

All Rivers Run into Sea: How Inclusive Finance Affect Local Stability? A Global Empirical Perspective

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Abstract. This study uses two-way fixed effect models to investigate the role of inclusive finance in enhancing local stability and apply generalized method of moments (GMM) estimations and synthetic control methods to overcome the endogeneity issue. Based on global terrorism index from 2011-2021, the empirical results show the following: (1) IF can significantly enhance local stability and has the greatest effect in middle-quantile countries. (2) The mechanism behind this effect is improving income equality and women participation and reducing poverty and unemployment rate through IF. In light of the findings, policy-makers can implement inclusive finance polices to achieve the goal of local stability. They should expand financial accessibility, take into account the significant opportunities for developing countries and the importance of equality across gender and income level.

Keywords: Inclusive Finance; Local Stability; GMM; Synthetic Control Methods.

1. Introduction

Amena Begum, like many other Bengali women, had accepted a life of physical abuse and abject poverty in 1990. All changed, though, when her neighbour Oloka Ghosh persuaded her to join one of Grameen's groups in Kholshi. Amena started her own business breeding hens and ducks with the help of a first loan of \$60 in the Grameen Bank. She started a second loan of \$110 after repaying her previous loan a few months later. Additionally, she followed Oloka's recommendation to notify her husband that "Grameen does not allow borrowers who are battered by their spouses to stay members and accept loan". Amena has experienced substantially less physical violence since then, and her business is still expanding and gradually meeting her family's essential requirements [1].

This story is just a snapshot of the tens of thousands of Bangladeshis who have been lifted out of poverty by microcredit from Grameen Bank. After 20 years since Muhammad Yunus established this bank for the unbanked, Grameen has been established in more than 39,000 villages in Bangladesh, lent to approximately 2.4 million borrowers and its repayment rate hovers between 96 and 100 percent [2]. More and more people in poverty like Amena can save more money and lead a stable life. The method of Grameen largely improved the problem of wealth distribution and thus in 2006, Professor Yunus was awarded Nobel Peace Prize. Not only has the Grameen Bank model reduced poverty in Bangladesh, in effect, the concept of inclusive finance has been expanded in 41 countries, including the United States, Mexico, and Turkey, reaching 16.88 million low-income households worldwide and proving to be a sustainable and effective poverty eradication strategy globally [3].

Grameen's microfinance method effectively illustrates the possibility that inclusive finance may have effects on local stability which our research aims to make clear. Inclusive finance (IF) can be defined broadly as the process of availing an array of required financial services, at a fair price, at the right place, form and time and without any form of discrimination to all members of the society[4,5 ,6]. With the development of "the financial system" paradigm, researchers have recently expanded this definition to include a more comprehensive set of financial services such as non-bank savings, investments, credit, insurance, and electronic payment and transfer services in both the formal and informal sectors[7, 8]. Without the implementation of financial inclusion policies, there exists an uneven distribution of wealth. Excessive inequality can erode trust and social cohesiveness, leading to disputes that discourage investment. Disputes are particularly widespread in the administration of common resources, where, for example, inequality makes settling disagreements more difficult. [9].

More broadly, inequality affects the economics of conflict, as it may intensify the grievances felt by certain groups or can reduce the opportunity costs of initiating and joining a violent conflict [10]. Hence, IF has emerged as an overarching development priority among governments facing the threat of poverty and terrorism and wanting to achieve more equitable economic growth [11].

A system is deemed stable if and only if the variables all return to the initial equilibrium following their being perturbed from it. A system is locally stable if this return is known to apply only certainly for small perturbations and globally stable if the system returns from all perturbations [12]. As applied to finance, these perturbations may be caused by demographic variables, economic variables, public policies, employment rate and net debt of local government [13]. Since financial inclusion can have positive impacts on economic growth, poverty alleviation and income inequality reduction [14], the control of such perturbations will in turn help maintain local stability.

The literature on inclusive finance and stability can broadly be broken down into three separate fields, specifically, the impact of inclusive finance on economic entities, the influence of inclusive finance on society and the role of governance in the nexus of inclusive finance and stability. The literature broadly developed over the period 1980-2020, with the largest number of contributions being made in the last decade. There is no consensus in the past literature on the impact of inclusive finance on economic entities, especially for banks. While some indicate that a higher level of financial inclusion from providing access to banking facilities contributes positively and significantly to stability in the banking sector and will lead to greater bank resilience [15, 16], others argue that financial inclusion has a negative influence on a bank's reputation, as several countries lower the standard of establishing financial institutions for rural areas [17]. As for enterprises, researchers found that digital inclusive finance can promote a company's innovations, especially small and medium ones. However, the benefits of this effect vary in terms of different regions [18, 19].

Research about the influence of inclusive finance on society indicates that inclusive finance can promote economic growth, alleviate poverty, and narrow income inequality [20, 21]. It has positive effects on financial stability [22] and can be beneficial to environmentally sustainable development [23, 24]. Governance studies in the context of inclusive finance and financial stability indicate the critical role of governance in eliminating the trade-off and improving the synergy between inclusive finance and financial stability. [25] [26]. However, one study points out that governance quality may have a positive relationship with financial stability but a negative relationship with financial inclusion [27].

The limitations of the previous literature include: firstly, past literature mainly focused on the relationship between inclusive finance and financial stability. Besides, most of them concentrated on simply one nation to give their political implementations, however, it may not be universally appropriated. Lastly, there exist problems like setting errors or endogeneity issues which could be reduced by using instrumental variables.

