MACROECONOMIC IMPLICATION OF DEBT RELIEF ON NIGERIAN ECONOMIC GROWTH FROM 1970-2016

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Abstract
Despite the debt forgiveness to the tune of $18 billion received by Nigeria from Paris club in the year 2005 including the subsequent payment of $12 billion to upset the remaining debt, there is no evidence of accelerating pace of growth and development of the country. It is therefore, instructive to find out the direction and the extent of the effectiveness of the debt relief granted to Nigeria. This forms the objective of this study. To achieve this objective, four macroeconomic variables include real gross domestic product, external debt service, total debt service and exchange rate are employed. These variables were analyses using co-integration analysis, causality test and the ordinary least square packages. The co-integration test shows an insignificant long run relationship, whereas the causality test shows no causality among the variables. The result of the OLS model showed that the debt overhang problem of Nigeria has been alleviated by the debt relief package but the debt service relief did not positively influence the growth indicators. The results strongly support the need for tougher conditionality in future debt forgiveness initiative. Policy makers should attach difficult conditions to borrowing and effective monitoring and evaluation team to guide the process of what will be done with gains of debt relief.

Keywords*: Debt Relief, Macroeconomic, Econometrics Models and Economic Growth*
JEL Classifications:

Introduction
Debt relief is the partial or total forgiveness of debt, slowing or stopping of debt growth, owed by individuals, corporations or nations. Traditionally, from antiquity through the 19th century, it refers to domestic debts, particularly agricultural debts and freeing of debt slaves. In the late 20th century, it came to refer primarily to third world debt which started exploding with the Latin American debt crisis i.e. Mexican 1982 debt crisis.

At one extreme, debt relief can mean palliative measures by the creditors to ameliorate a debtor country's repayments problem through re-scheduling (changing terms like interest rate and maturity) of existing debt. At the other extreme, it can refer to a complete write-off by the creditor of the debt. In between these two extremes there is various degree of debt relief that involves a combination of stock relief (partial write-off of debt stock) and flow relief (like partial write-off of debt servicing payments). In all case debt relief is creditor driven at discretion of the creditors (DMO 2004).

Sequel to the approval of a 2 year polices support instrument that monitored Nigeria's economic reform drive, Paris club agreed to write-off 60% of the $30.85 billion owed to its club members (Ayad & Ayadi, 2008), The deal was finally signed in July

2005. Thereafter, the country was able to offset the remaining 40% debt owed to the Paris club. By March 2006, Nigeria owed nothing to Paris club. The debt relief eventually saved the country from the yearly $2.3 billion debt service burden. It was however proposed that this amount will then be available to be plough back and channeled to those areas that concern wealth creation, employment generation, agriculture, health, education, water supply, power generation and road construction.

"Huge external debt does not necessarily imply a slow economic growth; it is a nation's inability to meet its debt service payments fueled by inadequate knowledge on the nature, structure and magnitude of the debt in question" (Were, 2001).

The significant debt relief as a matter of fact should help the country's goal of reducing poverty, accelerating the pace of growth and development and provide some boost for the ongoing reforms and millennium development goals. One would expect that by ten years after debt forgiveness to Nigeria, the country should be on the path of economic prosperity characterized by improved power supply, greater budgetary allocation to health and education, reduction in unemployment rate, improvement in road network, improvement in the living standard etc. which will be a good sign with respect to the expected impact of recent debt forgiveness benefit. But to the contrary, the country appears to be deteriorating further with worsen power supply, higher rate of unemployment, poorer road network and living standard. There is no evidence of accelerating pace in the growth and development of the country. Rather what we have is a signal of economic stagnation characterized by double digit inflationary trend and set back in poverty alleviation initiatives. The situation is quite worrisome. It is instructive to find out the direction, and the impact of the debt relief on the economic growth of the country.

