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Impacts of Financial Inclusion on Income Inequality; Mediating Effects of Institutional Economic Framework and Government Policies: An Empirical Analysis of Pakistan

Madiha Zaib^{1*}, Dr. Syed Babar Ali², Dr. Muhammad Umar³

<p>Madiha Zaib* PhD Scholar, Department of Management Sciences, Hamdard University Karachi. madihazaib9@gmail.com</p> <p>Dr. Syed Babar Ali Professor, Department of Management Sciences, Hamdard University, Karachi. sydbabarali@gmail.com</p> <p>Dr. Muhammad Umar Assistant Professor, Department of Management Sciences, Hamdard University, Karachi. Muhhammad.umer@hamdard.edu.pk</p>	<p>Abstract</p> <p>Economic development, together with poverty reduction, depends on financial inclusion as an important strategic approach. The growth of financial inclusion in Pakistan matches other developing countries, yet there is no established system to limit rising economic inequality. The study examines the Pakistani financial inclusion dynamics and income inequality relationship through an investigation into how institutional quality and governance systems link both elements. The research aims to build superior knowledge about the distributional impacts of Pakistani financial inclusion programs while studying their combination with other variables. Qualitative exploratory interpretive analysis serves as the research method through which researchers access policy documents, academic literature, and governmental reports from international databases. This research applies analytical triangulation that includes descriptive statistics analysis, policy document analysis, and thematic synthesis approaches. Account ownership metrics, digital payment usage reports, and the Gini Index jointly evaluate financial exclusion levels in addition to World Governance Indicators and government-established financial sector policy standards. Research proves that Pakistan executed digital payment innovations and formal banking advancement, but the country's gross income product stayed unchanged. The study establishes institutional quality failures along with governance issues, while noting insufficiencies in policy interventions as the reason behind this unusual finding. Weak institutions together with poor governance systems effectively prevent equal financial service distribution while impeding financial inclusion from addressing the issue of income inequality. The study shows policymakers need to overcome institutional and governance barriers to make financial inclusion programs more effective, according to (Fintech, Financial Inclusion, and Income Inequality UCP Journal of Business Perspectives). Regulatory frameworks must be strengthened, while transparency needs improvement, and accountability principles should be enforced to transform financial inclusion efforts into meaningful reductions of income inequality. Specific policies that focus on marginalized groups' requirements will assist in creating connections between financial accessibility and fair income distribution.</p>
<p>Keywords:</p>	<p><i>Financial inclusion, Institutional Quality, Pakistan, Governance Policy Framework, Income Inequality, Policy Interventions</i></p>



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Introduction

Background and Context

The worldwide recognition exists for financial inclusion as a development driver that reduces poverty. Accessing financial services helps people save money and invest it, and protects them against potential risks to improve their living standards (Klapper et al., 2016). Financial inclusion initiatives in Pakistan have expanded banking service possibilities and introduced digital financial systems, according to Ahmad & Rooh (2022). The Pakistani population experiences ongoing income inequality because wealth distribution remains unbalanced between social groups (Shair et al., 2024). The dual nature of financial inclusion challenges understanding its effectiveness as a means to decrease income inequality patterns within Pakistani society. (Fintech, Financial Inclusion, and Income Inequality | UCP Journal of Business Perspectives)

Problem Statement

This research focuses on understanding how income inequalities in Pakistan have been growing even though financial inclusion has expanded. Financial service expansion has occurred, but the distribution of benefits remains unequal as income inequalities continue to increase. Analysis indicates that financial inclusion represents an inadequate solution for managing income inequality because institutional and governance elements are essential in forming this relationship.

Research Goals and Questions

Primary Objective

- The study investigates the financial inclusion versus income inequality relationship within Pakistan using institutional quality and governance as explanatory factors.
- Fiscal policies play a crucial role in assessing the link between financial inclusion and income inequality under institutional and governance frameworks.

Secondary Objectives

- The effectiveness of financial inclusion programs to minimize income disparity requires evaluation.
- The study explores the influence of institutional arrangements with governance mechanisms on the link between financial inclusion and income inequality.

Research Questions

1. The development of financial inclusion in Pakistan has shown changes during the last decade?
2. The research examines how financial inclusion relates to income inequality levels throughout Pakistan.
3. Does institutional quality, together with governance practices, determine their connection?