In light of these facts, this paper aims to fill the academic gap related to three main issues. Firstly, this paper focuses on a new theme in the relationship between inclusive finance and local stability. Since the present international situation remains tense and turbulent, more and more small and developing countries are eager for a way to maintain peace and stability as well as the development [28]. Although researchers have shown the positive effect between inclusive finance and financial stability, it remains unclear whether inclusive finance will be beneficial to local stability. Secondly, this study uses the latest global data to find out more universal conclusions about the relationship between financial inclusion and local stability. Finally, this study aims to use GMM model and synthetic control methods to overcome the endogeneity issue.

2. Hypothesis

Although the world economy has overall made great progress, income disparity has remained high in the past decades in many developing and developed nations. Widening income inequality can concentrate political power and decision-making in the hands of minorities, leading to sub-optimal

use of human resources, discourages investment, and raise crisis risk, all of which have tremendous effects on economic growth and macroeconomic stability [29, 30]. As a result, more than 60% of respondents, regardless of culture or religion, view the gap between rich and poor as a key concern [31]. However, drawing on evidence from evaluation studies, inclusive finance has positive effects on reducing poverty and income inequality [32]. Thus, it may help promoting local stability. Considering these facts, we propose Hypothesis 1:

Hypothesis 1: Inclusive finance could significantly promote local stability.

Generally, the Gini coefficients of gross and net incomes have increased sharply during the past 30 years in most developed nations, whereas in emerging and developing economies (EMDCs), inequality, on average, has remained stable albeit at a much higher level than in advanced economies [33]. Among EMDCs, Asia and Eastern Europe experienced significant increases in inequality while Latin American countries experienced significant declines (although the region remains the most unequal in the world) [34].

The reason behind the increase in income inequality across advanced and developing nations is very different. Piketty and Saez (2011) found that rising income disparity in most advanced countries has been driven largely by the growing income share of the top 10 percent [35]. Effectively, the top 10 percent's income is about nine times of the bottom 10 percent in 2012 and has got bigger and bigger during the past decades [36]. However, the increasing inequality in developing countries is mainly due to the shift in income from the "upper middle class to the upper class" (such as China and South Africa). Meanwhile, in nations with falling inequality like Peru and Brazil, the biggest increase in income shares were those at the bottom and the middle of the income distribution. Since poverty is the root of most disasters, we propose Hypothesis 2 :

Hypothesis 2: Compared with developed countries, developing countries are more affected by inclusive finance on local stability.

Religious belief must also be taken into consideration because it influences the way people perceive the world. Different religions have different understandings of poverty and these understanding of poverty can have significant impacts on inclusive finance on poverty since if people suppose that poverty is fate they may not waste time trying to change their present situation.

Buddhists believe in Samsara. They suppose that poverty in this life is caused by evil deeds such as theft, stinginess, failure to repay debts, and bribery in past lives [37]. Recently, "Buddhist youth" has become more and more popular. According to a recent survey in China, more than 60% of over 240,000 respondents said they are longing to escape the pressures of modern life, where young people are expected to work long hours, buy property, get married and have children. Compared with struggling to become richer, they are more willing to lead a simple life.

Same to Buddhism, Christianity emphasizes the tolerance of poverty. The Holy Bible states: "The Lord came into the world in flesh, showing great compassion and concern for the poor, and preaching the gospel to them. Due to their material poverty and lack, they have less worldly greed, temptation, and pride, and are more likely to be humble, eager to receive the gospel, and enjoy the presence, mercy, and help given by the Lord." According to a survey of 401 Illinois residents aged 18 to 83, religion can lessen depression and offer meaning and hope. It also shows that Catholics had the least amount of discomfort among various religious groups [38].

While Buddhists and Christians see poverty as an evil thing, Islam supposes poverty is a grace and noble opportunity given by Allah. In the Quran, Allah said "I swear to repay the steadfast ninjas for their greatest good deeds", therefore, Muslims may be more likely to do their best during their poor period compared with Buddhists and Christians.

Since Christianity and Islam are the two largest religions in the world, we mainly compare their difference. Considering these facts, we propose Hypothesis 3:

Hypothesis 3: For regions that believe in Christianity, inclusive finance has less impact on regional stability than regions that believe in Islam.

Education level should also be carefully considered. This is because education influences people's knowledge, access to jobs, and pay level, and it serves as a signal of aptitude and productivity in the

labour market [39]. Studies have found that individuals with high level of education are more likely to pay back loans and have lower crime rates [40], as a result, education level is a key dividing index.

Particularly, education in digital technology is important to the development in inclusive finance. Since digital technologies that drive inclusive financial development have thresholds such as infrastructure, practical application and institutional environment, digital economic growth has varying effects on financial exclusion in different regions [41,42,43]. Recent literature has discovered that due to the lack of sufficient electronic devices or an inability to obtain proper Internet knowledge, a large proportion of low-income groups have unequal access to digital financial apps [44, 45].

According to the above literature, lower-educated regions tend to have lower inclusive finance levels. It may thus be concluded that countries with higher level of education will be more stable. However, considering the law of the diminishing margin and the Catch-up effect, our paper assume that the opposite is true. Because lower-educated regions could have a higher growth rate of finding jobs with the help of inclusive finance. Therefore, we propose Hypothesis 4:

Hypothesis 4: Compared with higher-educated regions, local stability is more affected by inclusive finance in lower-educated areas.

Previous literature has pointed to a robust and significant correlation between higher levels of financial inclusion and lower levels of poverty and income inequality in both developed and developing countries [46, 47, 48].

