

# The Impact of China's Digital Financial Inclusion on Urban-Rural Income Gap: Evidence from Panel Data Analysis

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**Abstract.** Using panel data from 2016 to 2020, this empirical study examines how the urban-rural residents' income divide in China is affected by digital financial inclusion. This paper investigates the association between the digital universal financial inclusion and the Thiel index, which gauges the income disparity in 31 provinces, using Stata16 software and a two-way fixed effects model. In this framework, this paper also look at the mediating role played by economic progress. The findings show that closing the income gap is significantly and favorably impacted by digital financial inclusion. In addition, this research discover that the per capita GDP of each area and the average amounts of years of schooling of the population over the age of 15 serve as significant mediating variables between digital financial inclusion and the income gap, although the urbanization rate does not. These results highlight the critical role that digital financial inclusion plays in encouraging inclusive growth, promoting balanced economic development, and minimizing regional differences in China.

**Keywords:** Financial Inclusion, China, Income gap.

## 1. Introduction

In today's world, nations worldwide share fundamental goals of achieving economic development and combating poverty. A crucial aspect of this endeavor is financial inclusion, which involves providing accessible financial services to individuals and businesses, especially those historically excluded from formal financial systems [1]. This approach holds the potential to foster inclusive growth, address economic disparities, and promote social harmony and sustainable progress.

Financial inclusion plays a pivotal role in fostering economic development and combating poverty on a global scale. It aims to provide all individuals and businesses with access to crucial financial services [2]. By ensuring such access, financial inclusion empowers people to actively participate in economic activities, thus stimulating growth and promoting more equitable wealth distribution.

China, being a rapidly growing economy, has witnessed remarkable urbanization and industrialization over the past few decades. These transformations have undeniably led to significant economic disparities between thriving urban centers and underdeveloped rural regions [3]. It is essential for the country's progress to address this income disparity and work towards creating social cohesion and stability.

A major challenge in achieving this goal lies in the exclusion of millions of people in rural areas from formal financial services. Without access to these essential financial tools, their economic potential remains untapped, impeding the overall progress of the nation. To overcome this obstacle and ensure inclusive growth, the Chinese government has made financial inclusion a top priority.

The government's focus on expanding financial services to rural populations aims to empower these underserved communities and uplift their economic well-being [4]. By granting them access to savings mechanisms, credit options, insurance coverage, and convenient digital payment platforms, rural residents can actively engage in economic opportunities, leading to enhanced growth prospects [5].

In our quest to narrow the income gap and create a more equitable society, one promising solution has gained significant traction - digital financial inclusion. With the rapid advancement of technology and the widespread adoption of digital platforms, financial inclusion has undergone a transformation, integrating digital technologies into financial services to enhance accessibility, affordability, and convenience for individuals in both urban and rural areas [6]. This transformative approach encompasses a wide range of offerings, such as mobile banking, digital payments, online lending, and other innovative financial products, now effectively reaching populations that were previously underserved [7].

## 2. Model Construction and Variable Selection

### 2.1. Model Construction

The stata16 program is used in this research to conduct an empirical analysis of the data. According to Bootstrap's Hausman test, it rejected the null hypothesis at the 1% level, i.e., did not use a random-effects model, so this paper used a fixed-effect model for regression analysis. As can be observed from the data, the urban-rural income disparity between China's provinces and cities would alter over time and between individuals, leading to the selection of the two-way fixed effect.