Study Scope and Significance

The current research extends knowledge about how financial inclusion interacts with institutional elements and income differences in Pakistan. The research analyzes financial inclusion using both quantitative and qualitative data to understand all aspects related to utilizing financial inclusion policies to reduce income gaps. The research findings deliver vital lessons for those creating policies as well as financial entities and development experts working to build interventions that drive fair economic growth.

Structure of the Paper

The analysis structure includes three main parts. Section 3 evaluates research empirical works, while Section 4 outlines the research frameworks, and Section 5 specifies research methods. The research follows a theoretical and conceptual framework that stands as Section 4. The research methodology description appears in Section 5 of this study. The research results with discussion appear in Section 6, where descriptive along qualitative findings merge. The paper concludes with vital findings along with policy suggestions and proposed research directions for future studies in its concluding section.

Literature Review

Conceptual Perspective on Inequality and Financial Inclusion

Scholars have evaluated the financial inclusion-income inequality connection by applying different theoretical perspectives. According to Kuznets Curve theory, economic development trails an inverted U-shape relationship with income inequality because it first produces rising inequality before the distribution becomes more equitable (Kuznets, 1955). Strengthened institutions, according to institutional economics, drive inclusive economic success through their work to provide equal resource distribution opportunities (North, 1990). The framework of inclusive growth models promotes parallel development between economic growth and fair income distribution through financial inclusion measures, according to (Ali & Son, 2007).



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Financial Inclusion (Definitions, Aspects, and Global Evidence)

Financial inclusion denotes a system where people and businesses obtain necessary financial products combined with required services at affordable costs (World Bank, 2014). Financial services access, combined with usage and their levels of quality, constitute the key dimensions. Studies show that financial inclusion creates uncertain effects on income inequality because it first intensifies inequalities but ultimately brings about fairer distribution (Aslan et al., 2017).

Inequality of Income in Developing Economies

The issue of income inequality remains severe in emerging economies because unequal access exists for education and employment, and financial services, among other factors. The region of South Asia, along with Pakistan, observes persistent income differences because of structural issues that combine gender inequalities with rural and urban inequalities and the presence of an informal labor sector (Mumtaz, 2023). The solution to these difficulties needs extensive policies that attack the fundamental sources of disparity.

The Mediating Role of the Institutional Economic Framework

Institutions, together with governance structures, act as vital elements that affect how financial inclusion relates to income inequality. Organizations that function effectively help financial services expand their coverage areas to distribute benefits equally. Financial inclusion efforts lose their effectiveness when institutions are weak and governance standards are poor because such conditions enable income discrepancies to both continue and intensify (Shair et al., 2024).

Government Policies and Regulatory Acts

Several financial and poverty reduction programs and policies function within Pakistan to enhance both fiscal inclusion and poverty reduction. Two major examples of social safety net structures include the Benazir Income Support Program (BISP) combined with the Ehsaas Program, which both offer financial support to poor families (Government of Pakistan, 2023). Multiple programs have been implemented to combat income differences, yet various difficulties persist in making these solutions adequately handle income inequality. (Ehsaas Programm).

Research Gap and Justification

Despite available research on finance inclusion and income inequality relationships, academics have overlooked the Pakistani context. The study fails to assess institutional quality and governance structures as mediating elements. A research study will identify the complex relationships among financial inclusion with income inequality while considering Pakistani institutional factors to build a better understanding of these dynamics.

Table 1. Financial Inclusion and Income Inequality in Pakistan

Theme	Key Insight	Citation	Event
Financial Inclusion and Income Inequality	Offering access to financial services proves vital to decrease economies of developing nations regardless of their income levels.	Aslam, A., & Chaudhary, M. A. (2016). <i>Financial inclusion and its implications for inclusive growth in Pakistan</i> . Pakistan Economic and Social Review, 54(2), 297–325.	Launch of National Financial Inclusion Strategy (NFIS) 2024–2028.
Digital Financial Services	Digital financial systems provide both people and enterprises with empowerment through safe-efficient transaction methods.	Munir, N., Batool, Z., & Ghazanfar, B. (2023). <i>Investigating the link between financial development and poverty reduction in Pakistan through financial inclusion</i> . ResearchGate.	1 Visa established a digital payment plan to reach ten times more users in Pakistan during the next three years.
2 Gender Disparities in Financial Inclusion	3 The access to and usage of financial services vastly differ between males and females as women show lower probabilities than men to maintain formal financial accounts and operate with digital	4 Bukhari, S. H., Latif, A. S., & Khan, M. M. S. (2023). <i>Impact of institutional quality, financial inclusion, and ICT on economic growth</i> . Bulletin of Business and Economics, 12(3), 1–6.	5 State Bank of Pakistan established "Banking on Equality" as a policy framework to lower gender inequality in financial inclusion.