Meanwhile, people with more resources at their disposal would show more responsible financial behavior, as their available resources allow them to act responsibly [49]. Researchers have found that, according to the 2001 Supply Chain Finance, respondents with lower incomes were less likely to report paying their bills on time than those with higher incomes [50]. Moreover, families with lower incomes were less likely to report saving behaviour [51]. Since people with higher incomes are more likely to repay their loans, we have a reason to believe that income has a positive effect on local stability, at least local financial stability. Considering these facts, we propose Hypothesis 5 and Hypothesis 6:

Hypothesis 5: Income Equality has a positive mediating impact on the effect of inclusive finance on local stability.

Hypothesis 6: Poverty has a negative mediating impact on the effect of inclusive finance on local stability.

Another aspect is that a high unemployment rate means an increase in the unskilled people's contribution to their involvement in crime, which will harm local social stability [52]. In a study of towns in Mexico where bank branches were rapidly opened, Bruhn and Love (2014) argue that better access to financial services leads to higher incomes for those on lower incomes, allowing informal business owners to keep their businesses open, leading to more jobs overall [53, 54]. Because inclusive finance indirectly affects local stability by creating more job opportunities for the poor, which could lead to a lower crime rate, we propose Hypothesis 7:

Hypothesis 7: The unemployment rate has a negative, mediating effect on the effect of inclusive finance on local stability.

In addition, a look at gender differences shows: in many countries, women are seen as the 'reserve' of labour in the family and they will leave the family and enter the labour market when more jobs are available [55]. However, research has found that in more than 150 countries, women are significantly less likely to have a bank account, savings and loans in countries with greater legal discrimination [56]. The success of the Grameen Bank has already demonstrated the fact that easier access for women to a loan can significantly increase women's income and reduce possible abuse from their husband, which could contribute to local stability. Hence, we propose Hypothesis 8:

Hypothesis 8: Women's participation has a positive mediating effect of inclusive finance on local stability.

3. Methodology

3.1 Data

The present research used secondary data from the 2022 International Monetary Fund Financial Access Survey, the Global Financial Development Database, the World Religion Database, World Bank Indicators, the Human Development Index and the mean years of schooling Index from the United Nations Development Program, the Global Peace Index and Global Terrorist Index from the Institute for Economics & Peace, and other sources. The data were for the 2011–2021 period. Our collected sample is at the country level, which includes 163 countries and regions globally.

3.2 Variables

The main dependent variable in this paper is Terrorism, which indicates the score of terrorism, showing the number of terrorist incidents etc. The source of the Terrorism measurement is the 2023 Global Terrorism Index Report from the Institute for Economics & Peace. As Terrorism is the opposite of our theme of “Peace”, the relationship between inclusive finance and local stability can be negatively reflexed by the relationship between inclusive finance and terrorism. Given the interaction of terrorism ranking among countries, which may cause estimation bias, we also use other indexes (the score of Global Peace Index) for a robustness check to measure Local Stability. The specific calculation of the Global Terrorist Index Report indicators is in Table 1.

Table 1. Specific calculation of the Global Terrorist Index

Index	Weight	Time Weight	Coverage
terrorist incidents number	1	current year 16 previous year 8 two years ago 4 three years ago 2 four years ago 1	2011-2021 163 countries
fatalities number caused by terrorists	3		
injuries number caused by terrorists	0.5		
hostages number caused by terrorists	0.5		

For the independent variable, we choose “SME borrowers from credit unions and credit cooperatives %”, one index in the 2022 International Monetary Fund Financial Access Survey, to measure the degree of inclusive finance in different countries. We also use another index from the same database “Number of non-deposit taking microfinance institutions ” as a replacement for the robustness check.

Table 2. Control Variables and Sources

Dimension	Reference	Index		Data Source
Financial Market Situation	Morgan, P. et al. (2014).	size	Financial institution account	Global Financial Development Database
		efficiency	Bank lending-deposit spread	
		stability	Bank capital to total assets	
		size	Logarithm of GDP per Capita	World Bank Data
		efficiency	Short-term debt	
		stability	FDI capital flow to GDP	
Social Development Situation	Freytag, A. et al. (2011).	Military expenditure of GDP logarithm of total population		World Bank Data
		Government Effectiveness index		Worldwide Governance Indicators

Apart from inclusive finance, many other indications will also affect local stability. We divide them into two dimensions: the first dimension is the current financial market situation, and the seconds one is social development level. For each aspect, we select some suitable control variables based on previous literature. Firstly, we try to fix the financial level from three dimensions: size,

efficiency and stability. We follow Peter J. Morgan (2014) [57] and use “FDI capital flow to GDP”, “Short-term debt” and “logarithm of GDP per Capita” from World Bank data as three control variables. Meanwhile, we choose “Financial institution account”, “Bank lending-deposit spread” and “Bank capital to total assets” from Global Financial Development Database as the other three control variables. Secondly, we follow Andreas Freytag et al. (2011) [58] and choose some social variables which may be determinants of terrorism. We use “Military expenditure of GDP” and “logarithm of total population” from World Bank data, and also “Government Effectiveness index” from Worldwide Governance Indicators. These data resources are highly praised and widely used in many other literatures among inclusive finance- and terrorism-related research. We then matched these data with dependent and independent variables. Control variables and their resources are clearly shown in Table 2.

3.3 Model

To formally verify the link between local stability and financial inclusion, we estimate the following two-way fixed effects model equation:

$$Terrorism_{it} = \alpha + \beta IF_{it} + \gamma X_{it} + year_t + v_i + \mu_{it} \quad (1)$$

where i and t represent country and time respectively, IF_{it} represents Inclusive Finance degree (SME borrowers from credit unions and credit cooperatives), X_{it} are the control variables, $year_t$ is the time fixed effect; v_i is the individual effect, and μ_{it} is the residual (Fig. 1).

