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The Influence of Financial Inclusion on Economic Development in Indonesia: A Literature Study in Developing Countries

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Abstract

Financial inclusion has become a crucial catalyst for economic growth, especially in emerging economies. This research aims to examine how financial inclusion influences economic development by conducting an in-depth analysis of current scholarly works. In recent years, financial inclusion has garnered significant attention in the global development discourse, with Indonesia being no exception. By facilitating access to formal financial systems, it empowers individuals to participate in more fruitful economic activities. Employing a literature review methodology, this research synthesizes insights from secondary sources such as scholarly journals, books, and research reports. The findings underscore that financial inclusion significantly enhances societal well-being, fosters economic expansion, and mitigates social disparities. Nevertheless, challenges like inadequate financial literacy and limited infrastructure persist as critical barriers in developing regions. Consequently, an integrated approach is essential to address these hurdles and fully harness the transformative potential of financial inclusion.

Keywords: Financial Inclusion, economic development, developing countries, financial literacy, social inequality.

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1. Introduction

In some year Lastly, the concept inclusion finance has develop become element key in the global development agenda , including in Indonesia. The ability For access service formal finance opens opportunity for individual For follow as well as in activity more economy profitable . Based on information from the World Bank (2020), countries with level inclusion high finance tend experience growth more economy fast and sustainable . For Indonesia, which has population more of 270 million people, the challenge geopolitical and social, as well as opportunities and challenges in reach inclusion finance very complex.

The increasingly complex economic challenges encourage individuals to find innovative ways to meet their living needs. In today's era, people living in the modern world are often trapped in complex financial problems. With the development of the digital economy, access to various information has become easier. The process of disseminating information is also getting faster, which has an impact on the surge in demand and increasing consumer activity, and this cannot be underestimated. This is also influenced by the economy of the upper class. Most people may not be able to manage their finances properly due to poor economic conditions and impulsive business practices (Haerani et al., 2019; Bulutoding et al., 2020; Mokhtar et al., 2020; Sudarsono et al.).

A luxurious lifestyle can increase desires, causing financial problems for high-income individuals (Lusardi et al., 2010; Meghir & Pistaferri, 2011; Parmitasari, Alwi, & Sunarti, 2018). Therefore, the skill of managing finances wisely is very important, especially with the increasing complexity of existing financial products (Grohman) (2018).

Indonesian government is targeting achievement inclusion finance by 90% by 2024, with implement a number of policy strategic. One of them is digital transformation in sector service finance as well as strengthening literacy finance society . Bank Indonesia also play a role in push achievement target this (2022), noted that use technology financial, such as service e-wallet and mobile banking, have push improvement significant in access finance among public urban areas. However, the gap access Still become challenge main, especially in the area rural and remote.

By increasing access to formal financial services, financial literacy improves people's lives, lifting them out of poverty while slowing economic growth rates (Blancher et al., 2019; Hidayat et al., 2022; Kim, 2016; Thathsarani & Jianguo, 2022). In developing countries, access to formal banking services is often limited, with a large portion of the population unable to take advantage of the conventional banking system.

The 2019 Financial Services Authority national survey showed that financial literacy in Indonesia only reached 38.03%, indicating that people's financial understanding is still quite low. Good financial literacy helps individuals manage their finances wisely, having a positive impact on financial stability. Conversely, low financial literacy often causes difficulties in financial management and affects financial well-bein.

Inclusion finance play role key in overcome existing inequality in system finances that are still limited its reach , especially for those who are in condition economy vulnerable , such as poor and near poor groups. With thus, inclusion finance expected can create more Lots opportunity work at a time functioning as means For leveling distribution welfare among public earn low. As explained by Ummah et al. (2018), one step strategic For strengthen inclusion finance is with utilise technology financial (fintech). Technology This give convenience access for public without need come direct to office branches , as described by Muzdalifa et al. (2018).