The main interest of this study then is the relevance of the debt cancellation to economic growth in Nigeria. Having established a background of the study, it could be stated that there are problems encountered. This study will however analyze the effectiveness of the debt relief for this purpose, the question is whether debt relief is effective in stimulating economic growth or not. The remaining section of this paper after the introduction is organized into four sections. Section two reviews the literature of the study. Section three describes the methodology. Section four discusses the empirical results and findings while section five provides the summary and recommendations of the paper.

Theoretical Literature
The debt overhangs theory.
According to this strand, reducing the debt overhang stimulates growth through improved incentives to invest and potential new capital inflows (Krugman, 1988 & Sachs 1989). Some earlier papers (among others, Elbadawi, Ndulu & Ndung'u, 1997; Pattillo, 2002, Poirson & Ricci, 2004; Clements, Bhattacharya & Nguyen, 2003), found that the debt-growth relationship follows a bell shaped curve where, beyond a certain threshold, the impact of debt on growth becomes negative. This suggests that debt relief can reduce the debt stock below that peak threshold, which helps reinstate the incentives to invest. Based on this theory, Pattillo et al. (2002) predict that having the debt burden of highly indebted poor countries from the levels in 2000 would raise real GDP per capita growth by about one percentage point. Moreover, they show that, in a lower debt environment, the uncertainty about the actions and policies of the government to meet its debt service obligations decreases

The crowding-out theory:
Under this strand, debt relief increases growth by freeing resources used for productive investments (Cohen 1993). In the case of a country with a high debt burden, debt service payments crowd out investment and thereby impede growth. Under these conditions, debt relief increases public investment and thus growth by easing the government budget constraint. Of course, resources are only freed if and only if the country was previously servicing its debt.

Debt relief has to be provided in addition to aid; otherwise the debt relief will only substitute for aid and will not ease the government budget constraint (Bird and Milne 2003). At the same time, higher public investment has not always been associated with better performance on social indicators as a result of inefficiencies in allocating resources to pro-poor spending. It is therefore critical that debt relief be directed to public spending for the poor, such as primary education and preventive health care in order to reduce poverty (Gupta, Clements, Guin-Siu, & Leruth 2001)

Empirical Review
One popular argument to the provision of debt relief is the debt overhang. Several studies have examined the existence overhang countries. Despite few ambivalent and mixed results, the empirical literatures mainly provide supports of the debt overhang hypothesis.
Ekperiware and Oladeji (2012) examined the structural break relationship between external debt and economic growth in Nigeria. The study employed the quarterly time series data of external

debt, external debt service and real GDP from 1980-2009. An empirical investigation was conducted using the chow test technique of estimation to determine the structural break effect of external debt on economic growth in Nigeria as a result of the 2005 Paris Club debt relief. The result of their findings revealed that the 2005 external debt relief caused a structural break effect in the relationship between external debt and economic growth. Based on these findings they concluded that the external debt relief made available resources for growth-enhancing projects.

Dessy and Vencatachellum 2007 study however showed that if a government has a high discount factor, it will rather consume than invest once debt relief is granted. This is particularly true of most developing countries that have high marginal propensity to import. These findings are consistent with the works of Cooper and Sachs (1985).

Arslanalp and Henry (2004) who argue that the problem faced by debt-relief countries is lack of good institutions. Thus, if the status-quo remains the same, the new debt-relief initiative would not achieve their objectives to increase growth promoting expenditure in these countries. Similar studies that have found a positive relationship between debt and growth includes Cohen (1995), Bovensztem (1990), Elbadawi et al. (1997) and Patillo et al. (2002, 2003).

In a related study by Adesola (2009), examined Debt Servicing and Economic Growth in Nigeria: An Empirical Investigation using ordinary least square multiple regression method to determine whether debt payment to Multilateral Financial creditors, Paris Club creditors, London Club creditors, Promissory notes holders and Other creditors (Non-Paris Creditors) have inverse relationship with gross domestic product (GDP) and gross fixed capital formation at current prices (GFCF) from 1981 to 2004. The study revealed that debt payment to London Club creditors, Paris Club creditors, Promissory notes holders and other creditors have significant impact on the GDP and GFCF. Debt payment to Paris Club creditors and debt payment to promissory notes holders are positively related to GDP and GFCF, while debt payment to London Club creditors and other creditors showed a negative significant relation to GDP and GFCF.

