	Islamic finance promotes ethical and socially responsible economic behaviour.
4	Kamla, R. & Alsoufi, R.	2015	Riba and Islamic finance critique	Critical analysis	Interest-based systems create structural inequality and deviate from Islamic principles.

The existing literature indicates that while conventional studies emphasize the effectiveness of interest rate policies in managing inflation, Islamic economic research highlights the importance of ethical constraints and real-sector integration. However, there remains a limited effort to integrate these perspectives into a unified analytical framework.

However, despite these contributions existing studies have yet to fully integrate Islamic economic principles with a strategic understanding of economic behaviour. Modern economic analysis increasingly recognizes that inflation dynamics are influenced not only by policy instruments but also by the expectations and interactions of economic agents. The field of game theory, developed by John von Neumann and Oskar Morgenstern, provides a useful framework for analysing such interactions. Nevertheless, its application within an Islamic macroeconomic context remains limited.

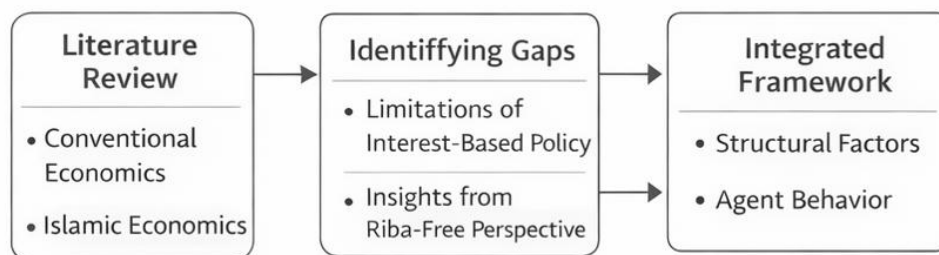
Therefore, a clear gap emerges in the literature: while conventional models rely heavily on interest-based policies, and Islamic economics offers normative alternatives, there is still a lack of an integrated framework that combines these perspectives with a strategic understanding of inflation dynamics. Addressing this gap is essential for developing a more comprehensive and sustainable approach to economic balance in a riba-free system.

## METHODOLOGY

This study employs a qualitative and conceptual research approach based on an extensive review of relevant literature. It synthesizes insights from conventional macroeconomic theory, Islamic economic principles, and contemporary policy discussions to examine the limitations of interest-based monetary frameworks and explore alternative approaches to inflation management. Rather than relying on empirical estimation, this paper adopts a theoretical analysis to develop an integrated understanding of inflation dynamics, particularly by considering the role of structural factors and strategic interactions among economic agents. This approach allows for the formulation of a *riba*-free macroeconomic framework that is both conceptually grounded and aligned with real-world economic challenges.

To support this analysis, the study reviews a range of academic literature, policy reports, and conceptual works relevant to inflation, monetary policy, and Islamic economics. The selection of sources is based on their relevance to the research questions and their contribution to understanding both conventional and alternative perspectives. By comparatively examining these sources, the study identifies key themes, limitations, and gaps within existing frameworks. This method enables a structured synthesis of ideas, providing a foundation for proposing a more integrated and context-sensitive approach to achieving economic balance without reliance on interest-based instruments.

Figure 1. Analytical Framework of the Study



## DISCUSSION

The limitations of interest-based monetary policy highlight the need for a more comprehensive approach to managing inflation. Rather than relying solely on interest rate adjustments, inflation should be understood as a multi-dimensional phenomenon shaped by structural conditions, financial mechanisms, and the behaviour of economic agents.

This study proposes a *riba*-free macroeconomic framework based on three interrelated components. First, inflation control should be anchored in the real sector by addressing supply-side constraints, improving productivity, and enhancing distribution efficiency. This approach shifts the focus from monetary contraction to structural economic stability. Second, the financial system should operate without reliance on interest-based instruments, instead emphasizing risk-sharing arrangements and asset-backed financing. By aligning financial returns with real economic performance, this mechanism reduces speculative behaviour and promotes sustainable growth. Third, inflation dynamics should be analyzed as the outcome of strategic

interactions among economic agents, including governments, firms, and households. Policy effectiveness therefore depends not only on instruments, but also on the alignment of incentives and expectations across these actors. A coordinated approach can mitigate inflationary pressures without resorting to interest-based interventions.