To investigate the direct effect of digital financial inclusion development on closing the income gap, the model is built as follows:

$$Inc_{it}=a_1+\beta_1Fin_{it}+c_2\sum_{t=2}^T\theta tDt+v_2+\mu_2+\varepsilon_1 \quad (1)$$

The following is the construction of the panel model to study the mediating role of economic growth in the process of closing the income gap between urban and rural areas:

$$Eco=a_2+\beta_2Fin_{it}+c_2\sum_{t=2}^T\theta tDt+v_2+\mu_2+\varepsilon_2 \quad (2)$$

$$Inc_{it}=a_3+\beta_3Eco+\beta_3Fin_{it}+c_3\sum_{t=2}^T\theta tDt+v_3+\mu_3+\varepsilon_3 \quad (3)$$

In the above formula, the subscripts *i* and *t* represent the relevant indicators of the provinces in the western region (2015-2020), respectively, and *Fin* refers to the digital inclusive financial development variable, which is the core explanatory variable of the above three formulas; *Eco* refers to the economic development variable, which is the explanatory variable of equation (2), the core explanatory variable of equation (3), *Dt* is a series of control variables that have a large impact on the explanatory variable,  $\alpha_1$  to  $\alpha_3$  is the intercept term,  $\beta_1$  to  $\beta_3$ ,  $c_2$  to  $c_3$  is the coefficient to be estimated,  $\theta$  is each control variable's corresponding coefficient vector, while  $v_t$  describes the time fixed effect,  $\mu_i$  describes the individual fixed effect, while  $\varepsilon_{it}$  is the random perturbation term, (*i, t, it*=1,2,3).

### 2.2. Data Description and Data Selection

#### 2.2.1 Introduction

To accurately analyze how the development of digital financial inclusion affects the urban-rural income gap in various provinces in China, this paper consults the data between 2016 and 2020 to conduct a regression analysis of the digital universal financial index development index and income gap data of 31 provinces in China, so as to empirically test the impact of financial development on urban-rural income gap and the magnitude of its impact.

#### 2.2.2 Metrics

The urban-rural income gap indicator (*Inc*) is an explanatory variable, and the main selection of urban-rural residents' income gap indicators is as follows. Wan Guanghua mainly applied the Thiel index to analyze this variable. In order to better reflect the differences between the western region and other regions and within the western region [8]. This study primarily employs the Thiel index, which is defined as the logarithmically weighted sum of the ratio of income share to population share

of each region, with income share serving as the weight, to quantify the income disparity in different areas.

$$T = \sum \left( \frac{I}{I_i} \times \log \left( \frac{I/I_i}{P/P_i} \right) \right) \quad (4)$$

In equation (4), P is the total population and P<sub>i</sub> is the population of region I; I is the total income and I<sub>i</sub> is the income of the region i. T is the Thiel index.

This study primarily employs the Thiel index, which is defined as the logarithmically weighted sum of the ratio of income share to population share of each region, with income share serving as the weight, to quantify the income disparity between urban and rural populations.

Economic development level (Eco) is an explanatory variable and a core explanatory variable, and this paper mainly selects the per capita gross domestic product (GDP) of each province in China to measure the level of economic development.

The ratio of the urban permanent population to the overall population is primarily employed in this paper as the proxy variable for the urbanization level (Ur) control variable that Lu Ming and Chen Zhao used [9].

Education level (EDU) control variable, this paper mainly uses the average amount of years of schooling of the population aged 15 years and above in each region to measure the level of education. According to the current school system, the number of years of education per capita is calculated based on the maximum number of years of education that an individual has received, and the specific formula is: average number of years of education = (total population over 15 years old / (number of illiterate individuals \* 0 + number of primary school graduates \* 6 + number of junior high school graduates \* 9 + number of high school and technical secondary school graduates \* 12 + number of people with a college degree or higher \* 16)) [10].

### 3. Results and Analysis

#### 3.1. Regression

The regression data of the Thiel Index and the regional universal digital financial inclusion index were used to further investigate the factors influencing the urban-rural income divide., the people's average amount of years of education over the age of 15 in each region, the per capita GDP of each region and the urbanization rate of each region from 2016 to 2020 were selected. The results are show in Table 1.