2. Literature Review

Universal Financial Access

Financial inclusion describes a situation where every individual has full access and ease in utilizing financial institution services in a timely, convenient, transparent, and affordable manner. This is done while respecting the values of human dignity. Muzdalifa et al. (2018). Corrado & Corrado (2017) stated that inclusive financial access plays a vital role in realizing equitable development. By opening equal and affordable opportunities for various financial services, financial inclusion not only plays a role in improving people's standard of living, but also motivates active participation from all levels of society, especially low-income groups, in productive and sustainable economic activities. By providing opportunities for individuals to compete and explore their economic potential, financial inclusion acts as a major driver for accelerating more stable and sustainable economic growth.

Inclusive finance plays a very crucial role, considering that there are still many Indonesian citizens who are not yet connected to the formal financial system. Access to these services is the right of every individual who should be able to obtain the best quality, easily accessible, transparent, convenient, and affordable. Therefore, it is important for all levels of society, including those with low incomes, poor but productive, migrant workers, and those living in remote areas, to have the same opportunities. Based on World Bank research (Park & Mercado, 2015), the main aspects of financial inclusion include bank account ownership, the ability to save in formal financial institutions, and the ability to access loans from legitimate financial institutions.

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Financial inclusion has various definitions from several researchers and financial institutions. According to Rangarajan (2008), Financial inclusion ensures that underserved groups in society can gain access to financial services at reasonable prices. According to Bank Indonesia, This effort aims to overcome various barriers that prevent people from accessing banking services. According to Sharma et al. (2014) and Mialou et al. (2017), financial inclusion is achieved when individuals can easily access banking services without any obstacles. On the other hand, Bank Indonesia (2020) stated that financial technology (fintech) is the application of technology in the financial sector that produces innovations in products, services, technologies, and new business models. This innovation has the potential to affect monetary stability and the financial system, as well as increase the efficiency, smoothness, security, and reliability of the payment system.

The importance of financial inclusion is very large in accelerating economic growth in developing countries. This is related to expanding access to various more affordable financial services, such as savings, loans, insurance, and payment systems, which were previously difficult to access by individuals or businesses that were not involved in the formal financial sector (Abubakr & Kaya, 2021). Through the development of financial inclusion, it is hoped that opportunities can be opened to reduce poverty rates, create income equality, and support more inclusive economic growth by providing opportunities for individuals and businesses to participate more actively in economic activities (Tran & Le, 2021)

Research in Indonesia

A study conducted in Indonesia revealed that financial inclusion has the potential to be a major driver in accelerating the pace of the economy. Based on a report by Bank Indonesia (2020), initiatives such as Laku Pandai and Kredit Usaha Rakyat (KUR) have succeeded in creating opportunities for people in remote areas and MSMEs to access financial services more easily and widely. This is reflected in the increase in income and the decrease in poverty rates in areas that previously had difficulty accessing formal financial services.

In addition, research by Nugroho and Wulandari (2019) revealed that expanding access to formal financial sector services in Indonesia has brought significant changes to increasing financial understanding among the community. A deep understanding of finance allows a person to make smarter financial decisions, such as choosing to save at a banking institution or using loans to develop a business. Therefore, progress in financial inclusion not only opens access, but also strengthens better economic decisions, but also empowers people economically

The Role of Digitalization

Digitalization also plays a major role in driving financial inclusion in Indonesia. Haryono et al. (2020) noted that fintech has become an innovative solution to reach people in remote areas. Through digital financial services such as e-wallets and peer-to-peer lending , people who previously did not have access to banking can now enjoy financial services more easily. This digital transformation not only increases financial inclusion but also drives efficiency and transparency in the financial system.

Challenges Faced

On the other hand, major challenges are still faced in implementing financial inclusion in developing countries. Research by the Financial Services Authority (OJK) Indonesia (2020) revealed that the low level of financial understanding and limited existing infrastructure are significant challenges in increasing financial literacy in this country, such as adequate internet networks in rural areas, which are the main obstacles in achieving optimal financial inclusion. This shows that financial inclusion strategies must be accompanied by a comprehensive approach that involves public education and strengthening infrastructure.