### **Conventional Macroeconomy Theory**

Conventional macroeconomic theory places significant emphasis on the role of interest rates as the primary instrument for managing inflation and stabilizing the economy. Central banks are expected to adjust policy rates in response to inflationary pressures, with higher interest rates reducing aggregate demand through lower consumption and investment. This approach is grounded in well-established frameworks such as the Taylor Rule and inflation-targeting regimes, which have been widely adopted across both advanced and emerging economies.

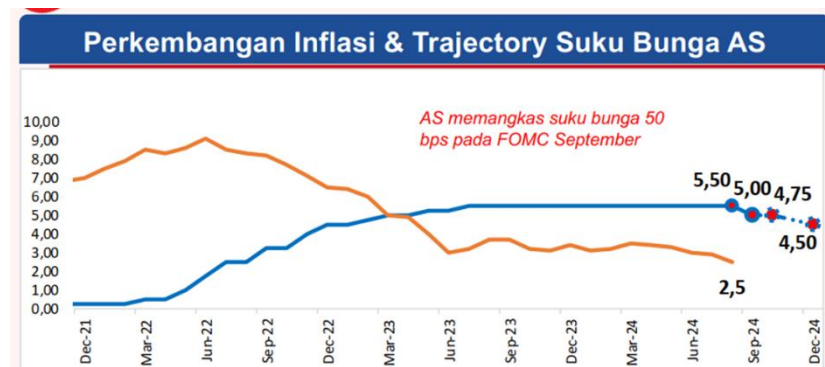
While this mechanism has proven effective in certain contexts, particularly in addressing demand-driven inflation, its limitations have become increasingly evident in recent economic developments. Inflation in the modern economy is often driven by supply-side factors, including disruptions in global supply chains, rising energy costs, and structural inefficiencies. In such cases, interest rate adjustments may have limited impact on the root causes of inflation, as they primarily influence demand rather than production and distribution.

Moreover, the use of interest-based policy introduces inherent trade-offs. Efforts to control inflation through monetary tightening may lead to reduced investment, slower economic growth, and increased financial burdens on businesses and households. This is particularly relevant in developing economies, where access to capital is more sensitive to changes in borrowing costs. As a result, the reliance on interest-based policy instruments may inadvertently constrain real-sector development while attempting to achieve price stability.

In addition, conventional frameworks often assume a relatively passive role of economic agents, treating their responses as predictable and largely uniform. However, in reality, firms, consumers, and policymakers interact strategically, shaping expectations and influencing inflation dynamics in more complex ways. The absence of this behavioural dimension limits the explanatory power of standard models and reduces the effectiveness of policy interventions based solely on interest rate adjustments.

Taken together, these limitations suggest that while conventional macroeconomic theory provides a useful foundation for understanding inflation control, it may not offer a comprehensive solution to the increasingly complex and structurally driven nature of inflation. This creates the need for alternative perspectives that can address both the structural and behavioural dimensions of economic stability.

Figure 2. US Inflation and Fed-Rate (Interest) Trajectory



Info : title “US inflation development and FOMC interest rate trajectory”; in red text “US cuts 50 points FOMC rate in September”

The persistence of interest rate adjustments as the primary tool for inflation control is clearly reflected in recent monetary policy developments in the United States. As illustrated in Figure 2, the trajectory of U.S. interest rates shows a consistent tightening phase in response to rising inflation, followed by gradual rate cuts as inflation begins to ease. This pattern highlights the conventional policy cycle in which central banks raise interest rates to suppress inflationary pressures and subsequently lower them to stimulate economic activity. Such an approach remains dominant not only in the United States but also globally, as many central banks adopt similar strategies in response to inflation shocks.

