

# Deposit Money Banks Activities and Economic Development of Nigeria

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## Abstract:

The study examines the impact of Deposit Money Bank (DMB) activities on economic development in Nigeria. The study used annual data from the period 1981 to 2018 sourced from the CBN statistical bulletin and World Bank Development Index Website. Preliminary test of descriptive statistic, unit root test and correlation analysis were employed. The analysis involved the estimation of the Ordinary Least Squares (OLS) and General Least Squares (GLS) estimation techniques to determine the dynamic pattern of response of economic development with respect to changes in DMB activities. Specifically, findings showed that only DMB branches have significant positive effect on economic development in Nigeria. Bank Deposits and Exchange rate have a non-significant positive effect on economic development in Nigeria while bank credit and interest rate have non-significant negative impact on economic development in Nigeria during the period under review.

## Keywords:

Deposit Money Banks, Economic Development, Bank Credit, Banking Sector

## 1. Introduction

Economic development for over a century has been the main objective of both developed and the developing nations of the world. However, development process will require deliberate investment in human and material resource to achieve this objective. As such, development is economic growth that comes with changes in output re-distribution and economic structure. The process of economic development focuses on quality improvements, the introduction of new goods and services, risk moderation and the changes in inventions and industrial leadership [36].

Therefore, the banking sector is vital for the financing of these investments and production through its basic activities performed by banks; one is deposit-taking through the mobilization of idle funds in the hands of customers thereby offering them interest on amount saved and the other is lending activities, from here, the bank earns interest on funds borrowed for personal and business investment [30].

In extant literature, a vibrant and sound banking sector has been identified, indisputably, as a vital catalyst driving the growth rate of an economy [33,39,10].

Globally, the banking sector is seen as the livewire of any economy and as such determines the financial health of such an economy. In fact, the activities of Deposit Money Banks (DMBs) and specialized (development) banks play vital role in financing economic development. Moreover, the level of intermediation in banking sector ultimately increase the growth rates of an economy. Most empirical literature in economics and finance agreed with this submission [46]. Therefore, Economic growth theory affirms that financial institutions especially DMBs are necessary drivers of the productive capacity of the economy as well as provider of internal financial resources during the birth stages of economic growth of a country [44].

Thus, part of the functions of DBMs included but not limited to: mobilizing and attraction of deposits from customers, funding of real economic activities through loan provisions, trade financing etc. Therefore, they serve as an important channel that connects both savers and investors in their intermediation role in an economy. Since a larger part of international trade is not a spot transaction (contract); DMBs provide references and guarantees, on behalf of their customers, when they act as forfeiters to importers and exporters. This is particularly important in international finance when the parties reside in different countries and are very often unknown to one another.

Before now, the direction of relationship between banking sector activities and economic growth has been widely researched with miss findings in extant literatures. Hicks [25] posited that financial sector drives economic growth and development. This is called supply leading, because DMBs provide liquid funds to support economic activities leading to economic development. On the other side of the debate, some researchers believe that economic development leads to financial growth and development. Notwithstanding, this paper believes in the supply leading trajectory.

While it is the position of economist and finance experts that the Nigerian banking sector has not played its intermediation role efficiently in the case of lending to Small and Medium Scale Enterprises (SMEs) which to a large extent constitute the drivers of the development process, nevertheless the low saving rate and high cost of borrowing justifies this signify inefficiencies. This challenge nonetheless, this study assesses the impact of banking sector activities on Nigeria' economic development from 1980 to 2018. Besides, there have been several studies on the impact of financial development on economic growth, bank credit on economic growth as well as the impact of banking sector reforms on economic growth [11,4,19; Igbiosa, 2012, 2014). But we find relatively scanty studies concerning the impact of banking sector activities on economic development in Nigeria. Therefore, this study is aimed at filling this gap in knowledge.

The rest of this paper is structured as follows. Following the above introduction is the review of the literature (conceptual review and empirical review). Sections 3 deals with the Methodology of the study while sections 4 & 5 present and interpret the results and finalize with the conclusion and recommendations respectively.