In another study carried out by Ndubuisi (2011) on the Effect of External Debt Relief on Sustainable Economic Growth and Development in Nigeria using Chi-square, Regression and Correlation analysis to test the relationship between external and internal debt stock in relation to debt relief, he found that there is a relationship between external and internal debt stock in relation to debt relief, that debt relief affected the economic growth of the economy and that gradual reforms and investments will help bring back a healthy economy for the nation.

In a similar study Impact of External Debt Management on Selected Macroeconomic Indicators in Nigeria (1970 – 2010), Okegbe (2012) used Regression analysis to analyze the extent to which external debts and its service costs impacted on such macroeconomic indicators as Gross Domestic Product (GDP), Total Export, Total Revenue, Total Reserve and Exchange Rate. The study showed that debt utilization, diffusion in the management of loans, poor documentation and deficient external debt accounting and politics in the management of debt in the 80's and 90's, our macroeconomic indicators had a negative trend thus aggravating debt burden at that period.

Few other studies did not find a significant effect of debt on growth and they include Savvides (1992) and Dijkstra (2001).

No doubt the debt reduction is expected to promote growth. In a study conducted by Chauvin and Kraay (2005) on a sample of 62 low-income countries assessed the extent to which debt relief induces government to embark on social spending. They conclude that the marginal benefits of debt relief may not be same in Africa, Latin America and Asia. Lora and Olivera (2006) test the crowding out effect of public debt on social services between 1985 and 2003 and find that the effect comes mostly from stock of debt and not debt service. They posit that loans from multilateral organization do not ameliorate the adverse consequences of debt on social expenditures. Thus, if Lora and Olivera's (2006) results hold for Africa, beneficiaries of debt relief should have increased their expenditure in the social sector

Imbs and katada (1996), provide non-parametric evidence supporting the existence of a debt laffer curve among developing countries. Their result indicated that debt overhang occurs when the face value of debt reaches 60% of GDP or 2000% exports, since both theoretical literature and empirical evidence suggest that huge burden trend to be associated with low investment and low economic growth in low-income countries, debt relief might have a stimulating effect on investment and economic growth. This justification of debt relief seems to be quite convincing at first glance. But the clincher with respect to the resources position of low income countries and therefore to the capacity to pay their obligation at least in the short run and to invest is still the net resources transfer from the donor including bilateral and

multilateral aids which of special importance for HIPCs. Since the reduction of multi-lateral debts partly financed by bilateral donors and these contributions usually comes from the same political

reservoir, namely the donors and the budget, there might be a trade-off between debt relief and the official development assistance.

Methodology

The aim of this research works is to examine the impact of debt relief on the growth of the Nigerian economy. This study focuses on four chosen macroeconomic variables such as real gross domestic product, external debt, total debt service and Exchange rate. Time series data from 1970 to 2016. Ware used and obtained from World Bank statistical Database (WDI, 2017) and others. To assess the impact of debt cancellation on economic growth. A model with Real Gross Domestic

Product (RGDP) is the dependent variables and external debt, total debt service and Exchange rate are the explanatory variables to be estimated is specified, a priori expectations of these variables, techniques of estimation and method of data analysis are all discussed in this chapter.

Model Specification

The functional form of the relationship of the model is writing as:

$$RGDP = F (TDS, EXR, TED,)\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(1)}$$

Where:
RGDP = Real Gross Domestic Product
TDS = Total debt service
EXR = Exchange Rate
TED = Total external debt

The equation (1) model can be change into mathematical model as follows:

$$RGDP = \alpha_0 + \beta_1 TDS + \beta_2 EXR + \beta_3 ED \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(2)}$$
$\beta1\ 0;\ \beta2\ 0;\ \beta3,$

The above equation (2) displays the mathematical shape of relationship between RGDP, which is the explained variable and TDS, EXR, and TED which

are the explanatory variables. Moreover, the equation (2) can be change from mathematical to Econometric Model.

$$RGDP = \alpha_0 + \beta_1 TDS + \beta_2 EXR + \beta_3 ED + \epsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(3)}$$

In equation (3) error term is introduce into the model to estimate the coefficient in $\beta1$, $\beta2$, and $\beta3$.