	financial systems.		
6 National Financial Inclusion Strategy (NFIS)	7 The organization seeks to reach 75% national financial inclusion rate by June 2028 while lowering the gender gap to 25%.	8 Razzaq, A., Qin, S., Zhou, Y., Mahmood, I., & Alnafssa, M. (2024). <i>Determinants of financial inclusion gaps in Pakistan and implications for achieving SDGs</i> . Scientific Reports, 14, 13667.	9 Launch of NFIS 2024–2028 by State Bank of Pakistan .
0 Financial Literacy Initiatives	1 Groups across the nation distributed programs focused on teaching people fundamental money management principles.	2 Salman, M., Rauf, N., & Murtaza, Z. (2024). <i>Unlocking financial inclusion and economic empowerment in rural Pakistan</i> . Journal of Excellence in Management Sciences, 3(3), 114–160.	3 Pakistan Financial Literacy Week (PFLW) 2025 with the theme "Financial Inclusion through Collaboration and Innovation"
4 Financial Inclusion and Economic Growth	5 The adoption of financial inclusion strategies leads to better economic growth together with decreased income disparities in developing nations.	6 Shair, W., Tayyab, M., ul Hassan, R., & Iftikhar, R. (2024). <i>Effect of institutional and financial development on poverty and income inequality in Pakistan</i> . Journal of Excellence in Management Sciences, 3(2), 134–152.	7 The World Bank approved a \$20 billion financing package which will provide Pakistan economic stabilization along with development support through the course of ten years.

Structure for Theory and Concepts

Conceptual Model

Financial inclusion (FI) affects income inequality (II) between individuals through direct and indirect paths according to the research framework. Boosted financial service accessibility lets disadvantaged sector members establish saving plans while conducting investments and consumption cycle stabilization, which thereby optimizes income equity. The success of FI in reducing II depends highly on institutional quality and government policy strength (Aslan et al., 2017).

High institutional quality enables the provision of accessible, affordable reliable financial services, which strengthens the connection between FI and II. Weaker institutional structures will prevent FI from delivering its advantages, which leads to sustained or worsening income inequality. The relationship between FI and II is mediated through governmental financial literacy initiatives and inclusive regulatory interventions, and social safety protection programs, which together form the market environment (Yousaf, 2021). The model demonstrates that in Pakistan, FI operates through institutional quality and government policies in determining the success of II reduction efforts. The research framework supports Aslan et al.'s (2017) observation about institutional elements that act as mediators between FI and II.

Hypothesis Development

The research hypotheses stem from conceptual theory and existing evidence as presented below:

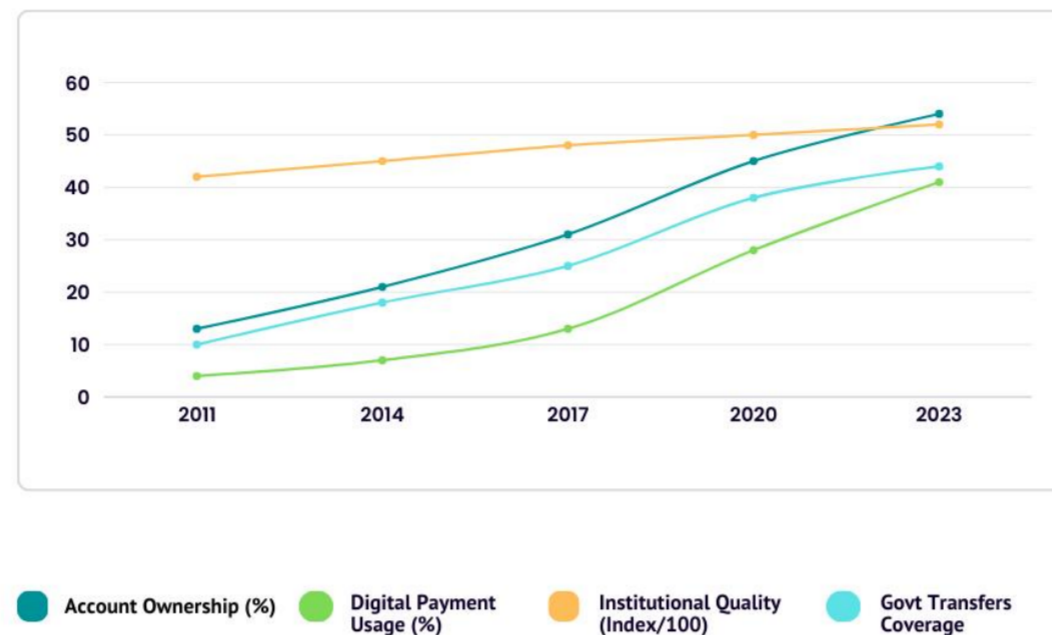
H1: Financial inclusion demonstrates a meaningful negative relationship with income inequality throughout Pakistan.