## **2. Literature Review**

### ***2.1. The Concept of Economic Development***

Economic development in a broad sense entails increase in per capita income, low unemployment, increase in gross domestic product, low inflation, elimination of poverty and mal-nutrition, high life expectancy rate, access to clean environment, availability of electricity supply at affordable rate, clean drinking water, and health

care services, low infant and maternal mortalities; improved facilities for education and learning as well as high human development index. Existing literature has supported the relationship between banking sector development and economic growth. The supply-leading hypothesis that was well espoused by McKinnon [28] and Shaw [37] confirms the fast-tracking effect of banking sector and financial activities on economic growth. In 1993, King and Levine posited that financial markets, majorly DMBs play an important role in the growth of real sector capital formation that stimulate the tempo of economic activities.

Alfara [8] examined the contribution of the banking sector in funding the process of economic development in Palestine over the period of 1995 to 2011. The study submitted that banking sector activities like credits extended, bank deposits, interest income, and the number of bank branches positively affect economic growth. And concluded that bank credits positively affect GDP (Gross Domestic Product), however the link is not significant to guarantee the attainment economic development in Palestine

Furthermore, Christopolus and Tsionas [16] examined the link between financial development and economic growth using a case of ten developing countries. The study found no bidirectional relationship between financial deepening and the growth rate of the economies in the short run but confirm a unidirectional causality from financial developments to growth rate of these economies at least in the long run. Theoretically, banking sector activities affects economic growth through a combination of increase access to financial services, and the efficiency of financial intermediation which will stimulates capital formation and economic growth.

## **2.2. Banking Sector Activities**

World Bank (2009) observed that credit to the private sector is the most comprehensive indicator of the activities of the DMBs which is estimated as the amount of domestic credit allocated to the private sector by the banking sector divided by GDP. It shows the degree to which the banking sector finance real economic activities and more specifically the extent to which DMBs finance private investments and business investments in a country.

Therefore, the indicator shows the capacity of the banking sector as well as its impact on private sector investments in the aggregate economy. Bank credit extended to the organize private sector includes funds that represent a claim for repayment which include loans, purchased of fixed-income securities, trade credits and other accounts receivables hence this domestic credits excludes credit extended to government and public enterprises (Beck and Levine, 2004). This indicator is however expected to positively impact on economic development.

Savings mobilization by the DMBs determines the level of capital formation in an economy for investment and working capital. The volume of deposit/lending attracted by the DMBs is partly a function of the yield spread between deposit and loans to creditors. Therefore, the intermediation between deposits (savings mobilization) and investment (bank lending) contributes to economic development. It has been the submission of some experts that there exist no significant relationship between bank credit and economic growth [48]. Nonetheless, the level of economic activities can be stimulated and the growth rate of the aggregate economy increased by the volume of domestic credit advanced by the banks to the private sector (World Bank, 2008). Becks, Levin, Loayza (2008) noted that bank credit to the private sector determines

the pace of industrialization thereby promoting economic growth in the long-run. Kale, Eken and Selimer [47] noted that the number of bank branches have no effect on economic development, but it helps to deepen financial inclusion. Studies of King & Levine [27], Ndebbio [31], documented that banking sector activities promotes economic development.

### 3. Empirical Review

Kar and Pentecost [24] use system investigation methods to explore the causal relationship between financial development and economic growth in Turkey from 1963-1995. They found that the direction of causality runs from financial development to economic growth. On the other hand, using bank deposit and its credit to the private sector as proxy for financial development; growth is found to lead financial development. On the whole, they assert that growth appears to lead financial sector development.

Güryay and Şafaklı [22] employ OLS Estimation Method to investigate the link between financial development and economic growth in Northern Cyprus between the period 1986 to 2004. They reveal that the impact of financial development on economic growth is almost insignificant. From the Granger causality test result, financial development does not cause economic growth, whereas economic growth was found to cause development of financial intermediaries.

Abugamea [2] investigate the econometric categorization of the inter-relationship between real GDP and actual deposit with banks in Palestine over the period 1993-2006. Employing a Vector Autoregressive (VAR) model and found that actual credit to the private sector and bank customer deposits significantly affect economic growth. On the other hand, a negligible relationship exists between lending and economic growth.

Adegbaju and Olokoyo [5] use descriptive statistics and regression analysis on secondary data to investigate the effect re-capitalization in the banking sector on the performance of DMBs in Nigeria. They found that the mean of key profitability ratios, Return on Equity (ROE) and Return on Asset (ROA) significantly impact performance in the during and after the re-capitalization.

