Financial Development, Trade Performance and Economic Growth in Nigeria

Chidum Chibueze CHINDA
Department of Economics, Faculty of Social Sciences, Rivers State University,
Port Harcourt, Rivers state, Nigeria.
riches4nwenda@yahoo.com

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Abstract

The study examined the link between financial development, trade performance and economic growth in Nigeria between the period 1985 to 2021. Financial deepening (FD), government expenditure (GOVEXP), inflation rate (INFL) exports (EXP) and imports (IMP) are the measures used to proxy the independent variables while real gross domestic product (RGDP) was used as a dimension of economic growth which is the dependent variable. The data used in this study were sourced from secondary sources which includes; World Bank, the Central Bank of Nigeria annual statistical bulletin and World development indicators. The Eview10 Software was used to empirically and econometrically analyze data. The stationarity test shows that financial development, government expenditure, trade openness and real gross domestic product are all of order one I(1) while inflation rate is of order zero I(0). The data were analyzed using the Autoregressive distributed lag. The ARDL result estimates show that in the long run financial development and government expenditure variables have positive relationships with real gross domestic product and they are also statistically significant. The study amongst others recommends that appropriate trade and foreign exchange policies in favor of export expansion should be encouraged because exports drive economic growth. Proper implementation of import control measures that will certainly sharpen the understanding of the determinants of import behaviour.

Keywords: *Financial Development, Trade Performance, Economic Growth, and Nigeria*

INTRODUCTION

The financial sector allows a conducive environment for economic growth and development, productive activities, financial interposition, net investment and management of the payments system (CBN, 2017). The process which creates increase in quantities, quality and efficiency of financial intermediary services is known as financial development. The process has to do with the connectivity of many activities and institutions which possibly give way for economic growth. Put in another way, it has to do with the level of development and innovation of traditional and non-traditional financial services (Valverde, et al., 2004). Some other notable authors have as well

defined financial development in some other ways. The World Economic Forum (2012) defines it as the factors, policies, and institutions that bring about efficient financial intermediation and markets, as well as deep and broad access to capital and financial services. It is a stimulus in economic development and is widely recognized by both the development economists as well as the monetary economists (Noureen, 2013). For Garba (2014), financial development is the increased provision of financial services with a wider choice of services directed towards the betterment of all sectors of the economy. According to the new growth theorists, a proper developed financial system brings about high economic growth that can be sustained (Hicks, 1969).

The engine oil of any economy is the financial sector as it allows the availability of resources for investment, and so, bringing about economic growth. The need for capital market development has been recommended by so many studies. For example, a more developed financial sector, according to Bencivenga et al. (1996), might provide liquidity that ensures that the cost of the foreign capital necessary for economic development purposes, most importantly, when it involves low-income countries that cannot raise enough domestic savings. Development of the financial sector could as well be a factor for the reduction of poverty, especially through their interposition activities. The availability of credit has helped in expanding small businesses, which brings about increase in income and the generation of employment. In recent times in Nigeria, there has been a steady growth of the financial sector, despite, the socio-economic nature of the Nigerian economy, caused by weakness of the institutional quality, poor governance, graft and insurgency in some areas of the country, among others.. Financial development has been seen as the principal input for economic growth and an important component that affects growth through adjustment in productivity growth and efficiency of capital. (Pagano, 1993; Levine, 1997).

Gross Domestic Product (GDP) is used to measure economic growth.. According to Ivic (2015), Economic growth is the increase in the GDP as the major quantitative measure of production for one year, whereas economic development includes both quantitative and qualitative improvements in a country's economic position. Economic growth is a society's ability to enhance its human capital, physical capital, and technological capital over a certain period. Economic growth, as it is often and interchangeably used for sustainable development, is defined as economic development that feeds the hunger of the present generation without jeopardizing the yearnings of future generations (Acemoglu and Robinson, 2010).