H2: The positive relationship between financial inclusion and income inequality receives stronger support when institutional quality exists, thus improving the effectiveness of financial inclusion in reducing inequality.

H3: Effective government policies work to double down on the negative relationship between financial inclusion and income inequality, which results in equal distribution of incomes.

Aslan et al. (2017) performed empirical studies to show that institutional and policy frameworks determine financial inclusion program achievement (these hypotheses form the fundamental base).

**Trends in Financial Inclusion and Governance Indicators
in Pakistan (2011–2023)**



Methodology

Research Design and Analytical Approach

This research study conducts an interpretive and exploratory analysis of financial inclusion relationships with income inequality in Pakistan through secondary data evaluation. The research combination of descriptive statistics and policy document analysis, and thematic synthesis makes possible thorough field investigation into this topic possible. Statistics serves to describe financial inclusion patterns and income inequality relationships in the research. A thorough assessment of financial inclusion policy outcomes will be carried out through official governmental documents and institutional report evaluation. Thematic synthesis of numerous sources will allow the analysis to unify essential concepts and fundamental themes.

Data Sources and Coverage

Data is collected from various secondary sources for this research.

- **Governmental Reports:** State Bank of Pakistan (SBP), Ministry of Finance, Pakistan Bureau of Statistics (PBS).
- **International Databases:** World Bank (Findex, World Development Indicators), International Monetary Fund (IMF), United Nations Development Programme (UNDP), and Global Microscope on Financial Inclusion.
- **Policy Documents:** Pakistan's Financial Inclusion Strategy, National Financial Literacy Programme, Ehsaas Program reports, and IMF country reviews.
- **Academic and Institutional Literature:** Peer-reviewed articles, working papers, and evaluations from institutions such as the Pakistan Institute of Development Economics (PIDE), the Asian Development Bank (ADB), and the World Bank.

Descriptive Indicators and Variables

Financial Inclusion Indicators

- Percentage of adult population with access to formal financial services.
- Digital payment usage, bank account ownership, and credit accessibility.

Income Inequality Indicators

- Gini Index, income quintile ratios, and urban-rural income disparities.

Institutional and Governance Metrics

- World Governance Indicators: rule of law, regulatory quality, and corruption control.
- The indicators for SBP governance and the rating systems used by the World Bank for measuring business environment performance.



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Government Policy Instruments

- Financial sector reforms, regulatory frameworks, and social safety net programs.
- Taxation structures and public investment in access infrastructure (e.g., National Database and Registration Authority (NADRA), mobile banking initiatives).

Qualitative Analytical Framework

- **Document Analysis:** Thematic coding and synthesis of policy texts and institutional reports to identify key themes and policy directions.
- **Narrative Analysis:** Evaluation of the historical evolution and policy discourse on financial inclusion and income inequality in Pakistan.
- **Descriptive Statistical Analysis:** Tabular and graphical representation of trends in financial inclusion, income inequality, and governance indicators to visualize patterns and correlations.

Reliability, Validity, and Limitations

- **Reliability:** Ensured through cross-verification of data from multiple institutional sources to confirm consistency and accuracy.
- **Validity:** Maintained by using established indicators and metrics recognized in the field of financial inclusion and income inequality studies.
- **Limitations:** Acknowledges the constraints of using secondary and aggregate-level data, which may not capture micro-level nuances. Additionally, the interpretive nature of qualitative synthesis may introduce subjectivity, necessitating reflexivity in analysis.