Fadare [19] examine the effect of banking sector reforms on economic growth in Nigeria between 1999 and 2009 using the OLS technique. The study found a significantly positive relationship between economic growth and bank capital while the other banking sector indicators were wrongly signed.

Abdulsalam and Ibrahim [4] investigate the relationship between financial development indicators and economic growth in Nigeria from 1970 to 2010. Using the Johansen and Juselius (1990) approach to co-integration and Vector Error Correction Modelling (VECM). They found that in the long-run, the liability profile of DMBs and trade openness exert significant positive impact on economic growth, but private sector credit, interest rate yield as well as public expenditure significantly impact growth with a negative contribution.

Ehikiorya and Ismailia [41] investigate the impact of commercial bank credits on SMEs (Small and Medium Scale Enterprises) in Nigeria. Using some macroeconomic variables as factors of SMEs output. The results show that bank deposits and exchange rate have a significant influence on SMEs output while interest rate

negatively influenced their output. The study concluded that banks credits had non-significant impact on SMEs output in country.

Abueida and Zibda [1] using econometric model based on Cobb-Douglas production function examine the DMBs lending on economic growth between 1994 and 2013. They found bank credit to the private sector impacted positively on economic growth in Palestine at 5 per cent significant level.

Igbinosa (2015) examined the role of the financial system in financing economic development in developing nations with Nigeria as an example. Specifically, the study analyzed the relationships between financial system credits - deposit money banks', microfinance/community banks', primary mortgage credits and per capita income (proxy for economic development) between 1991 and 2013. Employing the ordinary least squares multivariate regression and the Engle and Granger two-stage techniques, the study found, among others, that microfinance/community bank credits and capital market transactions are significant drivers of economic development, and that deposit money bank credits have no appreciable impact on economic development in Nigeria. In addition, he found that the impact of primary mortgage finance, capital market credits and central government capital expenditures on economic development manifest at least one year later.

Muhammed (2017) explore the effect banking sector indicators on GDP using OLS regression on quarterly data from 2000 to 2015. The study found that banking credits have significant influence on economic growth. Thus banking sector development improve the productive capacity of Palestinian economy as a case of supply leading. However, the other indicators had no significant effect on economic growth.

Okpala, Ezeanolue and Edoko [34] investigate the contribution of commercial banks to economic growth in Nigeria based on secondary data covering the period of 1980 to 2016. Using OLS technique to determine the relationship between financial intermediation and economic growth in Nigeria. The findings show that financial intermediation proxied for banks operations, has a positive and significant effect on economic growth in Nigeria.

Lucchetti, Papi and Zazzaro [45] examine the relationship between the banking sector and economic growth in the Italian sub-regions, adopting a dynamic panel technique. The regression results show that banking sector activities impacted positively on the growth of Italian regional bank.

Ahmed, Yousuf and Lubna [6] using some banking sector indicators such as money supply, domestic and private credit as financial development indicator analysed the relationship between economic growth and financial development. Per capita GDP was proxy for economic growth rate on time series data covering the period 1980 to 2016. Employing co-integration, vector error correction method and Granger Causality test, as analytical methods. The results confirm a unidirectional and bidirectional causality between the financial development and economic growth in Bangladesh. They concluded that financial development leads to economic growth in short-term and long-term dynamics.

From the empirical literature reviewed, only the studies of Muhammed 2017 and Igbinosa 2015 analysed the relationship between some banking sector indicators and economic growth/economic development using data from 1980-2015. While other studies either examined the impact of financial system development on economic growth or bank credit on economic growth [41,4] and to the best of the researchers'

knowledge none of these studies directly examined the impact of banking sector activities on economic development by using data that cover the period of the last economic recession in Nigeria and its rebounding. Hence, this study employs the Ordinary Least Squares (OLS) and General Least Squares (GLS) estimation techniques to provide a robust analysis of the dynamic pattern of response of economic development with respect to a shock in DMB activities from 1981 to 2018.

### **3.1. Theoretical Framework**

#### **Endogenous growth model: The New Growth Theory (Romer, 1990)**

New Growth Theory views technological progress as an off-shoot of economic activity as well as knowledge and technology driving the process of growth. Therefore internalizing technology into a model of how markets functions (Ogbokor, 2001).