This study contributes to the existing literature by incorporating financial deepening (FD), government expenditures (GOVEXP), inflation rate (INFL), exports (EXP) and imports (IMP) as proxies for the independent variables (Financial Development) and (Trade Performance) while Real gross domestic product as proxy for the dependent variable (economic growth). Therefore, the link between financial development, trade performance and economic growth using the above dimensions and measure is the issue this work seeks to address. These issues give credence to this work.

REVIEW OF LITERATURE

Conceptual Clarification

Financial Development: Financial development can be defined as the process which creates increase in quantities, quality and efficiency of financial intermediary services, (Calderon, 2003). The brain of any master plan of any economic success of a nation is financial development.. many economists consider Financial development as the ultimate importance for the growth of output. Most especially, the restrictions by the government on the banking system which hinders financial development and reduce output growth (Ronald & Shaw, 1973).
It is a truism that both financial innovation and technological advancement have direct bearing on growth since a reasonable technological advancement and innovations require large quatum of investments that the banks, finance and insurance companies financed. Furthermore, it is homesick to call to mind that the financial systems in Nigeria was not properly developed and highly regulated during 1970s and 1980s. For example, interest rates and imposed credit ceilings were common; similarly, the ownership and management of banks were seriously regulated by the government. The reason for this was basically to make it easy for the government to secure financial resources at a rate that is reduced and to manipulate the operational and managerial capabilities of the banking institutions.

Financial Deepening: The growth and development of the financial markets, financial intermediaries and financial institutions to make available financial resources in order to facilitate improved economic performance is known as financial deepening. When the financial system is developed properly it will enable the right mobilization of resources for maximum use. The most important part of financial deepening is thefact that it helps to reduce poverty according to Hassan, et al. (2011). Finance plays a major role as it helps to determine the economic growth and development of countries. Over the years, theories of economic growth have asserted that financial sector innovations helps financial sector development and the economy as a whole. Review of literature showed that the mobilization of capital, the distribution of resources, risk diversification, lead to economic growth which explains the financial intermediation theory (Jbili, et al. 1997).

Importance of International Trade: The importance of international trade cannot be over emphasized. Perhaps, the most crucial of these areas has to do with economic growth. During the 19 and the 20 centuries, international trade played a commanding role in bringing about world economic growth. Apart from playing a role as an engine of growth for the global economy, foreign trade has also played a leading role in ensuring quick economic growth and development is achieved in several countries of the world. Exports expansion can lead to growth through the stimulation of technological change and investment, or by spilling demand over other sectors. The expansion of main commodity exports led to economic growth in the 19 century particularly in the following countries; Australia, Canada and Sweden. Sweden in particular, growth was aided by exporting lumber and wood products while in Australia, growth was propelled by wool, lamb and

mutton that were the main exports. Those primary products with high income and price elasticity of demand are likely to be more growth inducing than orders, (Oviemuno, 2007).

Exports Contribution to Economic Growth

Below are the positive contributions of exports to economic growth in Nigeria:
i. Increase in exports promotes the specialization in producing export commodities which would as well cause a rise in the productivity of the export sector.
ii Export encourages improvement in technological advancement of an economy as a result of foreign market competition.
iii. As a result of export expansion efficient resource allocation is encouraged by bringing incentives for home resources allocation nearer to international real costs.
iv. Comparative advantage based exports allow the use of economies of scale that are external in the non-export sector, but internal to the overall economy.
iv. The expansion of exports benefit from foreign market and allow greater capacity utilization by exploiting increasing foreign demand in world markets.

Why Countries imports goods and services from other countries
Piana (2001), listed the five major reasons why many countries import good and services from other countries:

i. When such goods and services do not exist in the importing country
ii. Where such goods and services do not exist at the required level of quality in the importing country
iii. When such goods and services are a specific product variety which cannot be exactly replicated in the importing country.
Iv. Due to economics of scale, it is cheaper to purchase abroad than produce domestically;
v. Where there is insufficient domestic supply at the current market price. Imports remain a prefarable channel in world trade relations among countries.