This reliance on interest-based policy has also been widely discussed in policy circles beyond advanced economies. In Indonesia, for instance, deliberations within the national parliament (DPR) have addressed the implications of U.S. monetary policy, particularly the potential for interest rate hikes to manage inflation and the corresponding effects on domestic economic stability. These discussions underscore the extent to which global economic systems remain interconnected and dependent on interest-based policies. At the same time, they reveal an inherent cyclical dependency: interest rates are increased to control inflation and later reduced to stimulate growth, suggesting that the system continuously oscillates between contraction and expansion without fully resolving underlying structural issues.

Figure 3. Panic, Speculation, and Instability in Financial Markets



The instability of conventional macroeconomic systems is further amplified by the behavioural dynamics of financial markets. As illustrated in Figure 2, market participants often react collectively in ways that are driven less by fundamentals and more by sentiment, speculation, and herd behaviour. Periods of uncertainty can quickly trigger panic selling, followed by abrupt shifts toward aggressive buying, creating excessive volatility in asset prices. These reactions are frequently disconnected from real economic conditions, yet they significantly influence financial markets and, ultimately, the broader economy.

Such dynamics can have direct implications for monetary policy and inflation. Sudden shifts in market sentiment may lead to rapid changes in capital flows, exchange rates, and liquidity conditions, prompting central banks to respond through interest rate adjustments. In turn, higher interest rates increase the cost of borrowing, which can suppress investment while simultaneously contributing to rising costs in the real sector. In extreme cases, this cycle may escalate into broader economic instability, where inflation, financial stress, and declining growth interact in a self-reinforcing manner.

Moreover, the speed at which this market reactions occur highlights a critical limitation of conventional frameworks: the lack of a clear and predictable causal structure. Economic conditions can shift rapidly from expansion to contraction, often driven by changes in expectations rather than underlying fundamentals. This creates an environment where inflation, interest rates, and economic activity appear to move in unstable and sometimes contradictory ways, reinforcing the argument that conventional interest-based policies may not be sufficient to ensure long-term economic stability.

## **Rethinking on Islamic Studies and Literature View**

The limitations identified in conventional macroeconomic frameworks invite a reconsideration of alternative approaches that are not solely dependent on interest-based policies. Within this context, Islamic economic thought offers a distinct perspective by emphasizing the prohibition of *riba* (الربا) and promoting a financial system that is closely linked to real economic activity. Rather than relying on monetary contraction to control inflation, Islamic principles encourage structural solutions that address the underlying causes of price instability.

A central feature of this approach is the emphasis on risk-sharing financing, which aligns financial returns with actual economic performance. By eliminating guaranteed returns without corresponding risk, the system reduces speculative behaviour and discourages excessive financialization. This creates a more balanced relationship between the financial sector and the real economy, potentially mitigating the volatility observed in interest-based systems. In addition, Islamic economic thought places strong emphasis on ethical conduct and market discipline. Practices such as hoarding, manipulation, and unjust pricing are discouraged, reinforcing a system where price formation is more closely tied to real supply and demand conditions. This moral and institutional framework contributes to economic stability by reducing distortions that may otherwise lead to inflationary pressures.

Furthermore, inflation is understood not merely as a monetary phenomenon, but as an outcome of broader economic interactions. By encouraging coordination between economic agents and promoting fairness in transactions, Islamic economics provides a foundation for a more stable and predictable economic environment. This perspective complements the need for a framework that integrates structural factors and behavioural dynamics, rather than relying solely on reactive monetary tools.

Taken together, these principles suggest that a *riba*-free macroeconomic framework is not only normatively grounded, but also offers a structurally coherent alternative to conventional monetary policy. By focusing on real-sector development, ethical constraints, and balanced financial practices, such an approach holds potential for achieving sustainable economic stability beyond the limitations of interest-based systems.