It contains other variables not mention in the model but determine the dependent variables.

ϵ_t = Error term

To get the best result, the equation (3) must be in log for all variables. This is to see the percentage of

change in dependent variables when the independent variables change around 1 percent.

$$\log RGDP = \alpha_0 + \log\beta_1 TDS + \log\beta_2 EXR + \log\beta_3 ED + \epsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(4)}$$

Estimation Technique

A three stage procedure was followed to test the direction of causality. In the first stage the order of integration was tested using the Augmented Dickey-Fuller (ADF). Unit root tests. The second stage involves testing for the existence of a long-run equilibrium relationship between total debt service, external debt and exchange rate. The third stage involves testing the causal relationship between the variables so as to know the cause of one variable and another this can be achieve by constructing granger causality test

Unit Root Test

Unit root test is applied to see the stationary of the series at the level and first difference test by using Augmented Dickey Fuller (ADF) and also Akaike Information Criteria (AIC). The hypothesis in this test is: H0: $\delta = 0$ (unit root test / not stationary), H1: $\delta \neq 0$ (no unit root test / stationary).

If the value of t-statistic is greater than ADF critical value, the null hypothesis is not rejected (unit root test exists) but if the t-statistic is less than ADF critical value, the unit root test does not exists (so,

the null hypothesis is rejected). The following equation 5 and 6are the equation at level without

Without constant and trend

$$\Delta Yt = \delta Yt\text{-}1 + Ut \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (5)$$

With constant and trend

$$\Delta Yt = \alpha + \beta T + \delta Yt\text{-}1 + Ut \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (6)$$

The Co-integration Test

The second step is the testing of the presence or otherwise of co-integration between the series of the same order of integration through forming a co-integration equation. A lack of co-integration suggests that such variables have no long-run Auto regression (VAR) of the P given by

constant and trend and with constant and trend.

relationship. If Yt is a vector of n stochastic variables, then there exists a p-lag vector auto regression with Gaussian errors of the following form:

$$_t = \mu +_{1t\text{-}1} +_{t\text{-}p} +_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (7)$$

Where:

Y_t is an nx1 vector of variables that are integrated order commonly denoted (1) and $_t$ is an nx1 vector of innovations.

This VAR can be rewritten as:

$$_t = \mu +_{yt\text{-}1} +_{it\text{-}1} +_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (8)$$

Where:

$= _{i\text{-}1}$ and $_I =$

To determine the number of co-integration vector, Johansen (1988, 1989) and Johansen and juseliu (1990) suggested two statistic test, the first one is the trace test (trace). It tests the null hypothesis that

the number of distinct co-integrating vector is less than or equal to q against a general unrestricted alternatives q = r. the test calculated as follows:

$$\text{Trace (r)} = \lceil 1^{\wedge}_t \rfloor \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (9)$$

T is the number of usable observation, and the $_1$ are the estimated eigenvalue from the matrix.

Granger-Causality Test

The causality test is to see a reaction between the variables. For example, if variable X is granger cause to Y and Y is also granger cause to X, it

means that the value after X can help to expected value for the next period of Y and also the value after Y can help to expected value for the next period of X (Sorensen, 2005). The following equation 7 and 8 are the formula for granger causality regression test for two-way variable and Y:

$$Y_t = \Sigma^p_{i=1} \sigma_i Y_{t\text{-}1} + \Sigma^q_i =_1 \beta_j X_{t\text{ -}1+\mu\text{1}t} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (10)$$
$$Y_t = \Sigma^p_{i=1} \gamma_i Y_{t\text{-}1} + \Sigma^q_i =_1 \delta_j X_{t\text{ -}1+\mu\text{2}t} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (11)$$

Theoretical Explanation of the Model

Unit root test: Augmented Dickey-Fuller test are employed to determine the presence or otherwise of a

Table 1: Unit Root Results

Variables	ADF Level(int.& trend)		ADF First Difference(int.& trend)		Order of integration
	t-statistics	p. value	t-statistics	p. value	
RGDP	0.3968	0.9985	3.4524	0.0010	I (1)
ED	2.6633	0.9998	3.9981	0.0032	I (1)
EXR	2.0252	0.1013	8.5817	0.0000	I(1)
TDS	4.2930	0.0882	7.2939	0.0000	I(1)

Source: Author's Computation from E-views 7.0, * denotes 1% level of significant. ** 5%.

