CHAPTER I

INTRODUCTION

1.1 Problem Identification

In the world of economics, trade begins with exchange or known as barter. Barter has several difficulties, such as it is difficult to find people who need each other at the same time and also does not have a clear standard of value. As a result of these weaknesses, the way people transact develops using the payment system. The payment system is divided into commodity money and fiat money.

Commodity money is a goods which has a certain characteristic value that can be accepted by peoples and the quality of goods does not change. In this case in the form of gold and silver. The use of commodity money is more often used because it has a clear value and is easy to control. However, it still has lacks such as high risk to be carried from place to place. In addition, the continuous use of silver will lead to inflation. Because if there is a discovery of silver in large quantities, it will reduce the value of the silver and cause inflation.

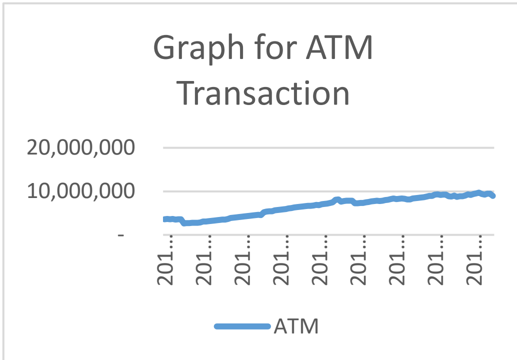
Because economic development is growing rapidly and the production of goods and services is also increasing, the use of gold is deemed unable to meet these needs. Furthermore, the payment system changed to fiat money. Fiat money has no intrinsic value or value in the item. However, the value of fiat money is determined by the government and the central bank. Fiat money is usually in the form of paper money and coins. However, there is also fiat money that has no physical form, namely demand deposit. Demand deposit in the form of checking or savings accounts and also checks that can be exchanged for physical money through a withdrawal slip for a savings book or through an ATM (Automatic Teller Machine).

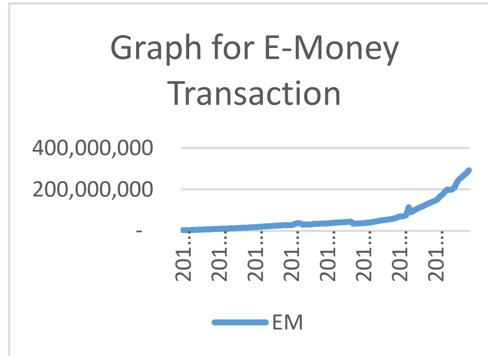
Over time, the payment system has changed as a result of technological developments. This is also known as financial innovation. What is meant by financial innovation is technological advances that have an access to information, trading as a mean of payment, emergence of new financial instruments and services, and more developed and complete financial market (European Central Bank). An example of a financial innovation that is often encountered today is e-money and debit/ credit card. Financial innovation has both positive and negative impacts. The positive impact of using financial innovations is to create a more complete market, increase resource allocation and also support long-term growth prospects. With a faster and easier transaction process, the level of public consumption will increase. The circulation of money accelerates and triggers the development of the real sector. More businesses in the real sector will attract investors. However, the using of financial innovation also gives negative impacts, especially an increase in cybercrime.

The use of financial innovation results in demand for money. If the use of financial innovation such as debit / credit cards and e-money increases, it will affect the money demand for cash. Reducing the money demand for cash will reduce the circulation of counterfeit money, reduce the cost of printing money and also increase economic efficiency. The use of financial innovations has a further effect on monetary policy. The demand for money is an important variable in preparing monetary policy. The demand for money is very important to measure the effect of monetary policy on the economy. The use of financial innovation also results in an unstable demand for money. The instability of money demand will have an impact on real income and interest rates. This will also refer to economic instability where the amount of money in circulation is not in accordance with the availability of goods and services in the community. This will result in drastic increases and decreases in prices and refers to inflation. This is because new products or new intermediaries in financial markets will tend to complicate the distinction between monetary and non-monetary variables.

In Indonesia, the use of financial innovations in the form of debit / credit cards and e-money is already familiar. Data from Bank Indonesia, shows the number of ATM transactions as well as e-money continues to increase every year.

Figure 1ATM Transaction **Figure 2 E-Money Transaction**





From figure 1.1 and figure 1.2, it shows that ATM and E-Money transactions continued to increase every year from 2010-2019. This increase was due to the use of ATMs and e-money which made it easier for consumers to transact. As a result of this convenience, public consumption has increased, further impacting on increased economic growth.

This paper will analyze the effect of financial innovation on money demand for cash with the title “The effect of Financial Innovation to Demand for Money in Indonesia”. The proxy of financial innovation in this paper are e-money transaction and ATM transaction. The meaning of money demand for cash is the real money demand, where the demand for money (M2) is divided by price level. The aim for this research is to know what impact to demand for cash to the emergence of financial innovation. It proves nominally the impact of financial innovation to demand for cash in Indonesia.

1.2 Problem Statement

Based on problem identification that has been described below, this study will focus on the impact of financial innovation to money demand for cash in Indonesia using time period 2010-2019.

1.3 General Research Objectives

Objectives for this research is to determine the effect that financial innovation has on the demand for money in Indonesia.