### **1. Real Sector-Anchoring**

A central element of a *riba*-free macroeconomic framework is the anchoring of economic stability in the real sector, particularly through the enhancement of production capacity and the efficiency of distribution systems. Unlike conventional monetary policy, which primarily targets demand through interest rate adjustments, this approach addresses inflation at its source by focusing on the availability and flow of goods and services.

In practical terms, inflationary pressures can be mitigated by improving supply-side conditions, such as strengthening domestic production, reducing bottlenecks in logistics, and ensuring the smooth distribution of essential goods. For instance, disruptions in transportation or delays in ports can lead to price increases that are unrelated to excessive demand. In such cases, policy responses aimed at improving infrastructure and supply chain coordination are more effective than monetary tightening.

A real-sector-oriented approach encourages investment in productive activities rather than financial speculation. When financial resources are directed toward sectors such as manufacturing, agriculture, and infrastructure, the overall supply capacity of the economy increases, thereby reducing upward pressure on prices. This creates a more stable relationship between demand and supply, which is essential for maintaining price stability. By shifting the focus from monetary contraction to structural improvement, real-sector anchoring provides a more direct and sustainable mechanism for managing inflation. It recognizes that price stability is not solely a function of controlling demand, but also of ensuring that the economy is capable of meeting that demand efficiently and consistently.

Conventional approaches often treat inflation primarily as a demand-side phenomenon, addressed through interest rate adjustments. Islamic classical and contemporary literature emphasize that price instability frequently stems from supply-side constraints, structural inefficiencies, and inequitable distribution (Chapra, 2000; Siddiqi, 2006). The real sector is central to promoting sustainable economic activity. Price stability, or *istiqrar as-sa'ir* (استقرار السعر), can be achieved by enhancing production capacity, streamlining distribution channels, and improving overall efficiency. For instance, investments in productive infrastructure, fair trade practices, and cooperative partnerships (*mudaraba* or *musharaka*) support both growth and ethical wealth allocation, without recourse to interest-bearing mechanisms.

This approach prioritizes the tangible creation and circulation of goods and services as the anchor for economic stability. By focusing on production and supply-side management, an interest-free economy addresses the root causes of inflation rather than merely curbing purchasing power through monetary tightening.

Moreover, Islamic economics encourages mechanisms such as *zakat*-funded subsidies or strategic reserves to balance supply and demand, ensuring equitable access and mitigating artificial scarcity that can trigger price volatility. Therefore, real-sector anchoring aligns with the Islamic macroeconomic ethos: promoting justice, risk-sharing, and societal welfare while maintaining price stability. This system relies on tangible productivity and ethical distribution as the foundation of a resilient, interest-free economy. Inflation control should be approached not only as a monetary issue, but as a problem of coordination, capacity, and distribution within the real economy.

In Quranic verse and hadith Nabi Saw we can profound this belief:

وأحل الله البيع وحرم الربا

(*Al-Baqarah* 2:275)

“Allah has permitted trade and forbidden *riba*.” → Encourages trade, real economy and development

فإذا قضيت الصلاة فانتشروا في الأرض وابتغوا من فضل الله

(*Al-Jumu'ah* 62:10)

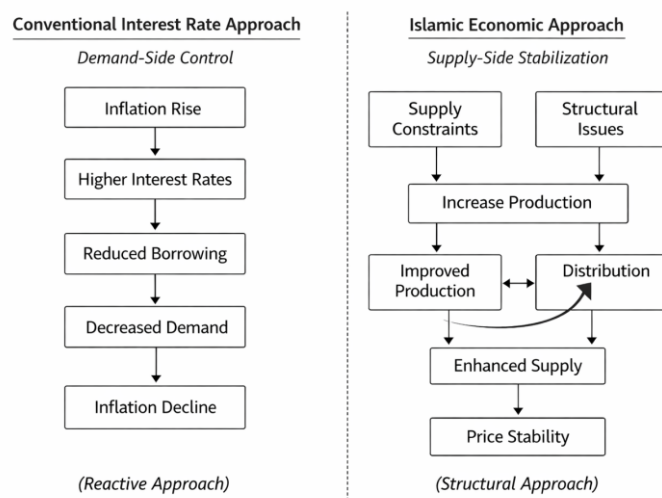
“Disperse in the land and seek the bounty of Allah.” → Encourages real economy