Economic Growth: Economic growth can be defined as a rise in the monetary value of goods and services produced in a country. Economic growth implies a rise in real gross national product per unit of labor input. This refers to a change in the productivity of labour over time. Economic Growth is conventionally measured as the rate of increase in Gross Domestic Product (GDP). Growth is usually calculated in real terms (netting out the effect of inflation on the price of the goods and services product). Growth improved the standard of living of the people in that particular country. Economic growth is measured by the Gross Domestic Product (GDP) in Nigeria, economic growth is the rise in the gross domestic product (GDP) as the major quantitative measure of production for one year, whereas economic development includes both quantitative and qualitative improvements in a country's economic position **(**Ivic, 2015).

Theoretical Review

Financial Development and Growth Theory: The endogenous growth theory models services like risk diversification, savings mobilisation and liquidity generation offered by financial

intermediaries. The theory proposes that through these services there is an implied positive relationship between financial intermediation and economic growth (Ghali, 1999). However it is important to note that this relationship can be affected negatively by intense government intervention in financial institutions. According to Ghali, 1999 government intervention through direct interventions such as interest rate ceilings and direct credit programs on the banking system restricts financial sector development, thus reducing economic growth. However, one of the oldest debates in economics has remained the relationship between financial development and economic growth. Its root can be traced to Schumpter (1912), when he posits that finance is paramount for economic growth. However, Robinson (1952) argues that economic growth promotes financial development. Financial markets provide an economy with vital services comprising, for example, the management of risk and information, and the pooling and mobilization of savings (Gries et al, 2011).

Financial Repression Theory: This theory bothers on the notion that a set of government legislatures, laws and other non-market restrictions prevent the financial intermediaries of an economy from functioning at their full capacity. The policies that cause financial repression include interest rate ceilings, liquidity ratio requirements, high bank reserve requirements, capital controls, and restrictions on market entry into the financial sector, credit ceilings or restrictions on directions of credit allocation and government ownership or domination of banks. Economists have commonly argued that financial repression prevents the efficient allocation of capital and thereby impairs economic growth (Okpara, 2010).

Empirical Literature

Many empirical studies carried out have supported the idea that financial development does indeed brings about economic growth while others opposed the proposition that financial development leads to economic growth. Oriavwote and Eshenake (2014) examined the implications of financial development on economic growth in Nigeria, using time series data for the period of 1990-2011. The study applied the co-integration analysis with its error correction mechanism; the variables included Real Gross Domestic Product, Financial deepening (ratio of money supply to GDP, liquidity ratio, interest rate and the credit to private sector). These findings show that financial sector development has not significantly improved private sector development, while the capital base and liquidity ratio has improved the level of economic growth in Nigeria. Madichie, et al., (2014), applied OLS, ADF and PP unit root tests, Johansen cointegration, error correction model, and the Granger causality procedures to examine the relationship between financial development and economic growth in Nigeria using data from 1986 – 2012. The results revealed that financial development affects economic growth negatively in the long run whereas its impact on economic growth is positive in the short run. The results also revealed that long run relationship exist between financial development and economic growth while causality runs from economic growth to financial development in Nigeria.

Olanrewaju, et. al. (2015) studied the causal linkages between banking sector reforms and output growth of manufacturing sector as well as the direction of such causality. A selected sample of financial development and manufacturing output of Nigeria with annual data between 1970 and 2008 were used and co integration and Granger-causality techniques were applied to ascertain evidence regarding this important issue. The result of Granger causality analysis according to the