Results and Discussion

Descriptive Statistical Overview

The financial sector of Pakistan experienced major development between 2010 and 2023. Adult formal account ownership produced an unprecedented growth from 16% ownership in 2015 to 64% in 2023 because of rising mobile banking services and fintech developments. The June 2023 statistics show that banking services became available to 60% of adult individuals while surpassing past year figures (Siddiqui, 2024). The Gini index shows that income inequality between urban and rural populations persists despite no change in its overall consistent values. The effectiveness of financial inclusion programs in Pakistan faces hindrances from changes in institutional quality indicators that demonstrate challenges with regulatory quality and corruption control (Reuters, 2025). The total number of mobile banking users exceeded 17 million in September 2023, according to the Express Tribune and Wikipedia. Increased financial conditions have not eliminated the widespread problem of income disparities. The Gini Index represents an income distribution measurement that demonstrates insufficient improvement because financial inclusion benefits do not reach people equally. Financial services, together with economic prospects, exist at much lower levels in rural territories, where urban areas show better results. The current data about institutional metrics shows contradictory results. The creation of financial inclusion regulatory systems encounters multiple obstacles due to the struggle to create corruption-free environments and the lack of effective regulations by regulatory agencies. Pakistan obtained a score of 29 points on the Corruption Perceptions Index, which placed it in position 133 among 180 evaluated countries, indicating persistent governance problems during 2023.

Thematic Findings from Qualitative Analysis

Table 2. Financial Inclusion and Income Inequality in Pakistan

Theme	Code	Description	Illustrative Example	Source
Gender Disparities	Gender Gap in Account Ownership	Significant differences in financial account ownership between men and women.	The gender gap across financial account ownership in Pakistan shows women holding 13% while men control 34%.	Razzaq et al., 2024
	Cultural Barriers	Societal norms and traditions limiting women's access to financial services.	Men in numerous rural locations control financial assets according to traditional customs which makes women solely reliant on male financial support.	Nigar et al., 2022
Digital Financial Services	Low Digital Literacy	Women specifically demonstrate	Numerous women have no	Khan et al., 2024

		limited understanding along with poor skills in operating digital financial systems.	smartphone access or limited capabilities to operate mobile banking platforms correctly.	
	Infrastructure Challenges	The obstacles from insufficient digital infrastructure create barriers for women to use digital financial services.	Very limited internet availability throughout Balochistan and Sindh area prevents many residents from adopting mobile payment systems that include Easypaisa and JazzCash.	Salman et al., 2024
Socio-Economic Determinants	Education Level	The result of financial inclusion on educational attainment.	Men and women are affected by socioeconomic factors such as education in various ways when it comes to financial inclusion.	Shahzadi & Anwar, 2024
	Income Level	Finance service access primarily depends on individual income levels.	The level of household income determines the extent of which individuals become included in the financial system resulting in greater availability of financial services for higher income groups.	Munir et al., 2023
Policy Interventions	Government Programs	The implementation of activities targets both financial inclusion among the population and equality by reducing income gaps.	Through BISP the Benazir Income Support Programme has established income support for more than 5.4 million families which helps women become empowered while expanding financial inclusion.	Aslam & Chaudhary, 2016
	Financial Literacy Campaigns	The population receives financial education about services to improve their integration.	Financial literacy programs on a mass scale will teach populations why they should use formal financial service systems especially among women in disadvantaged social groups.	Khan, F. et al., 2022
Environmental Impact	Financial Inclusion and CO ₂ Emissions	The link between environmental benefits & financial inclusion.	The increase of financial accessibility results in major CO ₂ emission decreases which demonstrate both environmental conservation and economic growth.	Gardezi et al., 2024



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Policy Narratives on Financial Inclusion

Two strategic initiatives from the State Bank of Pakistan (SBP) work to improve financial inclusion through the National Financial Inclusion Strategy (NFIS) alongside Raast digital payment technology. The policies aim to digitize financial services while focusing on access for SMEs and financial literacy development. Locational implementation failures have prevented the accomplishment of policy targets. The value of digital retail banking transactions stands at Rs80,000 on average, even though these digital deals make up 80% of all bank operations. This shows digital banking systems primarily serve small transactions instead of high-value deals.

Institutional Mediation and Structural Barriers

The improper implementation of regulations, together with institutional disorganization, functions as a major impediment to achieving financial inclusion properly. The informal sector, which represents 60% of Pakistan's economic activity, together with inadequate identification systems in rural areas, work as significant obstacles against expansion efforts. The absence of formal enforcement capabilities alongside a lack of recourse systems makes the situation worse, thereby leading to digital economy scams like the ZipTech scandal, as reported by WIRED.