The Role of Government and the Private Sector

Hypothesis is a temporary answer to the formulation of research problems, where the formulation of Furthermore, the role of government and the private sector is very necessary to accelerate financial inclusion. According to a study by Suryani et al. (2020), collaboration between the government, banks, and fintech companies can create more effective synergies in providing access to financial services. For example, government subsidies for digital financial service fees can increase the participation of low-income people in the formal financial system.

3. Research Design and Method

This study uses a literature analysis method, where the author collects and assesses secondary data taken from various relevant journals, books, and relevant research reports. The literature selection process is carried out through keyword searches such as “financial inclusion ", " economic development ", and " developing countries " in academic databases such as Scopus, PubMed, and Google Scholar. The selected literature includes empirical research, case studies, and reports from international institutions such as the World Bank and IMF.

To increase the validity of the analysis, a triangulation approach is used in comparing research results from various sources. This aims to identify patterns, differences, and relationships between existing studies. In addition, the thematic analysis method is used to group information into main themes, such as the relationship between financial inclusion and economic development, the role of technology, and implementation challenges in developing countries. Through this method, it is hoped that research can present a broader and more detailed understanding.

4. Results and Discussion

Based on the results of the literature review, financial inclusion has been shown to have a very positive impact on economic progress in developing countries, as has been proven in various previous studies. For example, research conducted by Az Zahra and Ajija (2023) Financial inclusion has been shown to have a vital role in accelerating Indonesia's economic progress, especially by expanding the reach of financial services through financial technology (fintech). A study by Pramaswara and Athoillah (2023) revealed that financial inclusion has a major impact on economic growth, with third-party funds and savings ratios being the determining factors. However, other variables such as the number of bank branches and mobile phone usage did not show a significant effect on this.

Suryaningrum et al. (2023) Encouraging financial inclusion is essential for equitable economic development in developing countries, through policies, digital services, increasing financial literacy, and collaboration between the government and private sectors. A study by Wahyuningtya (2021) revealed that there is a positive relationship between financial inclusion and inflation on the stability of the financial system. However, GDP per capita does not show a significant impact on the stability of the financial system. Research by Amanda and Marta (2024) Research results show that access to financial services from bank branches and ATMs used has an effect on income distribution inequality, Meanwhile, the role of bank loans does not show a significant impact on income inequality in developing countries.

In a study conducted by Muzdalifa et al. (2018), it was found that the existence of fintech companies has a major impact on the development of MSMEs. Not only in providing financing, fintech has also penetrated other sectors such as digital payment systems and financial management. Further research by Lailiyah et al. (2022) confirmed that all hypotheses tested were statistically valid. Factors such as Locus of Control, attitudes towards finance, income, and religiosity have been shown to influence the financial behavior patterns of Muhammadiyah members in Indonesia. Furthermore, financial literacy strengthens the relationship between financial attitudes and income with positive financial behavior. In general, Muhammadiyah members show healthy financial behavior. Meanwhile, Abadi et al. (2021) revealed that the advantage of fintech in the sharia banking sector in Lamongan lies in its ability to reach various levels of society. However, the biggest challenge is the security issue associated with the use of fintech, while the biggest opportunity lies in the majority of the Lamongan community who are Muslim. Sharia banks in Lamongan also face difficulties in developing amidst the dominance of conventional banks.

According to research conducted by Aziz and colleagues (2020), their findings show that collaboration between the banking sector and fintech institutions has not only succeeded in expanding financial access for people previously marginalized from banking services, but also provided significant operational benefits for both parties involved. Furthermore, research conducted by Saraswati (2022) shows that the availability and utilization of financial inclusion services have a positive impact on economic growth. Therefore, the government is expected to simplify the loan process and provide interest subsidies to support investment and create job opportunities. However, the impact of fintech payments is still limited, indicating the need for more efforts from the government and OJK to improve financial literacy and inclusion for the community.