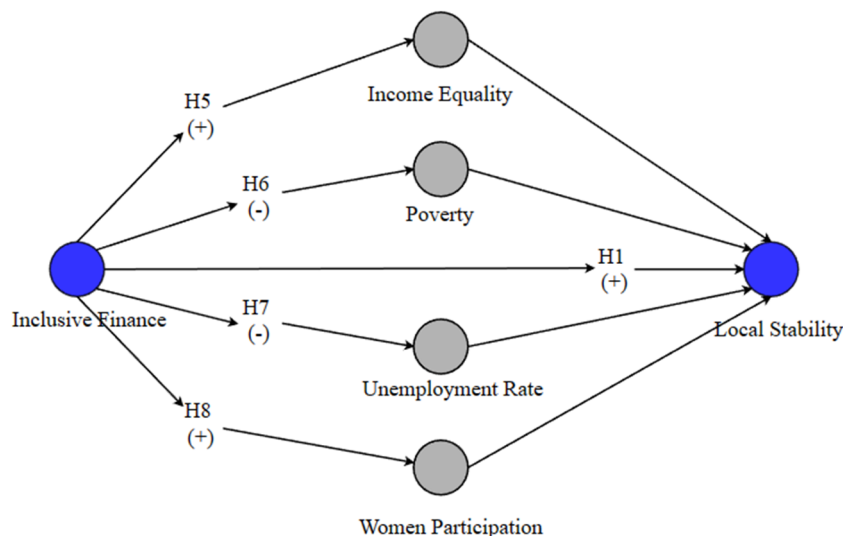


Fig 1. The theoretical framework of inclusive finance on local stability.
Note: (+) indicates positive impact, (-) indicates negative impact

4. Empirical Analysis

4.1 Descriptive Statistic Analysis

By replacing the missing value with 0 and matching the control variables with dependent and independent variables, the final data contains 1474 observations from 134 countries from 2011-2021.

The descriptive statistic of variables is presented in Table 3. This shows that there exists a great difference among different countries’ financial and social development level as shown by the large standard deviation of the indicators (Table 3).

Table 3. Descriptive Statistics of Terrorism and IF Indicators of 134 Countries during 2011-2021

Variable	Min.	Max.	Mean	Std.Dev
Terrorism	0	10.000	2.2282	2.4322
Inclusive Finance(IF)	0	2.2649	0.0287	0.1909
Financial institution account	0	100.00	16.948	31.094
Bank lending-deposit spread	0	49.050	3.4072	5.7954
Bank capital to total assets	0	23.680	6.5080	5.7269
Logarithm of the GDP per Capita	0	5.0125	3.7186	0.7745
Short-term debt	0	134.67	28.562	19.891
FDI capital flow to GDP	0	279.35	4.4986	15.165
Military expenditure of GDP	0	15.480	1.7737	1.6651
Logarithm of total population	5.5038	9.1500	7.0774	0.6470
Government Effectiveness index	0	3891.5	50.233	240.96

4.2 Main Result

Using the data described above, we run random effects regression (RE) and fixed effects regression (FE) respectively in order to assess the influence of inclusive finance on the likelihood of reducing terrorism on national levels. As can be seen in Table 3, the IF of models (1) and (2) is significant at the 1% level, and the absolute value is 1.767 – 3.160, which indicates that countries with higher levels of inclusive finance have decreased their terrorist index by 1-3 points on average. This proved Hypothesis 1, which states the relationship between inclusive finance and local stability (Table 4).

Table 4. Hypothesis 1 results

Variable	Terrorism	
	(1)RE	(2)FE
IF	-1.767***(-3.39)	-3.160***(-4.60)
Control Variables	Y	Y
Time Effect	Y	Y
Individual Effect	Y	Y
N	1474	1474
Prob (F-statistic)	0.0000***	0.0000***
R-squared	0.2377	0.2394
t- value in parentheses, *** represent significance at 1% levels		

4.3 Quantile Regression

Since inclusive finance's effects on reducing local terrorism may be different with different levels of the country's terrorism level, we also run the quantile regression to identify the quantile processing effect. The result can be seen in Figure 2.

The results show that inclusive finance's impact on reducing terrorism and enhancing local stability in different quantile countries shows a Bimodal pattern, with large effects in 2 quantiles to 4 quantiles and 4 quantiles to 6 quantiles. This means that in the middle quantile countries (the middle of the global terrorist index), inclusive finance has the greatest effect on enhancing local stability. For countries with higher or lower quantiles, the effect of inclusive finance's impact is relatively small.