من احتكر فهو خاطئ

(*Hadith Muslim* No. 1605)

“Whoever hoards is a sinner.” → To stay away from speculation, and onto real economy

Figure 4. Comparative Framework of Inflation Management



## 2. Riba-Free Financial Mechanism

A riba-free macroeconomic framework replaces interest-based instruments with risk-sharing and real sector financing to align financial activity with the real economy. Instead of predetermined returns, financing outcomes depend on the performance of underlying assets and productive ventures, reducing incentives for speculative behaviour and limiting excessive financialization.

Operationally, financial resources are channelled into real economic activities through contracts that tie returns to actual production and trade. This encourages more prudent investment decisions and strengthens the link between finance and output. As capital flows increasingly support productive sectors rather than purely financial gains, supply capacity expands and inflationary pressures are mitigated at their source. By eliminating guaranteed returns in financial transactions, a riba-free system encourages greater accountability and shared risk between capital providers and entrepreneurs. This mechanism promotes more prudent investment decisions, as returns are contingent upon the success of underlying economic activities. As a result, financial flows are more likely to support productive sectors rather than speculative or purely financial gains.

Furthermore, real sector financing ensures that financial activities are directly linked to tangible economic assets or services. This linkage enhances transparency and reduces the likelihood of systemic imbalances that may arise from excessive leverage or financialization. In this context, financial stability is achieved not through monetary tightening, but through the structural integration of finance with real economic activity. Taken together, a riba-free financial mechanism offers an alternative pathway for achieving economic balance by fostering stability, reducing speculative behaviour, and reinforcing the role of the real sector in driving sustainable growth.

This approach challenges the conventional reliance on interest rates as a stabilizing tool, by proposing a system in which stability emerges from the structure of financial relations rather than from external monetary intervention.

Table 3. Sharia-Compliant Financial Mechanisms in a Riba-Free System

No	Instrument	Contract Type	Key Features	Economic Function
1	<b>Mudarabah</b>	Profit-sharing	One party provides capital, the other manages the business; profits shared, losses borne by capital provider	Encourages entrepreneurship and risk-sharing
2	<b>Musharakah</b>	Joint partnership	All parties contribute capital and share profit/loss proportionally	Promotes equitable investment and joint ownership
3	<b>Murabaha</b>	Cost-plus sale	Seller discloses cost and adds agreed profit margin; no interest involved	Facilitates trade and asset financing
4	<b>Ijara</b>	Leasing	Asset is leased for a fixed fee without transferring ownership	Supports asset utilization without debt burden
5	<b>Salam</b>	Forward contract	Payment made in advance for future delivery of goods	Supports agricultural and commodity financing
6	<b>Istisna</b>	Manufacturing contract	Financing for production or construction projects	Enables infrastructure and industrial development
7	<b>Sukuk</b>	Asset-backed securities	Investors hold ownership in underlying assets, not debt	Provides alternative to conventional bonds
8	<b>Qard Hasan</b>	Benevolent loan	Interest-free loan with only principal repayment	Promotes social welfare and financial inclusion

The instruments presented in Table-3 demonstrate that a riba-free financial system is not devoid of mechanisms for capital allocation, but rather operates through alternative structures that emphasize risk-sharing, asset linkage, and ethical considerations. Unlike interest-based systems that rely on predetermined returns, these instruments align financial activities with real economic transactions and productive outcomes. This reinforces the argument that financial stability can be achieved through structural design rather than dependence on interest rate adjustments.

It is also important to acknowledge that contemporary Islamic financial practices have been subject to criticism for closely replicating conventional debt-based

structures, highlighting the need for a more genuine implementation of risk-sharing principles.