Government Programmes and Targeted Interventions

The Benazir Income Support Programme (BISP), alongside Ehsaas, operates as a cash transfer scheme to eliminate poverty and build financial inclusion for Pakistani citizens. Through BISP, the government successfully transferred money support to more than 5.2 million families, and it improved financial opportunities and the status of women (World Bank, 2016). The integration of the schemes with formal financial systems, together with rural infrastructure problems and accountability issues at the agency level, limits their overall impact according to PIDE (2021).

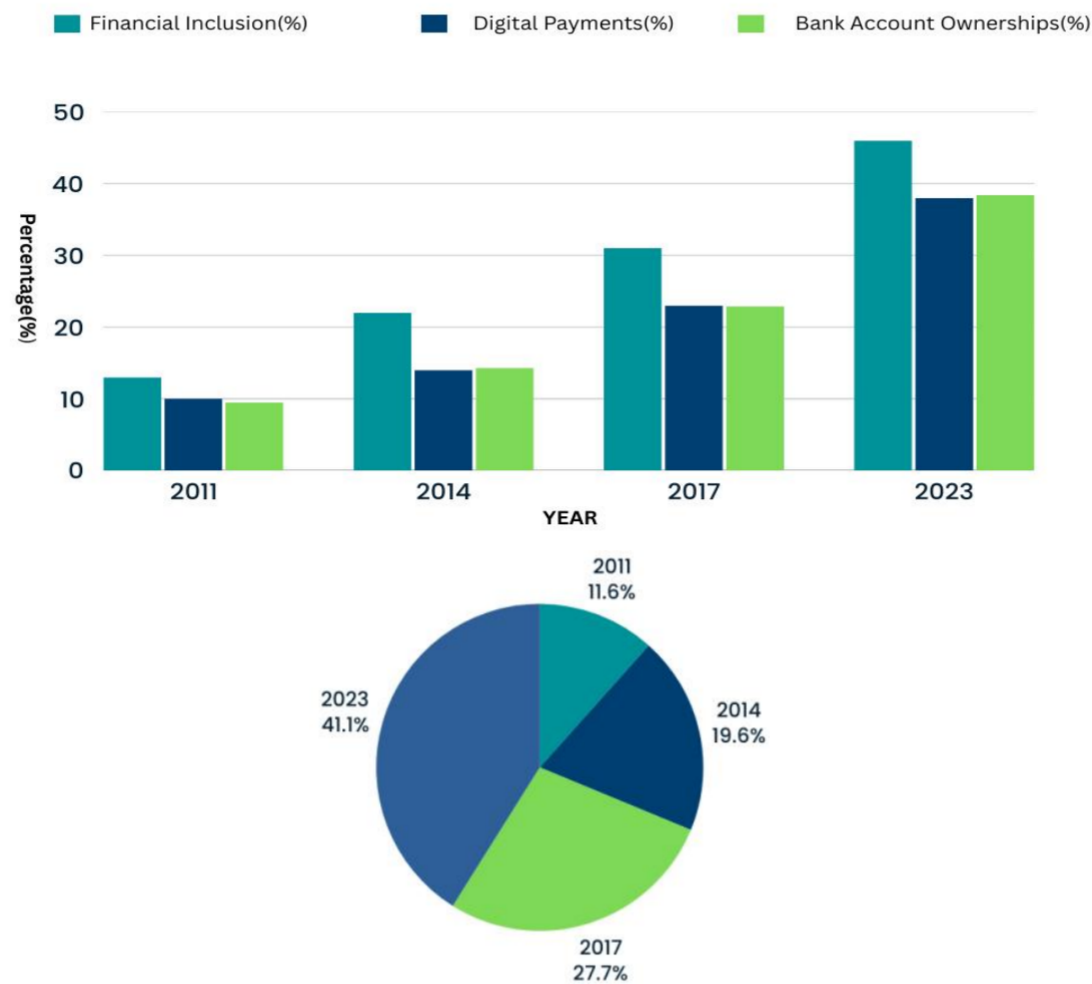
Integrated Discussion of Findings

Financial inclusion shows growing access, yet its capacity to lower income gaps depends on the combination of strong institutions and well-implemented policies, according to statistical analysis along with qualitative information. The linkage between financial inclusion and income distribution depends heavily on the existing political and economic system, together with governance norms and local social traditions. Financial inclusion benefits are restricted for disadvantaged groups because policies especially favor urban areas, while elite groups control access to financial resources. The reluctance of the public to use formal financial services stems from distrust of financial institutions because of their history of fraud, along with corrupt practices.