**Table 1** Regression result 1

| Theil Index | Coefficient | Standard Error | Time  | P> t  | [95% Confidence. Interval] |
|-------------|-------------|----------------|-------|-------|----------------------------|
| x1          | -0.021      | 0.012          | 1.74  | 0.089 | -0.003                     |
| x2          | 0.006       | 0.017          | 0.38  | 0.703 | -0.027                     |
| x3          | 0.020       | 0.019          | 1.03  | 0.310 | -0.019                     |
| x4          | -0.098      | 0.065          | -1.51 | 0.137 | -0.229                     |

Note: y is the Thiel Index, x1 is the Digital financial Inclusion Index, x2 is the people's average amount of years of education over the age of 15 in each region, x3 is the per capita GDP of each region, x4 is the urbanization rate of each region

The above regression data shows that the digital universal financial index has a significant effect on the Thiel Index, while the other three variables, the people's average amount of years of education over the age of 15 in each region, the per capita GDP of each region and the urbanization rate of each region, have no significant impact on the Thiel Index. Further investigation reveals that the beta value of the digital universal financial index and the Thiel Index is 0.021, implying that every 100 percentage points increased digital financial inclusion has the potential to lower the Thiel index by 2.1 percentage points. The digital universal financial index has a considerable effect on the income

disparity of different areas, demonstrating that digital universal financial inclusion can minimize the income disparity between rural and urban residents, promote the relatively balanced economic development of various regions, and reduce the detrimental influence of geographical differences on economic development.

In recent years, the effect of digital universal finance on the discrepancy in different areas has steadily grown. The regression results of rural and urban residents' income from 2016 to 2020 are shown in Table 2.

**Table 2** Regression result 2

| Year | Coefficient | Standard Error | Time  | P> t  | [95% Confidence Interval] |
|------|-------------|----------------|-------|-------|---------------------------|
| 2016 | -0.006      | 0.002          | -2.51 | 0.015 | -0.010                    |
| 2017 | -0.006      | 0.004          | -1.52 | 0.135 | -0.014                    |
| 2018 | -0.013      | 0.006          | -2.30 | 0.026 | -0.024                    |
| 2019 | -0.014      | 0.007          | -2.01 | 0.050 | -0.028                    |
| 2020 | -0.027      | 0.009          | -3.00 | 0.004 | -0.046                    |

It can be seen from Table 2 that the Thiel index gradually changed from -0.006 in 2016 to -0.027 in 2020. This indicates that every 100 percentage points increased digital universal financial inclusion has the potential to lower the Thiel index by 0.6 percentage points, and gradually decrease by 2.7 percentage points, indicating that digital universal inclusive finance has a good momentum of development in recent years, and its influence on closing the income gap in different communities is progressively becoming considerable. As can be observed, China has continued to prioritize the development of digital universal inclusive finance and the enhancement of inclusive finance for citizens' income in recent years, and gradually promote the balanced development of various regions, and finally achieve common prosperity. In the field of comprehensive poverty alleviation, the targeted poverty alleviation loans of inclusive finance have supported more than 90 million people, playing a positive role in comprehensively winning the battle against poverty as scheduled, and basically completing the construction of an inclusive financial service system consistent with the construction of a moderately successful society in all ways. It is easier for small and micro firms and other entities to acquire finance support through internet channels, and the overall financing cost has been decreasing.

Simultaneously, digital financial inclusion can encourage the comparatively backward parts of the economy, thereby closing the income gap of different areas. The following table 3 is produced from the regression data of the Theil index of 11 provinces in eastern and northern China in 2020:

**Table 3** Regression result 3

| Pro                              | Coefficient | Standard Error | Time  | P> t  | [95% Confidence Interval] |
|----------------------------------|-------------|----------------|-------|-------|---------------------------|
| Tianjin City                     | 0.003       | 0.012          | 0.27  | 0.786 | -0.021                    |
| Hebei Province                   | -0.017      | 0.004          | -4.70 | 0.000 | -0.024                    |
| Shanxi Province                  | -0.009      | 0.009          | -1.10 | 0.276 | -0.027                    |
| Inner Mongolia Autonomous Region | 0.049       | 0.013          | 3.79  | 0.000 | 0.023                     |
| Liaoning Province                | 0.043       | 0.013          | 3.34  | 0.002 | 0.017                     |
| Jilin Province                   | 0.018       | 0.023          | 0.79  | 0.431 | -0.028                    |
| Heilongjiang Province            | 0.017       | 0.004          | 4.38  | 0.000 | 0.009                     |
| Shanghai City                    | -0.051      | 0.016          | 3.28  | 0.002 | 0.020                     |
| Jiangsu Province                 | -0.019      | 0.009          | 2.11  | 0.039 | 0.001                     |
| Zhejiang Province                | -0.002      | 0.005          | -0.39 | 0.701 | -0.013                    |
| Anhui Province                   | 0.005       | 0.009          | 0.57  | 0.574 | -0.013                    |

Through the above data, it is found that in the eastern coastal areas of China, digital financial services have the potential to narrow the income gap between different communities. For example, in Hebei Province, the regression value beta of the Thiel Index in 2020 is 0.017, indicating that every 100 percentage points increased digital universal financial inclusion has the potential to lower the Thiel index by 1.7 percentage points. In Shanghai and Zhejiang province, the Thiel index fell even more. Shanghai's 2020 Thiel Index fell 5.1 percent. This demonstrates that digital financial inclusion is fast expanding in eastern China and has a substantial influence on closing the urban-rural income divide. The eastern region will benefit greatly from digital inclusive financing. For example, digital universal inclusive finance can use the Internet's ease to develop quickly, accelerate development efficiency, and ensure the balanced and stable development of all regions.

### 3.2. Intermediary Effect

To demonstrate that digital universal financial inclusion has a major influence on closing the wealth disparity between urban and rural locations, this paper will use the intermediary effect to further prove the relationship between the two variables. When analyzing the influence of two variables, the mediating effect denotes whether the influence of X on Y is influenced first by the mediating variable M. That is, whether there is a connection such as  $X \rightarrow M \rightarrow Y$ , if there is, it implies that there is a mediating effect. This paper will prove one by one the relationship between the intermediary variables x2, the people's average amount of years of education over the age of 15 in each region; x3, the per capita GDP of each region; x4, the relationship between the urbanization rate of each region and x1 digital universal inclusive finance, and the relationship between the above three intermediary variables and urban and rural income. The above test process will be broken down into three steps: the first step is to find the regression data between x1 digital universal financial Inclusion Index and Thiel Index; the second step is to find x1 digital universal financial inclusion Index and the intermediary variable x2, respectively, the people's average amount of years of education over the age of 15 in each region; x3, per capita GDP of each region; x4, urbanization rate of each region's regression data to the Thiel Index. The third step is the correlation between x1 digital universal financial inclusive Index and the intermediary variable x2, the people's average amount of years of education over the age of 15 in each region, x3 is the per capita GDP of each region, and x4 is the regression data of the urbanization rate of each region. Table 4 shows the regression data for the intermediary variable x2 for the people's average amount of years of schooling over the age of 15 in each location.

**Table 4** Regression result 4

| Panel A: Regression data from the step 1 |             |                |       |       |                           |
|------------------------------------------|-------------|----------------|-------|-------|---------------------------|
| Theil Index                              | Coefficient | Standard Error | Time  | P> t  | [95% Confidence Interval] |
| x1                                       | 0.019       | 0.004          | 4.20  | 0.014 | 0.006                     |
| x3                                       | 0.047       | 0.021          | 2.22  | 0.091 | -0.012                    |
| x4                                       | 0.093       | 0.057          | 1.62  | 0.180 | -0.066                    |
| Panel B: Regression data from the step 2 |             |                |       |       |                           |
| x1                                       | -0.021      | 0.012          | 1.74  | 0.089 | -0.003                    |
| x2                                       | 0.006       | 0.017          | 0.38  | 0.703 | -0.027                    |
| x3                                       | 0.020       | 0.019          | 1.03  | 0.310 | -0.019                    |
| x4                                       | -0.098      | 0.065          | -1.51 | 0.137 | -0.229                    |
| Panel C: Regression data from the step 3 |             |                |       |       |                           |
| x1                                       | -0.230      | 0.042          | -5.46 | 0.005 | -0.348                    |
| x2                                       | 0.194       | 0.124          | 1.56  | 0.193 | -0.151                    |
| x3                                       | 0.683       | 0.542          | 1.26  | 0.276 | -0.823                    |