From the ADF test which is presented above, it is clear that all the variables are non-stationary at level, but was found to be stationary at first difference. At levels, the observed values of ADF statistics are less than their critical values in trend and intercept. While at first difference the observed values of ADF statistics are greater than their critical values. Thus, null hypothesis of the variables are rejected at 1% and 5%. However, the a priori expectation when using the ADF tests is that a variable is stationary when the value of the

ADF test statistic is greater than the critical values. None of the variables used met this a priori expectation at levels and thus were integrated at first difference and found to be stationary.

Cointegration Test Results

To ascertain if the variables in the model have a long run relationship with real gross domestic product, external debt, total debt service and exchange rate the Johansson cointegration test is used .the result is presented below

Table 2: Cointegration Test

Hypothesized No. of CE(s)	Eigenvalue	Trace statistics	0.05 Critical value	Probability **
None *	0.4695	64.32764	47.85613	0.0007
At most 1	0.382644	35.79534	29.7970	0.0090
At most 2	0.19184	14.09138	15.49471	0.0805
At most 3	0.09529	4.506447	3.841466	0.0338

Source: Author's Computation from E-views 7.0,
Trace test indicates eqn (s) at the 0.05 level
denotes rejection of the hypothesis at the 0.05 level

From the result above, trace statistic and maximum Eigen values reveals two cointegration equation each 5% significant level. This indicate there exit a long run relationship real gross domestic product and some of the variables in the model. By implication changes in the real domestic product will bring about increase in the government revenue through debt cancellation, changes in the explanatory variables proxy of debt relief will affect the gross domestic product negatively in the long run because the resources were not use effectively

Granger Causality Test

The dynamic natures of the causal relationship between variables were analyzed through the use of Granger causality approach. Granger causality allows for several causal relationships to be identified in different alternative models. Table below shows the summary results of the Granger causality tests. The results reveal the dynamic behavior of all variables

Table 3: Granger Causality

Null hypothesis	Obs	F. statistics	Probability
ED does not Granger cause RGDP		0.00345	0.9534
	46		
RGDP does not Granger cause ED		0.54824	0.0055
EXR does not Granger cause RGDP		6.20082	0.0167
	46		
RGDP does not Granger cause EXR		3.28089	0.0771
TDS does not Granger cause RGDP		0.00304	0.9563
	46		
RGDP does not Granger cause TDS		0.23877	0.6276
TDS does not granger cause EXR		0.22704	0.9483
	46		
EXR does not Granger cause TDS		1.47200	0.2317
ED does not granger cause EXR		0.00425	0.9483
	46		
EXR does not granger cause ED		16.5080	0.0002
ED DOES NOT Granger cause TDS		30.6410	2E-06
	46		
TDS does not Granger cause ED		1.40959	0.2416

Source: Authors compilation from Eviews7

From the table above, the focus of the analysis is to examine the relationship between RGDP, ED, EXR, and TDS. The null hypothesis states that ED does not granger cause RGDP and RGDP does not granger cause ED. The rule of thumb states that, the probability must be less than 0.5 to show a causal relationship. The probability of our variables ED and RGDP are 0.9534 and 0.0055 Therefore we accept the null hypothesis and conclude that there is no uni-directional causality between them. Similarly the null hypothesis states that EXR does not granger cause RGDP and RGDP does not granger cause EXR. The probability of our variables RGDP and EXR are 0.0167 and 0.0771 which means EXR does not granger cause RGDP but RGDP granger cause EXR and therefore conclude that there is uni-directional relationship.