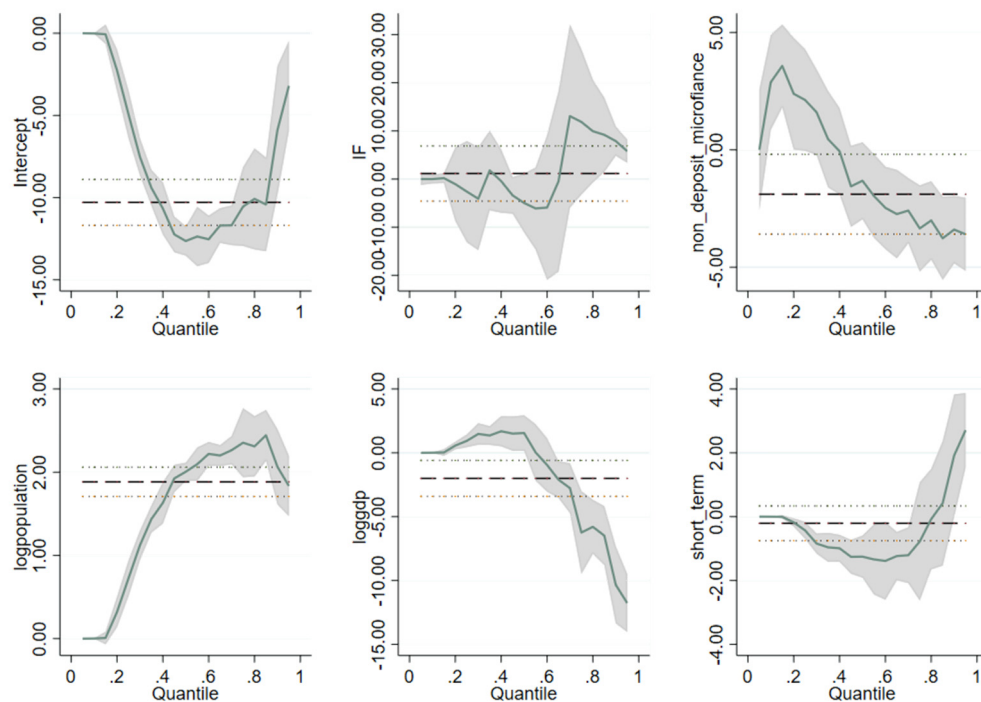


Fig 2. Quantile processing effect

4.4 Heterogeneity Analysis

As discussed in Hypothesis 2-4, we believe that whether a country is a developing country, the proportion of people in the country believe in Christianity, and the country's education level will significantly affect the relationship between inclusive finance and local stability. As a result, we conduct three sub-sample heterogeneity tests. The dividing index and its source and descriptive statistics are shown in (Table 5).

Table 5. Sub-sample dividing indexes- its resources and descriptive statistics

Dimension	Reference	Index	Min	Max	Mean	Std.Dev
H2: Developing < Developed	United Nations Development Program	HDI	0.346	0.962	0.7134	0.1626
H4: Low Education < High		Mean years education	0.975	14.13	8.5265	3.4143
H3: Christianity < Islam	World Religion Database	Christianity	1	99	54.3478	36.3827
		Islam	1	99	27.0246	36.3066

4.4.1 Developed or Developing

Table 6. Hypothesis 2 results

Variables	Terrorism	
	(1) Developing countries	(2) Developed countries
IF	-44.13(-2.04)*	-3.123(-5.39)***
Control variables	Y	Y
Time effects	Y	Y
Individual effects	Y	Y
N	629	845
Prob (F-statistic)	0.0000***	0.0000***
R-squared	0.2392	0.1763

t- value in parentheses. *, **, and *** represent significance at 10%, 5%, and 1% levels

Regarding United Nations Development Program (Human Development Index), we divide the sample into developed countries and developing countries. Considering the balance of sub-samples, we use HDI higher than 0.71 as the standard to divide developed countries and developing countries.

The regression result of the sub-samples is in Table 6. It shows that the coefficient of both developing and developed samples is significant, and the absolute value of developing countries is ten times than that of developed countries. Therefore, there is sufficient reason to believe that Hypothesis 2 is correct (Table 6).

4.4.2 Christianity or Islam

We use data “the proportion of people believe in Christianity and Islam” from the World Religion database to show the mechanism. To reduce sample bias caused by the small sub-sample size, we decide to use the proportion of people in the country who believe in Christianity higher than 0.9 as the standard to treat this country as a Christian faith. Similarly, we also use the proportion of people in the country who believe in Islam higher than 0.1 as the standard to consider this country to be a believer in Islam.

The results are shown in Table 7. Comparing the absolute value of regression (1) with regression (2), we can find that for regions that believe in Islam, inclusive finance’s effect on reducing terrorism is more significant than regions that believe in Christianity, this demonstrates the correctness of Hypothesis 3. And as mentioned above, this may be caused by different religions’ various attitudes towards the current poor situation. While the former may be more likely to take actions to change the current situation, the latter may tend to accept the fate and take few actions (Table 7).

Table 7. Hypothesis 3 results

Variable	Terrorism	
	(1) Christianity	(2) Islam
IF	-2.736(-3.34)***	-39.94(-1.98)*
Control variables	Y	Y
Time effects	Y	Y
Individual effects	Y	Y
N	264	627
Prob (F-statistic)	0.0000***	0.0000***
R-squared	0.0873	0.2879
t- value in parentheses. *, **, and *** represent significant at 10%, 5%, and 1% levels		

4.4.3 High Education Level or Low

Table 8. Hypothesis 4 results

Variables	Terrorism	
	(1) Low education countries	(2) High education countries
IF	-53.24(-2.28)*	-3.089(-5.01)***
Control variables	Y	Y
Time effects	Y	Y
Individual effects	Y	Y
N	1174	300
Prob (F-statistic)	0.0000***	0.0000***
R-squared	0.2687	0.1555
t- value in parentheses .*, **, and *** represent significant at 10%, 5%, and 1% levels		

We use data from United Nations Development Program (mean years education), and choose education year = 5 as the standard to divide high-education countries and low-education countries.

Table 8 shows that low-education countries' inclusive finance has a larger effect on reducing terrorism compared with high-education countries. This well demonstrates Hypothesis 4 (Table 8).