From the above data, it can be seen that every 100 percentage points increased digital financial inclusion has the potential to lower the Thiel index by 2.1 percentage points, which demonstrates that

the variable x1 digital financial inclusion index has a considerable influence on it. Then, the beta value of x1 digital financial inclusion and x2 average years of education of population over 15 years old in each region is analyzed, and the beta value of x1 digital financial inclusion and x2 people's average amount of years of education over 15 years old in every region is analyzed. The analysis shows that beta value a is negatively correlated, that is, every 100 percentage points increased digital financial inclusion has the potential to lower the average number of years of education of the people over the age of 15 by 2.3 percentage points, while beta value b is positively correlated, indicating that there is no obvious relationship between the two. After Sobel test, the result is significant, so x2, the people's average amount of years of education above 15 years old, is the intermediary variable.

The regression data of per capita GDP of each region of the intermediary variable x3 are shown in Table 5

**Table 5** Regression result 5.

| Panel A: Regression data from the step 1 |             |                |       |       |                           |
|------------------------------------------|-------------|----------------|-------|-------|---------------------------|
| Theil Index                              | Coefficient | Standard Error | Time  | P> t  | [95% Confidence Interval] |
| x1                                       | -0.014      | 0.020          | 7.28  | 0.000 | 0.098                     |
| x2                                       | -0.011      | 0.049          | -0.23 | 0.821 | -0.124                    |
| x3                                       | -0.351      | 0.074          | -4.76 | 0.001 | -0.522                    |
| Panel B: Regression data from the step 2 |             |                |       |       |                           |
| x1                                       | -0.063      | 0.019          | 3.32  | 0.009 | 0.020                     |
| x2                                       | 0.087       | 0.049          | 1.77  | 0.110 | -0.024                    |
| x3                                       | -0.064      | 0.013          | -5.05 | 0.001 | -0.093                    |
| x4                                       | -0.311      | 0.039          | -7.92 | 0.000 | -0.222                    |
| Panel C: Regression data from the step 3 |             |                |       |       |                           |
| x1                                       | 0.489       | 0.112          | 4.37  | 0.002 | 0.231                     |
| x2                                       | 0.224       | 0.103          | 2.18  | 0.061 | -0.013                    |
| x4                                       | 0.655       | 0.236          | 2.78  | 0.024 | 0.112                     |

The above data show that in the absence of the mediating variable x3, the per capita GDP of each region, the beta value of x1 digital financial inclusion and Thiel Index is -0.0143, that is, every 100 percentage points increased digital financial inclusion has the potential to lower the Thiel index by 1.43 percentage points. When the intermediate variable x3 is added to the GDP per capita of each region, the beta value of x1 digital inclusion index and Thiel Index is -0.063, that is, every 100 percentage points increase in digital inclusion finance, the Thiel index will decline by 6.3 percentage points. The beta value of x1 digital inclusive finance and x3 GDP per capita of each community is 0.489, that is, every 100 percentage points increase in GDP per capita of each region will increase by 4.89 percentage points. It further shows that per capita GDP can enable the effective development of digital universal inclusive finance, and more people are willing to accept the convenience and welfare brought by digital inclusive finance. Therefore, x3 per capita GDP of each region is an intermediate variable.

The regression data of the intermediary variable x4 urbanization rate in each region are in Table 6.