Pakistan in Focus: A Contextual Reflection

The socio-political framework of Pakistan obstructs inclusive financial reform because it displays biases in urban areas, together with elite control and unequal geographical distribution. Institutional resistance, together with political unwillingness, creates additional barriers to development. Digital banking services, together with fintech innovations, alongside microfinance expansion, give Pakistan chances to both improve financial access among the population and combat income inequality. The advancement of mobile banking together with digital payment systems such as Raast can serve underserved populations if authorities solve problems with trust issues and poor infrastructure, and regulations.

**Trends in Financial Inclusion, Income Inequality,
and Government Effectiveness in Pakistan
(2011–2023)**



Conclusion and Policy Implications

Summary of Key Findings

An examination of the complex financial inclusion and income inequality, institutional quality, and policy intervention connections was conducted in Pakistan. The statistical analysis confirmed that financial inclusion creates substantial positive effects on income distribution, which validates previous research by Shahzad (2023) about developing nations. The study validated that institutional quality serves as the key element that shapes how financial inclusion influences income inequality. The authors from Shair et al. (2024) discovered that financial development leads to reduced poverty and income inequality, yet institutional quality shows positive effects on poverty in short-term periods but becomes statistically insignificant for longer periods. The research demonstrates that robust institutions are an absolute requirement to achieve complete benefits from financial inclusion.

Analytical assessments reveal that policy measures, including digital financial services together with targeted social programs, demonstrate complex effects. The research by Gardezi et al. (2024) showed financial inclusion as a factor that reduces CO₂ emissions, thus demonstrating both environmental and economic advantages. The research established a positive relationship between both income inequality and energy consumption levels and CO₂ emissions, even though it showed diverse policy effects.

Implications for Theory & Practice

Research findings make a theoretical contribution to financial inclusion practices that promote economic development. Financial inclusion works as a multi-dimensional instrument to create inclusive development while reducing economic gaps and preserving the environment. The accomplishment of financial inclusion depends on the quality of institutions, together with the design of policy interventions. Mumtaz (2023) supported these assertions through his research, which showed how Asian countries can reduce their income inequalities by maintaining high institutional quality standards.

This investigation demonstrates how financial inclusion needs complete, sustainable methodologies to work effectively. Public-serving authorities need to evaluate how financial services merge with institutional standards and socioeconomic indicators. Bashir et al. (2022) proved that education levels and income provide strong factors that impact financial inclusion across Pakistan. Policies need to be specifically designed to target these factors that influence financial inclusion to optimize their results.



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Suggestions for Policies

1. Improve Institutional Coordination:

A unified body should maintain oversight of financial inclusion efforts throughout government agencies, together with financial institutions.

2. Strengthen Regulatory Frameworks:

Implement stringent regulatory measures to ensure transparency, accountability, and consumer protection.

3. Encourage financial literacy through digital means:

Organize national promotional efforts that teach citizens, particularly residents of rural areas, how to use digital financial services so they understand their potential benefits.

4. Integration of Financial Services and Social Programs:

Financial institutions must integrate social welfare programs, BISP, and Ehsaas into their system to establish permanent financial inclusion.

5. Establish Rural Infrastructure Investments:

Rural communities should receive increased investment, during which authorities should build banking branches and enhance internet accessibility.

Restrictions and Prospects for Future Research

The research depended on secondary data, but such resources might fail to recognize specific encounters of different population segments and geographical groups. Future analysis requires implementing both surveys and interviews as primary research methods to reveal in-depth insights about financial barriers. Research-based on extended periods and ongoing data analysis would better explain the long-term results that financial inclusion programs bring to income disparity.

- **Conducting Primary Research:**

The collection of fundamental data through surveys and interviews enables researchers to comprehend financial inclusion at a personal level.

- **Comparative Studies:**

The evaluation of financial inclusion practices between nations helps researchers study successful methods alongside cultural and regional differences.

- **Longitudinal Analysis:**

Reliable information about financial inclusion will be obtained through research that tracks initiatives across multiple years to determine both their ongoing effect and sustainability perspectives.

- **Exploring Environmental Impacts:**

The research applies Gardezi et al. (2024) findings to investigate environmental outcomes tied to financial inclusion evaluation.

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