The logic behind this finding may be that inclusive finance's effect on local stability has marginal diminishing effects, that is to say, the same marginal improvement in inclusive finance can reduce more terrorism in lower-educated economies.

4.5 Robustness Check

Although the global terrorist index is comprehensive and covers a series of information which can clearly show a country's peace situation, it should be pointed out that it has two deficiencies. For one thing, the index mainly focused on global systematic threats like warfare or war caused injury, which cause several countries without war to share the same score of "0", this could cause somewhat inaccuracy. Second, the use of terrorism could not clearly show the direct relationship between inclusive finance and local stability. Therefore, we further use the Global Peace Index (GPI, 2011 – 2021) developed by the Institute for Economics & Peace to describe the level of local peace (the missing values are set to 0).

GPI measures the state of peace across three domains: the level of societal Safety and Security; the extent of Ongoing Domestic and International Conflict; and the degree of Militarization. In this paper, the fixed effect model approach is still used, and the control variables selection is consistent with the above. We use *gpi* as the dependent variable "Peace" and use the index "Bank lending-deposit spread" from Global Financial Development Database as the independent variable "IF". Thus, the regression model in equation (1) can be changed into:

$$Peace_{it} = \alpha + \beta IF_{it} + \gamma X_{it} + year_t + v_i + \mu_{it} \quad (2)$$

The robustness check result of Hypothesis 1-Hypothesis 4 can be seen in Table 9.

The coefficient values of Regression (1)-(7) are all positive and significant at 1% level, which shows inclusive finance and local stability has a positive relationship.

Table 9. Robustness Check

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
VARIABLES	Peace	Peace	Peace	Peace	Peace	Peace	Peace
	Main	Developed	Developing	Christianity	Islam	High Edu	Low Edu
IF	1.122***	0.955***	1.395***	0.745***	1.976***	1.043***	1.248***
	(0.267)	(0.274)	(0.457)	(0.288)	(0.486)	(0.260)	(0.407)
Control Variables	Y	Y	Y	Y	Y	Y	Y
Time Effects	Y	Y	Y	Y	Y	Y	Y
Individual Effects	Y	Y	Y	Y	Y	Y	Y
Observations	1,474	845	629	693	803	707	767
R-squared	0.085	0.067	0.177	0.055	0.156	0.120	0.129
Standard errors in parentheses. *, **, and *** represent significant at 10%, 5%, and 1% levels respectively							

Regression (1) indicates that by improving one unit of inclusive finance level, the countries' global peace score can improve by 1.122 on average, which means inclusive finance can promote local

stability. Hypothesis 1 is confirmed. Since the average value of the global GPI in 2011 – 2017 is 2.01 and the standard error is 0.5, a coefficient improvement of 1.122 is of great economic significance.

Regression (2) only includes the developed countries ($HDI > 0.71$), while Regression (3) only includes the developing countries ($HDI \leq 0.71$), the absolute value of the IF coefficient shows that compared with developed countries, inclusive finance has a larger effect on developing country's local peace. This supports Hypothesis 2.

Regression (4) shows inclusive finance's effect on local stability for countries that believe in Christianity and regression (5) shows inclusive finance's effect on local stability for countries that believe in Muslims. The absolute value of the coefficient indicates that inclusive finance's promotion effects is twice larger for countries believe in Muslim than believe in Christianity.

Regression (6) includes countries that have a higher education level (mean years of education > 9) while regression (7) includes countries that have a relatively low education level (mean years of education ≤ 9), the absolute value of IF shows that compared with high education countries, local stability is more promoted by inclusive finance in countries with relatively low education level. Hypothesis 4 is thus confirmed.

In conclusion, our model is robust.

4.6 Endogeneity Test

To reduce endogeneity issues, we first use “the distance between the capitals of different countries and the Grameen Bank” as an instrumental variable to run GMM regression. In addition, we use synthetic control methods to find out whether China's 2013 policy of "developing inclusive finance, encouraging financial innovation, enriching financial market levels and products" is effective in promoting local stability.

4.6.1 Instrumental Variable

Since Grameen Bank is the birthplace of inclusive finance, the distance between the capitals of different countries and the Grameen Bank could affect the speed at which different countries accept and apply inclusive finance. Meanwhile, it is hard to say that the distance between the capitals of different countries and the Grameen Bank has a relationship with countries' local stability. Considering the above two facts, we suppose that “the logarithm of the distance between the capitals of different countries and the Grameen Bank per 1000 miles” (shorted as “Distance”) can be an appropriate instrumental variable.

We then use the GMM regression model and the result is shown in Table 10. The endogeneity test shows that IF is an endogenous variable (chi-square=13.64, $p=0.0002$). Meanwhile, Distance is a strong instrumental variable ($F=33.70$, $p=0.0000$).

Table 10. GMM regression results

Variable	IF	Terrorism
	(1)First-stage	(2)Second-stage
Distance (IV)	9.83***(5.80)	
IF		-19.303***(-2.98)
Control Variables	Y	Y
Time Effect	Y	Y
Individual Effect	Y	Y
N	1474	1474
t- value/z-value in parentheses respectively , *** represent significance at 1% levels		

The result shows that when the instrumental variable is added to the regression, the absolute value of the coefficient grows from 3.160 to 19.303, which has increased by six times. This indicates that

endogeneity issues have underestimated the impact of inclusive finance on reducing regional terrorist incidents.

4.6.2 Synthetic Control Methods

China maintains an international leading level in inclusive financial services. China officially proposed the policy of inclusive finance in November 2013 at the Third Plenary Session of the 18th Central Committee. We use Synthetic control methods and set China as the treatment group to find out the effectiveness of 2013's inclusive finance on local stability. The result is shown in Figure 3.