The theory provides an understanding of why the economy shifted from a resource-based to a knowledge-based type. That is, economic processes that created and diffused new knowledge are critical to shaping the growth of nations and individual firms. According to Romer (1993), the theory is a shift from resources-based economy to a knowledge-driven economy that guarantees sustained economic growth which ultimately leads to economic development. The main focus of the theory is increasing returns accompanied with new technology.

Therefore, the endogenous growth model is a result of technological progress. That is, the capacity of the economy to produce new goods more efficiently than before as financial development serves as a bridge through which capital moves from declining industries to innovative industries.

### **3.2. Methodology**

#### **3.2.1. Data**

This research assesses the impact of banking sector activities on economic development. It employs time series data over the period 1980 – 2018. The study makes use of secondary aggregate annual data obtained from Central Bank of Nigeria (CBN) statistical bulletin and the National Bureau of Statistics publications. The choice of the time period in this study was to take cognizance of the various reforms that have strengthened the banking sector. This study uses the following financial indicators to measure banking sector activities: bank credit to the private sector (BC), banking deposits (BD), the number of bank branches (BB), and interest rate (I). Moreover, it uses Exchange rate (EXR) as control variable while human development index as a proxy for economic development (HDI).

#### **3.2.2. Model Specification**

We adapted the econometric model used by Mohammed [29] with slight modification by adding a control variable to assess the impact of banking sector activities on economic development in Nigeria. Typically, the functional relationship between banking sector activities and economic development can be formulated as follows:

$$\Delta \text{HDI}_t = f(\text{BC}, \text{BD}, \text{BB}, \text{I}, \text{EXR})$$

Thus, the model can be re-specified in its econometric form as follows:

$$\text{Log HDI}_t = \beta_0 + \beta_1 \text{Log BC}_t + \beta_2 \text{Log BD}_t + \beta_3 \text{Log BB}_t + \beta_4 \text{I}_t + \beta_5 \text{Log EXR}_t + e_t$$

Where, the explained variable Log HDI is the logarithm of human development index at period  $t$ .  $\beta_0$  the intercept. Also, explanatory variables coefficients include;  $\beta_1$  is the coefficient of banking credit to the private sector,  $\beta_2$  is coefficient of banks deposits,  $\beta_3$  is coefficient of number of branches,  $\beta_4$  is coefficient of interest rate and  $\beta_5$  is the coefficient of exchange rate. While,  $e_t$  is residual error. The *a priori* expectations as derived from empirical literature are given as;

$$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5 > 0$$

### 3.2.3. Method of Data Analysis

Preliminary tests of descriptive statistic, unit root test and correlation analysis were employed. Both the Ordinary Least Squares (OLS) and General Least Squares (GLS) estimation techniques were deployed to analyse the dynamic pattern of response of economic development with respect to variations in deposit money bank activities.

## 4. Data Presentation and Analyses

### 4.1. Descriptive Statistics

Skewness of a symmetric distribution is zero which can be referred to as normal distribution. Table 1 shows that all the variables (except for HDI) are positively skewed to the right (that is, they have right long tail distributions established by the positive values). Only HDI has left long tail distribution affirmed by the negative value. Kurtosis measures the peakness or flatness of the distributions. The kurtosis statistics for BB and HDI respectively, were wide apart and not close to three (3) as the benchmark for normal distribution. This implies that the series for these two variables possess a flat distribution that is not a normal distribution. For BC, BD and EXCR had a kurtosis values that are close to three (3), this implies that the series has a normal distribution. While INTR has a peaked distribution that is different from normal with the kurtosis value that is greater than 3.0 approximately. The Jarque-Bera test statistics and its corresponding probability values that are not significant at 5% level also reject the null hypothesis of normal distribution of each variable (except for BC and BD). This means that only BC and BD variables are normally distributed.