These terms in Quran strongly (very strongly) opposes riba practice:

يا أيها الذين آمنوا اتقوا الله وذروا ما بقي من الربا إن كنتم مؤمنين فإن لم تفعلوا فأذنوا بحرب من الله ورسوله  
(Al-Baqarah 278-279)

*“O you who believe, fear Allah and give up what remains of riba if you are truly believers; and if you do not, then be informed of a war from Allah and His Messenger.”*

لعن رسول الله آكل الربا وموكله وكاتبه وشاهديه وقال هم سواء

(Hadith Muslim No. 1598)

*“The Prophet cursed the one who consumes riba... and said they are all equal.”*

### **3. Strategic Behaviour Alignment**

Inflation dynamics are also shaped by expectations and interactions among economic agents. In the absence of interest-rate signalling, stability depends on coordinated behaviour supported by credible policies and consistent economic governance. Governments, firms, and households must align their actions toward productive and stable economic outcomes.

In practice, this requires clear policy communication, institutional trust, and incentive structures that discourage speculative behaviour such as hoarding or panic-driven market reactions. When financial returns are linked to real economic performance and policy direction is credible, economic agents are more likely to engage in long-term productive activities. This alignment reduces volatility and supports a more stable and predictable economic environment.

Beyond structural and financial considerations, inflation dynamics are also shaped by the behaviour and expectations of economic agents. Conventional macroeconomic frameworks often assume that agents respond predictably to policy signals, particularly interest rate adjustments. However, as observed in real-world economic fluctuations, market participants—including firms, consumers, and investors—frequently act based on expectations, sentiment, and strategic considerations, which may not always align with policy intentions.

In this context, a riba-free macroeconomic framework requires not only alternative financial instruments but also a mechanism to align the behaviour of economic agents toward stability. Without the signalling role of interest rates, coordination becomes essential in shaping expectations and preventing destabilizing reactions such as panic buying, speculative hoarding, or abrupt withdrawal of investment. This highlights the importance of credible policy communication, institutional trust, and consistent economic governance.

Furthermore, strategic alignment can be fostered through incentive structures that encourage productive economic behaviour. When financial returns are directly linked to real economic outcomes, as in risk-sharing arrangements, economic agents are more likely to act in ways that support long-term stability rather than short-term gains. This reduces the likelihood of self-reinforcing cycles of inflation driven by expectations and speculative actions. This perspective is consistent with strategic interaction frameworks, where economic outcomes are shaped not only by policy instruments but also by expectations and interdependent behaviour among agents.

In Quran and Hadith you can see these relevances in this ayah and sunnah:

ولا تأكلوا أموالكم بينكم بالباطل

(Al-Baqarah 2:188)

“Do not consume one another’s wealth unjustly.”

التاجر الصدوق الأمين مع النبيين والصديقين والشهداء

(Hadith Tirmidhi No. 1209)

“The truthful and trustworthy merchant will be with the prophets...”

In game theoretical framework, an honest and hard-working economic individual have two options, two play by the rule of the game or by cheating the system that will end nicely for the individual but will suffer the other economic player. This game is similar to Prisoner’s Dilemma in which have different Pareto Optimum and Nash Equilibrium. This game pictures perfectly on how the economic will turn if there are no clear rules of game and ethics in economy.

Figure 5. Two Player Game – Honest and Greed

PA/PB	Player B: Honest	Player B: Greed
Player A: Honest	(3, 3)	(1, 4)
Player A: Greed	(4, 1)	(2, 2)