Financial inclusion plays a vital role in supporting Indonesia's economic progress. Through financial technology (fintech), people's access to financial services increases, which contributes to economic growth and financial sector stability. This inclusion also helps reduce income inequality, support MSMEs, and improve financial behavior. Collaboration between banking and fintech can reach people who are not yet served by the formal financial system. However, challenges such as increasing financial literacy and socializing the benefits of financial inclusion still need to be overcome.

In the homeland, Indonesia introduced the Service program Finance Without Office (Smart Business), a initiative inclusion similar finances with effort similar in developing countries . This program initiated by the Financial Services Authority (OJK) with objective main expand range service finance to communities , especially those living in remote areas , towards service formal finance . Through this program , agents banking that can in the form of a shop or individuals who have permission from the bank, providing service finance like opening account , transfer, deposit , withdraw cash , and payment bill . Example other is the increasing use of mobile banking develop , such as BRI Mobile, Mandiri Online, or BCA Mobile applications . People who previously difficult access the bank because limitations infrastructure , now Can do transaction with easy through mobile phone they .

As example , farmer or fishermen in the area remote parts of Indonesia now can save money, pay bill , or make a transfer to family they without must go to bank.In addition In addition , the Smart Indonesia Card (KIP) and Pre-Employment Card programs also help integrate more many people to in system formal economy with give help direct and access training For increase skills and power competition they are in the labor market work.The success of these programs seen from increasing amount account banking in Indonesia and the level participation public in formal economy . For example , in 2020, the number of bank accounts in Indonesia reached more from 400 million , with more Lots society that has access For save , transact and manage finance These programs also contribute to the stability economy With expand accessibility system finance and encourage level transparency as well as greater accountability tall in every transaction finance , things This participate strengthen policy fiscal and monetary policies implemented by the state.

With availability service finance now , Indonesian society own a better way practical For regulate and reduce potential risk the economy faced , such as in face disaster natural or crisis health , as well as increase ability they For invest in education or business small.inclusion programs finance this also plays a role important in strengthen the Indonesian economy as a whole overall , helpful government reach objective development sustainable , and facilitate equalization welfare throughout layer society . The discussion highlighted the importance of technology in expanding financial inclusion, especially in remote areas that are difficult to reach by traditional banking systems. Digitalization through fintech platforms and digital wallets has become the main solution in bridging the access gap. However, challenges such as low financial literacy and limited infrastructure remain significant barriers. Many people in developing countries do not yet understand the importance of formal financial services, resulting in low adoption rates. Therefore, financial literacy is a priority agenda to support the success of financial inclusion. In addition, government investment in digital infrastructure and internet networks is needed to reach underserved communities.

policies that prioritize vulnerable groups, such as women and communities in remote areas. Studies show that women often face obstacles in accessing financial services, even though they have a vital role in managing family finances and micro-businesses. Therefore, a more gender-sensitive approach is needed to ensure that financial inclusion can have a greater and more equitable impact. On the other hand, the government needs to strengthen collaboration with financial institutions, fintech, and international organizations to build more effective financial literacy infrastructure and programs. This comprehensive approach will accelerate financial integration as the main foundation in strengthening sustainable economic growth in developing countries.

5. Conclusions

Financial inclusion plays a vital role in driving economic progress in developing countries by opening up opportunities for access to formal financial services. This in turn accelerates the growth of micro, small and medium enterprises (MSMEs), creates employment opportunities, and reduces poverty. Furthermore, financial inclusion helps strengthen economic stability by building a more transparent and accountable financial system, and provides opportunities for people to save and manage risk better. Digitalization, through fintech platforms and digital wallets, is a key factor in expanding the reach of financial inclusion, especially in remote areas.

However, challenges such as low financial literacy, limited infrastructure, and gaps in access for vulnerable groups such as women, still need to be addressed. To ensure that financial inclusion has an equitable impact, adaptive policies, infrastructure investment, and collaboration between governments, the private sector, and international organizations are needed. Financial inclusion can be an important foundation for driving sustainable economies in developing countries.

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