*Table 1. Descriptive Statistics.*

	BC	BD	BB	INTR	EXCR	HDI
Mean	4825.212	2930.736	3149.211	17.57662	88.66243	0.391914
Median	480.7708	315.6509	2405.000	17.54000	97.39928	0.465000
Maximum	22521.93	14300.85	5809.000	29.80000	306.0802	0.532000
Minimum	8.570050	5.796000	869.0000	7.750000	0.610025	0.216000
Std. Dev.	7416.464	4461.879	1670.414	4.628232	87.19264	0.131204
Skewness	1.333422	1.342770	0.455852	0.204015	0.799107	-0.313965
Kurtosis	3.240348	3.318289	1.695561	3.668154	2.964197	1.221858
Jarque-Bera	11.35222	11.57960	4.010208	0.970454	4.046318	4.000596
Probability	0.003427	0.003059	0.134646	0.615557	0.132237	0.135295

*Source: Researcher's Computation Using E-view 0.9 (November, 2019)*

### 4.2. Correlation Analysis

From Table 2 only INTR has a fairly strong negative relationship with economic development (HDI) in Nigeria. Other variables show a very strong positive relationship with HDI in Nigeria. This means that increase in deposit money banks

activities increases economic development in Nigeria. Except for INTR increase that decreases economic development in Nigeria as indicated by its negative correlation coefficient.

**Table 2. Correlation Matrix.**

	HDI	BC	BD	BB	INTR	EXCR
HDI	1.000000	0.782207	0.787995	0.906598	-0.500008	0.822538
BC	0.782207	1.000000	0.994467	0.889945	-0.417029	0.861742
BD	0.787995	0.994467	1.000000	0.886854	-0.420555	0.856490
BB	0.906598	0.889945	0.886854	1.000000	-0.457994	0.784791
INTR	-0.500008	-0.417029	-0.420555	-0.457994	1.000000	-0.353157
EXCR	0.822538	0.861742	0.856490	0.784791	-0.353157	1.000000

Source: Researcher's Computation Using E-view 0.9 (November, 2019)

### 4.3. Stationarity Results

The ADF stationarity test shows that at levels only INTR and EXCR variables were stationary and integrated of I(0). However, after taking the first difference of other variables they became stationary and integrated of I(1). Thereby, making the variables fit for further regression analysis. (Table 3)

**Table 3. Unit root test result.**

Augumented Dicky-Fuller Test			
Variable	Adf Stat	Order	Remark
$\Delta$ HDI	-4.555746*	1(1)	Stationary
$\Delta$ BC	3.839125**	1(1)	Stationary
$\Delta$ BD	3.611618**	1(1)	Stationary
$\Delta$ BB	-3.817011**	1(1)	Stationary
INTR	-5.068783*	1(0)	Stationary
EXCR	-4.548282*	1(0)	Stationary
Critical Values			
1%	3.6394	1(0)	Level
	-4.374307	1(1)	1 <sup>st</sup> Diff
5%	2.9511	1(0)	Level
	-3.603202	1(1)	1 <sup>st</sup> Diff
10%	2.6143	1(0)	Level
	-3.238054	1(1)	1 <sup>st</sup> Diff

NB: \* and \*\* represents significant at 1% and 5% respectively.

Source: Researcher's Computation Using E-view 0.9 (November, 2019)

### 4.4. Regression Estimate

The OLS result at the right hand side of Table 4 shows that 91% and 89% of total systematic changes in economic development (HDI) was explained by all the independent variables taken together as indicated by the coefficient of determination  $R^2$  of 0.91 and its adjusted version 0.89. Significant relationship between all the independent variables and economic development was also established as shown by the F-statistic value of 43.48 that is statistically significant at 1% level. However, the D.W statistic value of 0.75 that cannot be approximated to 2.0 suggests the presence of serial correlation in the model and this rubbishes the predictive power of the model making the estimates spurious. The serial correlation was corrected with Concrate-

Ocult autoregressive process. Convergence was achieved after 22 iterations with 26 observations included and the result is presented as General Least Square (GLS) in Table 4.