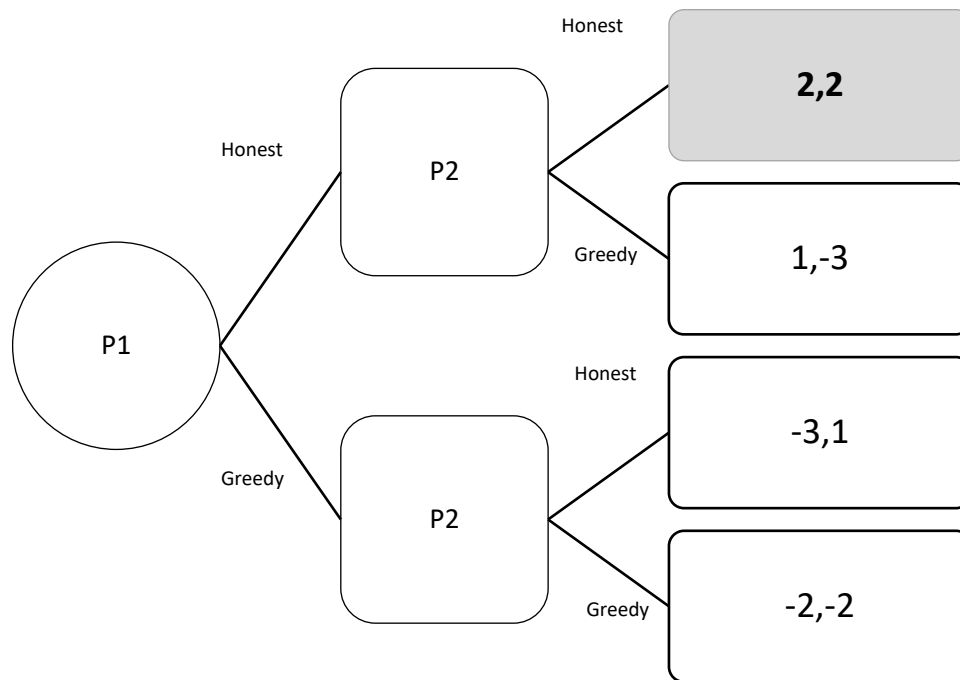
Pareto Optimum at (Honest, Honest at 3,3) and Nash Equilibrium at Greed and Greed (2,2). Incentives in behaving greedy pushing the equilibrium worse

In a conventional setting, economic agents are driven primarily by self-interest, leading to a dominant strategy of opportunistic behaviour (greedy), even when mutual cooperation yields a better outcome. This results in a suboptimal equilibrium, as illustrated in standard coordination problems such as the prisoner’s dilemma.

Now suppose that there is sufficient information for two players and clear rule of the game between them and a communication line between two. Such information can make the game changes, and communication between two (as opposed to simultaneous game where there is no such of communication) leads to two players coordinating and can make a greater for both. The two players can now coordinate toward reaching optimum return in which is the Pareto Optimum value/actions.

This game is also changing when the game is sequential games, and there is role government in creating a clear and just rules.

Figure 6. Sequential Game of Two Player – Honest and Greed



Pareto Optimum and Nash Equilibrium in the same direction, Honest-Honest choice (2,2). Conclusion used Backward Induction method.

In this sequential game, P2 is assessing the choice made by P1. There is a huge disincentive when choosing not taking honest action. Greedy action will result in -2 disincentive, since the nature of the game now is enhancing the government to eradicate law, ethics, and honesty among societies, *ceteris paribus*.

This implies that inflation dynamics can be interpreted as equilibrium outcomes of strategic interaction among economic agents. In the absence of coordination and credible rules, agents tend to converge toward suboptimal equilibria characterized by opportunistic behaviour. However, with clear institutional frameworks and aligned incentives, the equilibrium can shift toward cooperative outcomes that support price stability and sustainable economic performance.

### Closing Discussion

The analysis above demonstrates that inflation cannot be fully understood or effectively managed through a singular reliance on interest rate adjustments. While conventional macroeconomic theory provides useful tools, its limitations become evident when confronted with structural disruptions, behavioural dynamics, and the inherent trade-offs between price stability and economic growth. The persistence of cyclical monetary responses further indicates that interest-based policy may function more as a reactive mechanism rather than a comprehensive solution.