study showed that the MGDP and banking sector reforms indicators (BF) move differently with one not predicting the other within the study period. Moreover,
the empirical results showed that Bank assets, lending interest rate with co-efficient, exchange rate and real rate of interest positively and significantly affected the manufacturing sector‟s output growth in Nigeria. On the other hand, the financial deepening indicator (M2/GDP) and Interest rate spread negatively and significantly impacted on the MGDP in Nigeria, showing that the effects of banking sector reform indicators could vary widely in an economy. The study concludes that with proper banking policy formulations and guidance in the financial sector, the manufacturing output growth would be positively affected.
Chude and Chude (2016) investigate the impact of financial development on economic growth in Nigeria from 1980-2013. Vector error correction model were employed. They obtained the following results, firstly, the trace statistics of the Johansen co integrating equation shows that there exist a long run equilibrium relationship between financial development and economic growth in Nigeria, secondly, ratio of broad m one y supply to GDP have no significant impact on economic growth in Nigeria, thirdly, ratio of domestic credit to private sector to GDP have no significant impact on economic growth in Nigeria.
Adediran, et al. (2017), using the ARDL technique, found a long-run relationship existed between financial development and inclusive growth after employing proportion of domestic credit to GDP as a proxy for financial development. This study did not pay attention to other variables that can proxy financial development like credit to the private sector.
Nkamnebe, et al. (2023), investigated the impact of financial development on economic growth in Nigeria between the period 1985 to 2022 using ARDL as a method of analysis. The results of the long run show that all share index, exchange rate and financial technology positively and insignificantly impact on economic growth in Nigeria.

METHODOLOGY

Model Design

Given the nature of this study, the study employed a correlational research design which is suitable for the social sciences. The complexities and dynamic nature of the relationships existing between the variables informed the use of correlational design. Such relationships are not subject to manipulation.

Model Specification

The mathematical form of the model is expressed as

RGDP = F (FD, GOVEXP, INFL, EXP, IMP) 1

Where RGDP = Real gross domestic product

FD = Financial deepening measured by M2

GOVEXP = Government expenditure

INFL = Inflation rate

EXP = Exports

IMP = Imports

RGDP is the dependent variable

The linear regression model based on the above functional relation is expressed as:

$$RGDP = \beta_0 + \beta_1 FD + \beta_2 INFL + \beta_3 GOVEXP + \beta_4 EXP + \beta_5 IMP \quad 2$$

$$\Delta RGDP_t = \alpha_{0i} + \beta_{1i} RGDP_{t-1} + \beta_{2i} FD_{t-1} + \beta_{3i} GOVEXP_{t-1} + \beta_{4i} INFL_{t-1} + \beta_{5i} EXP_{t-1} + \beta_{6i} IMP_{t-1} + \sum^{q}_{i=1} \alpha_1 \Delta RGDP_{t-1} + \sum^{p1}_{i=1} \alpha_2 \Delta FD_{t-1} + \sum^{p2}_{i=1} \alpha_3 \Delta GOVEXP_{t-1} + \sum^{p3}_{i=1} \alpha_4 \Delta INFL_{t-1} + \sum^{p4}_{i=1} \alpha_4 \Delta EXP_{t-1} + \sum^{p5}_{i=1} \alpha_5 \Delta IMP_{t-1} + et \quad 3$$

ECM

$$\Delta RGDP_t = \alpha_{0i} + \sum^{q}_{i=1} \alpha_{1i} \Delta RGDP_{t-1} + \sum^{p1}_{i=1} \alpha_{2i} \Delta FD_{t-1} + \sum^{p2}_{i=1} \alpha_{3i} \Delta GOVEXP_{t-1} + \sum^{p3}_{i=1} \alpha_{4i} \Delta INFL_{t-1} + \sum^{p4}_{i=1} \alpha_{5i} \Delta EXP_{t-1} + \sum^{p5}_{i=1} \alpha_{6i} \Delta IMP_{t-1} + \lambda ECT_{t-1} + et \quad 4$$

$B_1 \geq 0$, $\beta_2 \geq 0$, $\beta_3 \geq 0$, $\beta_4 \geq 0$, $\beta_5 \geq 0$, $\beta_6 \geq 0$

Where β_0 is the regression constant or intercept,β_1,$\beta_2\beta_3\beta_4$and β_5 are the regression coefficients or parameters and U is the random variable. All other terms are as earlier defined.