Furthermore the null hypothesis states that the TDS does not granger cause RGDP and RGDP does not granger cause TDS. The probability of our variables RGDP and TDS are 0.9563 and 0.6276 which means both variables does not have any relationship thus there is no causality between them

Least Square Estimate
The secondary data used for the study were processed using the Ordinary Least Square (OLS) packages. These packages are suitable because they are time efficient in terms of output and adequacy of statistics generated. The empirical study uses a simulation approach to investigate the relationship between the economic growth debt relief and debt overhang variables

Table 4: OLS Results

R^2 SQUARE	0.5795
Adjusted R^2 SQAURE	0.5502
S.E OF REGRESSION	1.00E+11
SUM OF RESIDUALS	4.33E+23
F- STATISTIC	19.7565
PROB (F-STATISTIC)	0.0000
DURBIN WATSON	0.7618

Source: Authors compilation from Eviews7

The t-statistic and the standard error test revealed that the parameters were insignificant for total debt service and external debt. For the two variables in the model their values for standard error are not less than half of the values of their coefficients. Whereas the exchange rate was statistically significant as the value of its coefficient is twice greater than its standard error .The result show that changes in external debt and total debt service did not determine the output in the economy while exchange rate and exchange rate did.

The value of the coefficient of the independent variables; external debt manifest correct signs which is in consonance with the a priori expectations. Whereas debt service and exchange rate did not. meaning that external debt has a positive relationship with economic growth while debt servicing and exchange rate explain their negative relationship with the growth indicator, it then means that the debt burden problem has being alleviated but has not significantly improve the economic condition of the country.
Consequently, the result shows that a 1% of external debt in the current period leads to 6.06%

rise in output growth which conforms with the a priori expectation that debt relief will reduce the borrowing. Whereas a 1% rise in total debt service reduces output growth by 16.7% making the debt service ratio will fall. 1% exchange rate in the current period leads to 1.43% in output growth during the period under study.

The value of the adjusted R^2 for the model is normal, pegged at 57%, which implies that external

Conclusions and Recommendations

This study discussed and investigated whether or not debt relief granted to Nigeria is effective in improving its economic growth and development. We used Nigeria database to assess whether or not our data are consistent with the general thrust of the literature. The result of the OLS model show that the debt accumulation problem of Nigeria had been reduced by the debt forgiveness but the growth indicator was not positively influenced by the debt service relief which one would expect. We included the usual variables that determine growth and found that only external debt is positively correlated with growth indicator. The economic relationship of the country with other countries of the world measured by the exchange rate index has a negative and preponderantly insignificant effect on growth in the estimation. This variable did not show the expected sign. The only good thing found is that the country being an oil exporter is able to accumulate more foreign exchange earnings with the debt relief. The resources which were formerly transferred for debt service are now at least saved from capital flight. The answer to the question of the study-if debt relief has brought an improvement to the economic performances of the nation so far is therefore disillusioning. All in all, the findings

debt, total debt servicing and exchange rate explained about 57% systematic variation in economic growth over the observed years in the Nigerian economy while the remaining 43% variation is explained by other determining variables outside the model.

The value of Durbin Watson is 0.76 for the model. This fall within the determinate region and imply that there is a positive serial autocorrelation among the explanatory variables in the model.

suggest that the debt relief has not led to high economic growth in Nigeria.

Based on the conclusions, the following recommendations:
1.   Debt relief granted to Nigeria was not however efficiently and effectively utilized as the gains were not channeled to appropriate sectors of the economy that would have improved on the living standard of the country and further more expand the growth.
2.   One can confirm a path dependence with respect to the debt relief granted as institutional quality and good governance were not taken into account in the discussion-making processes of the creditor countries.
3.   The research strongly call for the disapproval of so much external borrowing because the gains from borrowing itself is quite worrisome, and in the end new government will come and ignore the projects the previous administration started and call for another borrowing which will lead to continuous raise in the debt itself, causing more to service the debt.

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