Figure 3 shows the synthetic control result of the Global Terrorism Index between the treatment group and the control group for 2011 – 2021, in which the vertical coordinate is the Global Terrorism Index (gti) (the smaller the value is, the less the number of terrorism incidents are), and the horizontal coordinate is time. The line of the treated unit shows the trend in China while the line of the synthetic control unit shows the result of the generated control group.

It can be found in the figure that there is a parallel trend between the treatment group and the control group before 2013. After 2013, the Global Terrorism Index (gti) of the control group exists a small range fluctuation while the treatment group's gti exists a sharp increase in the first year and a year later, it maintains a continuous dropping trend. The gti of China in 2021 is approximate 0 which clearly shows China's 2013 inclusive finance policy's significant impact on reducing terrorism incidents and enhancing local stability.

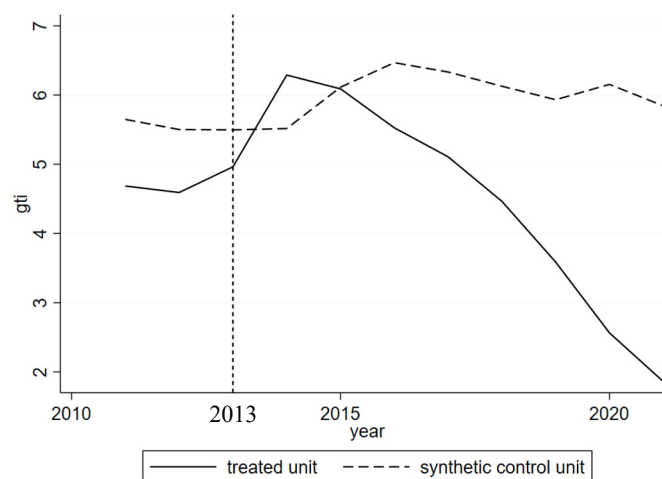


Fig 3. Synthetic control result

5. Mechanism

The next problem is determining how IF affects local stability. According to the theoretical study, IF may have a significant impact on local stability via various mechanisms. To check its correctness, we insert the adjustment variables in the benchmark model to see if the influence mechanism is significant. The following is the specific model design:

$$Terrorism_{it} = \beta_1(Moderator_{it} \times IF_{it}) + \beta_2 IF_{it} + \beta_3 Moderator_{it} + \gamma X_{it} + year_t + v_i + \mu_{it} \quad (3)$$

Inclusive finance refers to strengthening policy support, strengthening the construction of the financial system, improving financial infrastructure, and providing appropriate and effective financial services to all social classes and groups in need of financial services at affordable costs. Based on its theme, we suppose that inclusive finance can reduce terrorism through four channels: improving income equality, reducing poverty, reducing the unemployment rate and improving women's participation.

5.1 Income Equality

Income inequality is one of the biggest issue causing terrorism. Past literature has shown the positive relationship between inclusive finance and reducing income inequality, so income equality may be one of the channel that inclusive finance can reduce terrorism. We choose Gini from World Bank Data as the index to show income equality level (higher means more inequality).

The result is shown in the first column of Table 10. The coefficient is 0.510 and is significant at 1% level, which indicates the negative effect of income equality and terrorism. In other words, it proves Hypothesis 5 that income equality has a positive mediating impact on the effect of inclusive finance on local stability.

5.2 Poverty

Poverty can lead to hunger, robbery, poor medical conditions, and high mortality rates which are harmful to local stability. In this analysis, we choose “Poverty headcount ratio at \$2.15 a day of the population” from World Bank Data as the Poverty index to show its mechanism.

The result is shown in the second column of Table 10. The coefficient is 9.468 and is significant at 5% level, which confirms Hypothesis 6 that poverty has a negative mediating impact on the effect of inclusive finance on local stability.

5.3 Unemployment rate

Similarly, we use the index “Unemployment of total labour force” from World Bank Data and run the regression. The result is shown in the third column in Table 10, which indicates that unemployment has a negative mediating impact on the effect of inclusive finance on local stability. Hypothesis 7 is thus confirmed.

5.4 Female Participation

To show the mediating effect of female participation, we choose the index “Female employment of female labour force” from World Bank Data.

Table 11. Mechanism result

	(1)	(2)	(3)	(4)
VARIABLES	Terrorism	Terrorism	Terrorism	Terrorism
Gini × IF	0.510*** (0.156)			
Poverty × IF		9.468** (4.439)		
Unemployment × IF			3.771*** (1.032)	
Female_participation × IF				-3.567*** (0.986)
Control Variables	Y	Y	Y	Y
Time Effects	Y	Y	Y	Y
Individual Effects	Y	Y	Y	Y
Observations	1,474	1,474	1,474	1,474
R-squared	0.093	0.084	0.091	0.090
Standard errors in parentheses. *, **, and *** represent significant at 10%, 5%, and 1% levels respectively				

The result is shown in the fourth column of Table 11. The value of the coefficient shows that female participation has a positive impact on the effect of inclusive finance on local stability. The possible reason behind this result is likely to be that with more women participating in work, they do not need to rely on their husband to live. As a result, they have a rather higher social status and the possible abuse from their husband may thus decrease. Less abuse leads to higher social stability.