Empirical Results and Discussions

Table 1: Augmented Dickey Fuller and Philips Perron Unit Root Test for RGDP Model

Variable	ADF					PP				
	Level		1st Diff		I(.)	Level		1st Diff		I(.)
	Coeff.	5% CV	Coeff.	5% CV		Coeff.	5% CV	Coeff.	5% CV	
FD	-0.315	-3.527	-4.723	-3.530	I(1)	-0.080	-3.527	-4.827	-3.530	I(1)
GOVEXP	-2.030	-3.527	-6.402	-3.530	I(1)	-2.149	-3.527	-6.417	-3.530	I(1)
INFL	-4.124	-3.530			I(0)	-2.880	-3.527			I(0)
RGDP	-2.411	-3.527	-4.481	-3.530	I(1)	-2.355	-3.527	-4.398	-3.530	I(1)
EXP	-1.591	-2.937	-7.143	-2.939	I(1)	-1.533	-2.937	-7.187	-2.939	I(1)
IMP	-1.538	-3.563	-4.826	-3.563	I(1)	-1-114	-2.937	-6.361	-2.939	I(1)

The result of the unit root test using both the Augmented Dicky Fuller Test (ADF) and Philips Perron Test (PP) are displayed on Table 1 above. To get a robust result for this empirical study, we made do with the outcome of Philip Perron statistics due to the robust nature of the results in point of structural breaks. In line with the prepositions of Jenkins and Box (1970). Variable that

are not stationary at level will be made stationary after first difference. FD, GOVEXP, EXP, IMP and RGDP were all stationary after first difference while INFL rate was stationary at level.

Table 2: Bound Test for RGDP Model

ARDL Bounds Test
Date: 08/03/22 Time: 10:01
Sample: 1983 2021
Included observations: 39
Null Hypothesis: No long-run relationships exist

Test Statistic	Value	K
F-statistic	5.427127	5

Critical Value Bounds

Significance	I0 Bound	I1 Bound
10%	2.75	3.79
5%	3.12	4.25
2.5%	3.49	4.67
1%	3.93	5.23

Source: Computed from E-view
The result presented in table 2, shows that the F-statistics calculated is 5.427127 which is higher than the upper bound critical value of 4.25 at 5% significant level. Based on this result, it is concluded that a long run co-integration exists among the variables of RGDP model.

Table 3: ARDL-ECM Short-run Results for RGDP model

ARDL Cointegrating And Long Run Form
Dependent Variable: RGDP
Selected Model: ARDL(2, 2, 2, 2, 2, 2)
Date: 08/03/22 Time: 10:04
Sample: 1981 2021
Included observations: 39

Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(RGDP(-1))	0.558747	0.238176	2.345947	0.0294

D(EXP)	11.055469	15.021079	0.735997	0.4703
D(EXP(-1))	-22.154031	11.108344	-1.994359	0.0599
D(FD)	-0.567373	0.348569	-1.627719	0.1192
D(FD(-1))	-0.470420	0.369316	-1.273759	0.2174
D(GOVEXP)	348.28686 3	160.106827	2.175340	0.0418
D(GOVEXP(-1))	-437.33001 7	165.308446	-2.645539	0.0155
D(IMP)	-41.042526	26.635344	-1.540905	0.1390
D(IMP(-1))	47.768069	27.679107	1.725781	0.0998
D(INFL)	-16.807385	11.189455	-1.502074	0.1487
D(INFL(-1))	17.883285	11.059262	1.617041	0.1215
CointEq(-1)	-0.219319	0.101032	-2.170787	0.0402

Cointeq = RGDP - (217.2555*EXP + 1.6255*FD + 3774.1783*GOVEXP
-640.9022*IMP -84.6158*INFL + 6209.4409 + 1119.7802)