**Table 6** Regression result 6

| Panel A: Regression data from the step 1 |             |                |       |       |                           |
|------------------------------------------|-------------|----------------|-------|-------|---------------------------|
| Theil Index                              | Coefficient | Standard Error | Time  | P> t  | [95% Confidence Interval] |
| x1                                       | -0.177      | 0.032          | 5.45  | 0.001 | 0.102                     |
| x2                                       | -0.002      | 0.058          | -0.04 | 0.973 | -0.135                    |
| x3                                       | -0.110      | 0.022          | -5.03 | 0.001 | -0.160                    |
| Panel B: Regression data from the step 2 |             |                |       |       |                           |
| x1                                       | -0.063      | 0.019          | 3.32  | 0.009 | 0.020                     |
| x2                                       | 0.087       | 0.049          | 1.77  | 0.110 | -0.024                    |
| x3                                       | -0.064      | 0.013          | -5.05 | 0.001 | -0.093                    |
| x4                                       | -0.311      | 0.039          | -7.92 | 0.000 | -0.399                    |
| Panel C: Regression data from the step 3 |             |                |       |       |                           |
| x1                                       | 0.278       | 0.174          | 1.60  | 0.148 | -0.123                    |
| x2                                       | 0.016       | 0.105          | 0.15  | 0.885 | -0.227                    |
| x3                                       | 0.090       | 0.022          | 4.18  | 0.003 | 0.040                     |

According to the above data, in the absence of the intermediary variable x4, the urbanization rate of various regions, every 100 percentage points increase of x1 digital inclusive index will decrease the Thiel index by 17.7 percentage points. After adding the urbanization rate of each region of the intermediary variable x4, the beta value of x1 digital universal financial inclusion index and Thiel Index is -0.063, that is, every 100 percentage points increase of the digital universal financial inclusion index, the Thiel index will decline by 6.3 percentage points, which indicates that the urbanization rate of each city in x4 has a negative impact on digital financial inclusion, so x4 is not an intermediary variable.

## 4. Conclusion

This paper investigated the effect of digital financial inclusion on the income gap between urban and rural China using a two-way fixed effects model. The data this paper acquired made it clearer how economic inequalities and digital financial inclusion are related.

Our findings indisputably demonstrate that achieving digital financial inclusion is crucial to bridging the income gap in different communities. When the index measuring digital financial inclusion rises by 100 percentage points, this paper discovered that the Thiel index, which measures income inequality, falls by around 2.1 percentage points. This fascinating finding highlights how digital financial inclusion can promote social cohesiveness and more equal economic growth.

This paper also examined the possibility that economic development may serve as a moderating factor in the link between income inequality between different areas and digital financial inclusion. It turns out that the per capita GDP is a crucial intermediate variable. Growth in the economy creates a more balanced economy and reduces regional disparities as digital financial inclusion rises.

This paper also evaluated additional mediators, such as average education levels and urbanization rates, while investigating numerous factors that can potentially have an impact on inclusive growth. Their precise effect on the method for promoting inclusive growth as a whole is still unknown. However, it is critical to recognize the role that urbanization and education play in fostering economic growth and reducing wealth gaps. There is undoubtedly need for more in-depth research.

The advantages of digital financial inclusion are particularly clear along the eastern coast, where the growth of this industry has significantly narrowed the income gap in different areas. This emphasizes how important it is to encourage digital financial inclusion in order to boost economic growth in underdeveloped areas.

Because of this, our research makes it abundantly evident how crucial digital financial inclusion is for fostering equitable economic growth and bridging the income gap between urban and rural China. Policymakers must grasp the enormous potential of technology and use it to their advantage

to make sure that individuals from all walks of life can easily access financial services. Undoubtedly, this united effort will help create a more equitable and successful country for all. Due consideration should be given to enhancing urbanization, education, and overall economic development while maintaining the focus on boosting financial inclusion. By including these crucial components, this research can enhance the advantages of digital financial inclusion and proceed steadily toward China's ultimate aim of sustainable development and societal harmony, which will benefit all of its residents.

## Authors Contribution

All the authors contributed equally, and their names were listed in alphabetical order.

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