6. Conclusion and Discussion

This paper presents evidence of the effects of inclusive finance on local stability. Previous literature has shown inclusive finance's promotion effect on financial stability, however, rarely has paid attention to its impact on local stability. This paper thus tries to find out inclusive finance's impact on reducing terrorism and enhancing local stability. By conducting fixed effect models, GMM system methods and using global data from 134 countries from 2011 to 2021, this literature finds the following facts.

Firstly, the literature point out that an increase of one unit of inclusive finance can significantly reduce a country's global terrorism index by 1-3 points on average. Since the max value of the global terrorism index is 10, inclusive finance's effect on reducing local terrorism and improving local stability is huge. This result confirms the findings of other studies. Meanwhile, the quantile regression result shows that inclusive finance has the greatest effect in middle-quantile countries. By changing the dependent variable into the Global Peace Index and changing the independent variable into other inclusive finance indicators, this paper finds that the main result is still robust.

The practical implication for Hypothesis 1 is that countries should elevate and establish a competent financial system which can provide financial services to a greater proportion of the public. Countries should also implement policies to expand finance accessibility, improve financial inclusion efficiency and depth to address the concerns of poverty and income stability.

Secondly, We suppose that different financial and social development situations (Hypothesis 2), different religions (Hypothesis 3) and different education levels (Hypothesis 4) will affect inclusive finance's impact on local stability. Thus, we use HDI, the percentage of people who believe in Christianity and mean years of education as three indicators, and conduct heterogeneity tests on three samples separately. We found that on average, the marginal effect for developing countries is 15 times superior to that of developed countries. Meanwhile, regions that believe in Christianity's marginal effect is twenty times less than that of regions believe in Islams. In addition, inclusive finance's effect on local stability in low-educated regions is seventeen times higher than that in high-educated regions.

The practical implication of Hypothesis 2-4 is that inclusive finance is a more effective method for developing countries to reduce terrorism than developed countries. Meanwhile, influenced by religious belief, in countries where most of the people believe in Buddhism or Christianity, policy maker should be alert to the idea of "Buddhist youth" - accepting destiny and no longer striving to change the current situation of poverty. Government should help and encourage the poor, and try to implement policies like "targeted poverty alleviation" in China, to encourage more people to participate in the financial sector. In addition, compared with highly educated regions, countries with lower levels of education should implement inclusive finance more effectively although the cost of learning advanced inclusive finance technology may be relatively high. This is due to the fact that the marginal effect of lower educated countries' inclusive finance is relatively high. This also indicates that countries with advanced technology should pay attention to helping low-educated region's inclusive finance development, as the rapid development of the low-educated countries could have spillover effects on the economic growth of advanced countries.

Thirdly, we suppose that the mechanisms behind the impact of inclusive finance are the mediating role of income equality (Hypothesis 5), poverty (Hypothesis 6), unemployment (Hypothesis 7) and women participation (Hypothesis 8), which further support local stability. This finding confirms the previous findings of the studies in the literature.

The practical implication of Hypothesis 5-8 is that to promote local stability, government should pay attention to narrowing residents' income gap and promote the income distribution justly. They should also use inclusive finance policy to encourage people to find jobs. They could put in place adequate policies to expand the networks of financial services in rural areas and reach the unbanked population to bring them into the formal economy. Moreover, since inclusive finance can increase the number of women participating in work, which can reduce terrorism, the government can also consider adding conditions that can attract female participation when formulating inclusive finance policies.

There are two limitations of this paper. For one thing, since there exists a large amount of missing values, simply replacing them with 0 could cause weak empirical findings. As a result, if future research can find a better database or make a better process of the data, the empirical result may be more accurate. For another, although this study tries to use GMM and synthetic control methods to reduce the endogeneity issue, endogeneity problem like reversal causality may still exist.

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Appendix A

Table 12. Table of countries

Afghanistan	Central African Republic	Israel	Niger	Timor-Leste
Albania	Cyprus	Italy	Nigeria	Togo
Algeria	Denmark	Jamaica	Norway	Ireland
Angola	Djibouti	Japan	Oman	Tunisia
Argentina	Dominican Republic	Jordan	Pakistan	Turkmenistan
Armenia	Ecuador	Kazakhstan	Panama	Uganda
Australia	El Salvador	Kenya	Eritrea	Ukraine
Austria	Equatorial Guinea	Kuwait	Paraguay	Iraq
Azerbaijan	Papua New Guinea	Latvia	Peru	Indonesia
Bahrain	Estonia	Lebanon	Philippines	Iceland
Bangladesh	Ethiopia	Lesotho	Poland	Uruguay
Belarus	Finland	Liberia	Portugal	Uzbekistan
Belgium	France	Libya	Qatar	Zambia
Benin	Gabon	Lithuania	Romania	Zimbabwe
Bhutan	Georgia	Madagascar	Rwanda	
Botswana	Germany	Malawi	Saudi Arabia	
Brazil	Ghana	Malaysia	Senegal	
Bulgaria	Greece	Mali	Serbia	
Burkina Faso	Guatemala	Mauritania	Sierra Leone	
Burundi	Guinea	Mauritius	Singapore	
Cambodia	Guinea-Bissau	Mexico	Slovenia	
Cameroon	Guyana	Mongolia	South Africa	
Canada	Haiti	Montenegro	South Sudan	
Cuba	Honduras	Morocco	Spain	
Chad	Hungary	Mozambique	Sri Lanka	
Chile	Iceland	Namibia	Sudan	
China	United Arab Emirates	Nepal	Sweden	
Colombia	United Kingdom	Netherlands	Switzerland	
Costa Rica	United States	New Zealand	Tajikistan	
Croatia	Trinidad and Tobago	Nicaragua	Thailand	