Source: Computed from E-view

Explanation of estimated short run for RGDP model

The result of the short – run dynamic regression of the model is presented in table 3. The regression result indicates that in the short run, FD, IMP and INFL coefficients have negative relationship with RGDP but positive relationships for GOVEXP and EXP. What this means is, increase in financial deepening, imports and inflation rate would lead to decrease in real gross domestic product in Nigeria in the short run ceteris paribus. A unit increase in government expenditure would lead to an increase in real gross domestic product in the short run, all things be equal. A unit increase in export output would lead to an increase in real domestic product, ceteris paribus but exports coefficient is not statistically significant. Also increase government expenditure and exports would lead to increase in real gross domestic product in the short run all things being equal. Though financial deepening, imports and inflation rate coefficients are negative but do not significantly affect the relationship that exists between FD, IMP, INFL and RGDP. This means that financial deepening, imports and inflation rate do not meaningfully pose any problem to economic growth in Nigeria in the short run. What could be adduced for this type of relationships between RGDP and FD, IMP, INFL rate is the fact that there are other factors other than financial deepening, import output and inflation rate that could negatively affect economic growth (RGDP) such as high unemployment, pandemic, illiteracy etc.

The ECM turns up with a negative value of -0.219319 as the Error correction mechanism coefficient which suggests 21% speed of adjustment. This means that approximately 21% of discrepancy in the previous year is adjusted for the current year.

Table 4: ARDL Long Run Regression for RGDP Model

Long Run Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EXP	217.255528	86.489252	2.511937	0.0207
FD	1.625517	0.450207	3.610598	0.0017
GOVEXP	3774.178259	2114.517964	1.784888	0.0895
IMP	-640.902244	297.313236	-2.155647	0.0435
INFL	-84.615796	80.289492	-1.053884	0.3045
C	6209.440852	2215.642685	2.802546	0.0175

Source: Computed from E-view

Explanation of the Estimated Long-run for the Model

The result of the long run regression estimates for RGDP model is presented in table 4. The regression estimates indicate that all other coefficients except that of imports and inflation rate are positively signed. But it is only exports, financial deepening and imports that are statistically significant. This indicates that in the long run, an increase in exports and financial deepening would positively affect real gross domestic product (economic growth) in Nigeria. This result is consistent with that of Hassan et al. (2011) and Botev et al. (2019), which confirms a long-term positive relationship between financial deepening and economic growth in developing countries like Nigeria. This result is also in agreement with the findings of Abou-Strait (2005) who ascertained that export is a catalyst necessary for the economic growth of any nation. This according to him is because it leads to employment in the economy as higher demand for exports requires more production which in turn leads to employment of more people.

However, imports coefficient is negatively signed and also statistically significant. What does this portend? It thus means that an increase in imports would reduce real gross domestic product which is not good for the economy of Nigeria. Time might not be wasted to explain the effects of inflation and government expenditure coefficients since they are both not statistically significant.

Tables 4.1 Residual Diagnostics Test for RGDP

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.262070	Prob. F(2,18)	0.7723
Obs*R-squared	1.103504	Prob. Chi-Square(2)	0.5759

Source: Computed from E-view

The null hypothesis states that there is no serial correlation. Since each of the F-statistics probability value is greater than five percent we cannot reject the null hypothesis of no serial correlation. It means that the result is good.

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.777365	Prob. F(18,20)	0.7023
Obs*R-squared	16.05381	Prob. Chi-Square(18)	0.5888
Scaled explained SS	1.993922	Prob. Chi-Square(18)	1.0000

Source: Computed from E-view

The null hypothesis states that there is no heteroskedasticity. Since each of the F-statistics probability value is greater than five percentage we cannot reject the null hypothesis of no heteroskedasticity. It thus mean that the result of the model can be taken seriously, that is the result is good.

4.2 Stability Tests for RGDP

The test is meant to test the appropriateness and stability of the estimated ECM model. This is to check if the coefficients of the model are stable and can be used for prediction. The stability test was conducted using the cumulative sum (CUSUM) and cumulative sum of square (CUSUMSQ) tests. If the plot of the CUSUM and CUSUMSQ for the model lies within the 5 percent critical bound, it is suggestive that the model is stable. From our results, the model is stable.