In contrast, the proposed *riba*-free macroeconomic framework offers a more integrated perspective by combining real-sector strengthening, risk-sharing financial mechanisms, and the alignment of economic behaviour. Rather than addressing inflation through monetary contraction alone, this approach emphasizes structural balance, ethical constraints, and coordinated economic interactions. As such, it

provides a more holistic foundation for achieving sustainable economic stability in an increasingly complex global environment.

From a policy perspective, the proposed framework can be operationalized through a combination of structural and institutional interventions. Governments may prioritize supply-side policies such as infrastructure development, logistics efficiency, and industrial capacity expansion to address the root causes of inflation. At the same time, financial systems can be structured to promote risk-sharing and real-sector financing, ensuring that capital flows are directed toward productive activities. In addition, regulatory frameworks play a crucial role in aligning incentives and maintaining market discipline, thereby reducing speculative behaviour and enhancing economic stability.

Unlike conventional frameworks that rely on reactive monetary adjustments, this approach seeks to prevent inflationary pressures through structural design and coordinated economic behaviour.

Figure 7. Integrated Framework of New Model



The framework illustrates the interaction between structural, financial, and behavioural dimensions of inflation control.

It is important to acknowledge that contemporary Islamic finance has been subject to significant criticism, particularly for replicating conventional debt-based structures under different contractual forms. Several studies argue that widely used instruments, such as murabaha, often function in ways that closely resemble interest-based financing, raising concerns regarding the extent to which current practices truly reflect the underlying principles of risk-sharing and real-sector integration (El-Gamal, 2006; Chong and Liu, 2009; Khan, 2010).

## CONCLUSION

This paper has examined the limitations of conventional interest-based monetary policy in managing inflation and maintaining economic balance. While interest rate adjustments remain the dominant tool in modern macroeconomic frameworks, their effectiveness is often constrained by structural factors, supply-side disruptions, and the behavioural responses of economic agents. As a result, reliance on such mechanisms may lead to cyclical policy patterns without fully addressing the underlying causes of inflation.

In response to these limitations, this study proposes a riba-free macroeconomic framework that integrates real-sector anchoring, risk-sharing financial mechanisms, and strategic alignment among economic actors. This framework challenges the conventional dependence on interest-based instruments by demonstrating that economic stability can be achieved through structural and institutional design rather than monetary intervention alone. This study is limited by its conceptual nature and does not provide empirical validation of the proposed framework.

The findings suggest that Islamic economic principles offer not only a normative alternative but also a conceptually coherent approach to addressing contemporary economic challenges. By emphasizing fairness, productivity, and coordination, a riba-free system has the potential to provide a more sustainable pathway for managing inflation and promoting economic balance. This framework is particularly relevant in economies characterized by supply-side constraints and institutional capacity for coordination.

This study contributes to the literature by developing an integrated macroeconomic framework that combines structural, financial, and behavioural dimensions of inflation. Unlike conventional approaches that rely predominantly on interest rate adjustments, this framework incorporates real-sector dynamics, risk-sharing financial mechanisms, and strategic interaction among economic agents into a unified analytical structure. By doing so, it offers a more comprehensive understanding of inflation as a multidimensional phenomenon shaped not only by policy instruments but also by institutional design and coordinated behaviour. This framework is particularly relevant in economic environments characterized by structural constraints and institutional capacity for coordination, rather than as a universal replacement for existing monetary systems. This study contributes by integrating macroeconomic theory, Islamic economic principles, and strategic interaction analysis into a unified conceptual framework.

This paper contributes to the literature by proposing an integrated riba-free macroeconomic framework that incorporates real-sector dynamics, risk-sharing finance, and strategic behavioural alignment as an alternative to interest-based monetary policy. Although, this paper does not seek to replace conventional monetary policy entirely, but to offer an alternative analytical framework that complements existing approaches by addressing structural and behavioural dimensions of inflation. Future research may further explore the empirical applicability of this framework and its potential implementation within modern economic systems, particularly in emerging markets where structural vulnerabilities and financial constraints are more pronounced.

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