**Table 4.** Ordinary Least Squares (OLS) and General Least Squares (GLS) Regression Results.

Dependent Variable = HDI (Economic Development)				Dependent Variable = HDI (Economic Development)			
GLS Result				OLS Result			
Variables	Coefficient	t-Statistic	Prob.	Variables	Coefficient	t-Stat	Prob.
C	0.177173	1.150335	0.2643	C	0.032279	0.376750	0.7101
BC(-1)	-8.37E-06	-0.998406	0.3306	BC(-1)	-2.05E-05	-1.927209	0.0676
BD(-1)	3.22E-06	0.286947	0.7773	BD(-1)	1.25E-05	0.692229	0.4964
BB(-1)	6.53E-05**	2.542161	0.0199	BB(-1)	9.28E-05	6.379253*	0.0000
INTR	-0.000734	-0.325402	0.7484	INTR	-0.001793	-0.566543	0.5770
EXCR	0.000398	1.106430	0.2824	EXCR	0.001010	4.825017*	0.0001
AR	0.867556	5.969442	0.0000				
R-squared	0.948435			R-squared	0.911911		
Adjusted R-squared	0.932151			Adj R-squared	0.890937		
F-statistic	58.24395			F-statistic	43.47886		
Prob(F-statistic)	0.000000			Prob(F-statistic)	0.000000		
Durbin.W Stat	1.553295			Durbin.W Stat	0.753842		

NB: \* and \*\* represents significant at 1% and 5% respectively.

Source: Researcher's Computation Using E-view 0.9 (November, 2019)

The GLS result at the left hand side of Table 4 shows that 93% of total systematic changes in economic development (HDI) was explained by all the independent variables taken together as indicated by the adjusted coefficient of determination 0.93. that a linear relationship exist between the dependent variable (HDI) and the independent variables is indicated by the F-statistic value of 58.24 and it probability value significant at 1%. Only BB variable pass its significant test as shown by it probability value of 0.0199 that is < 0.05. This means that only BB hass significant relationship with economic development in Nigeria during the period under review. The D.W statistic value of 2.0 approximately may show the absence of serial correlation in the model.

#### 4.5. Discussion of Findings

The coefficient in the GLS table shows the different degree of relationship between explanatory variables and economic development. Firstly, Bank Credit to the private sector (BC) and Interest rate (INTR) have non-significant negative effect on economic development in Nigeria. BC did not conform to *a priori* expectation could be due to the fact that deposit money banks in Nigeria over the years have failed to meet the growing credit need of the private sector of the Nigerian economy. And from the little credit extended to this sector was at a high interest rate. Hence, the null hypotheses are accepted, that deposit money banks credit and interest rate have no significant effect on economic development in Nigeria. Secondly, Bank Branches (BB), Bank Deposit (BD), and Exchange rate (EXCR) have a positive effect on economic development in Nigeria. However, only the effect of bank branches was significant at

5% level. Hence, the alternate hypotheses is accepted, that deposit money bank branches has significant effect on economic development in Nigeria. This finding is in line with that of Guryay and Şafakli [22], Fadare [19], Ehikiorya and Ismailia [41], Muhammed (2017) in the literature. And contrary to the findings of Kar and Pentecost [24], Abugamea [2], Abueida and Zibda [1] in the literature.

## 5. Conclusion and Recommendations

This study examines the effect of deposit money bank activities on economic development in Nigeria. Using annual data covering the period 1981 to 2018 sourced from CBN statistical bulletin and World Bank Development Index Website. Preliminary test of descriptive statistic, unit roots test and correlation analysis were employed. The basic analysis involved the estimation of the Ordinary Least Square (OLS) and General Least Square (GLS) estimation techniques to determine the dynamic pattern of response of economic development with respect to change in DMB activities. Specifically, findings showed that only deposit money bank branches have significant positive effect on economic development in Nigeria. Bank Deposit and Exchange rate have a non-significant positive effect on economic development in Nigeria. While bank credit and interest rate have non-significant negative effect on economic development in Nigeria during the period under review.

Concluding that DMBs activities have no significant influence on economic development in Nigeria. Specifically, bank credit has negative effect on economic development a pointer to the fact that DMBs have over the years failed to meet the ever increasing credit needs of the private sector. Nevertheless, bank branches have significant positive effect on economic development.

From the findings the following recommendations are made:

- a. A comprehensive legal framework that will aid the monitoring of credit performance and recovery of debts owed to banks to encourage them to willingly lend to the economy.
- b. Deposit money banks should explore better avenues to attract and retain more deposits so as to boost their capacity for lending.
- c. Banks should be encouraged through appropriate incentives to lend more to the productive sector (real sector) if their impact on economic development is to be significant.
- d. A robust road map should be adopted through a collaboration between banks and the governments in tackling the near non-existence and sorry state of social infrastructure such as road networks, portable water and health care to enhance the welfare of the citizens.

## Conflicts of Interest

The author declares that there is no conflict of interest regarding the publication of this article.

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