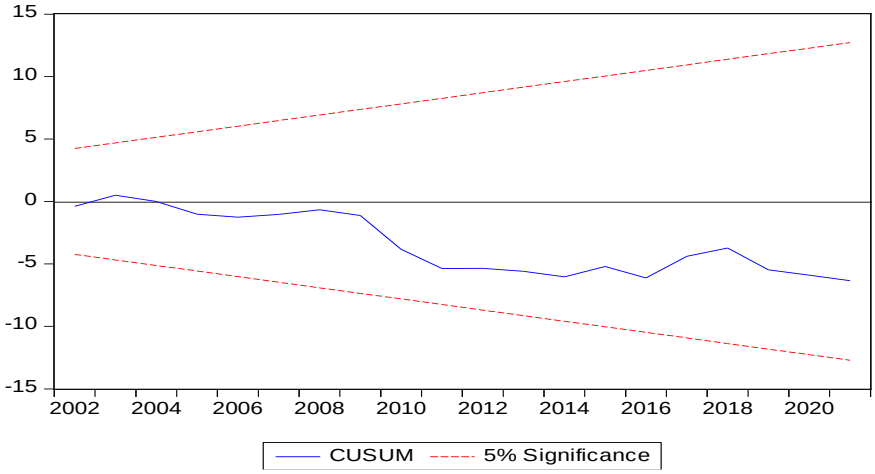

Figure 1b: Cumulative sum for the Model

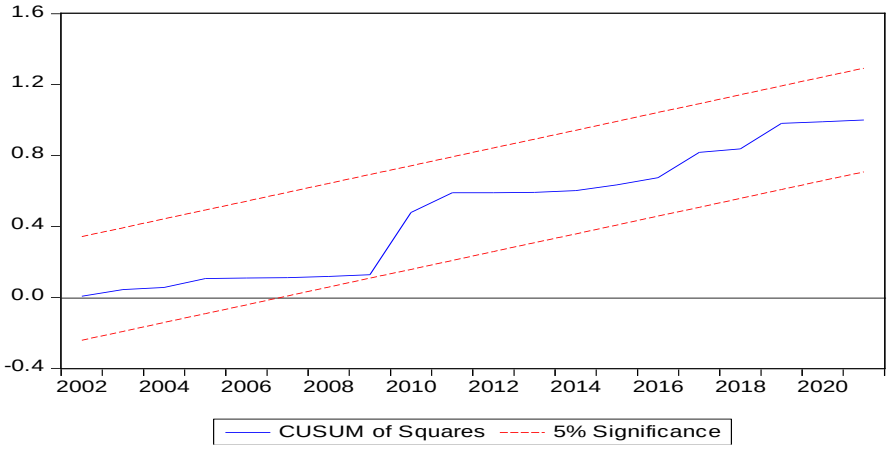

Figure 1b: Cumulative sum of Square for the Model

Conclusion/Recommendations

This paper examined the link between financial development, trade performance and economic growth in Nigeria from the period 1981 – 2021. The study investigated the long run and short run relationship between the variables by using Autoregressive distributed lag (ARDL). The empirical results show that Real gross domestic product (RGDP) is influenced positively by government expenditure (GOVEXP) financial deepening (FD) and Exports (EXP) in the long run and it is only GOVEXP and EXP that are positive in the short run. Financial deepening, exports and imports coefficients are found to be statistically significant only in the long run, while GOVEXP coefficient is statistically significant only in the short run. Import output coefficients (IMP) and inflation rate coefficient (INFL) are negatively signed in both the short run and long run and they are as well statistically significant.

The study recommends that in order to sustain and enhance the existing relationship between financial sector development and economic growth in Nigeria, there is need to sufficiently deepen the financial system through innovations, adequate and effective regulation and supervision, a sound and efficient legal system, efficient mobilization of funds and making such funds available for productive investment, and improved services.

Appropriate trade and foreign exchange policies in favor of export expansion should be encouraged because exports drive economic growth. Proper implementation of import control measures that will certainly sharpen the understanding of the determinants of import behaviour.

That Nigerian trade performance should be improved through economic diversification so as to reduce much emphasis on oil export and there should be availability of funds for private sector at Competitive interest rate in order to encourage the production of internationally competitive products.

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