

The Impact of Economic Liberalization on India's Regional Disparities

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Abstract:

The greater exposure to the market-oriented economy, heralded by the economic liberalization in India in 1991, saw an accelerated growth. But such growth has been distributed unevenly across different states of India, leading to an imbalance between the performances of states. This paper discusses liberalization and its impact on regional inequalities in economic growth within India. The growth of overall economic development following liberalization was faster, and states like Maharashtra, Gujarat, and Tamil Nadu, which are endowed with better infrastructure and human capital, have benefited disproportionately. On the other hand, relatively backward states like Bihar, Uttar Pradesh, and Odisha have lacked adequate investment and growth impetus. The paper looks at various reasons for such divergence: governance, infrastructure, human capital, and the implementation of policies. It also covers the role that interventions by the central and state governments can play in terms of balancing regional development. The paper concludes with proposed policy measures intended to reduce disparities and provide for inclusive growth in terms of improved infrastructure, education, and attracting investments in backward areas. Knowledge of such dynamics essentially stands before the policymakers who have to handle regional imbalances so that wholesome economic growth can take place in India.

Keywords: economic liberalization, regional disparities, economic growth, governance, infrastructure, human capital, inclusive development.

Introduction

The liberalization of the Indian economy in 1991 marked a sea-change in the economic history of the nation. Faced with an acute balance of payments crisis, the Indian government decided, under the helm of Prime Minister P.V. Narasimha Rao and Finance Minister Manmohan Singh, on a set of structural reforms to reorient the economy from a state-controlled and protectionist framework toward a more market-oriented and globalized model. Reforms were made to deregulate industries, reduce import tariffs, liberalize the financial sector, and promote FDI. In fact, these policies targeted economic growth, the reduction of poverty, and modernization of the Indian economy. Although they did succeed in accelerating the growth rate of India's GDP, placing it as one of the fastest-growing economies in the world, they also revealed massive regional disparities in development and a skewed distribution of wealth.

Background to India's Economic Liberalization (1991)

Up until 1991, India pursued a protectionist, socialist economic model—at least theoretically-defined by heavy-handed state control over industries, restrictive trade policies, and an inward-looking approach toward the stimulation of economic growth. The “License Raj” was the system through which the government put in an elaborate set of rules and regulations imposed on private enterprises. This seriously impeded innovation and growth. With an acute fiscal deficit, India's economy started stagnation, since, in the late 1980s, this caused a balance of payment crisis. India had to go to the International Monetary Fund for financial assistance. The prime conditionality for the same was that India had to introduce major economic reforms (Ahluwalia, 2002). These reforms were thus initiated with the stated objective of liberalizing the economy by reducing the role of the state, opening up sectors to private and foreign investment, encouraging competition, and so on. Thus, as an outcome

of all these processes, India's economy gained speed in such a way that GDP growth rates went from an average of 3.5% in the pre-reform era to over 6% in the post-reform period (Joshi & Little, 1996). However, the gain in growth was not distributed properly amongst the country's regions, resulting in possible regional disparity.

Overview of Regional Disparities in India Before and After Liberalization

Even before the liberalization, there was considerable regional disparities in terms of income level, industrialization, and infrastructure development in India. There were advanced states like Maharashtra, Gujarat, and Tamil Nadu with a higher level of per capita incomes coupled with more industrial activities, whereas states like Bihar, Uttar Pradesh, and Odisha were backward (Dholakia, 1994). Actually, liberalization exacerbated these disparities, as the more industrialized states with better infrastructure, governance, and human capital were better positioned to attract investment and benefit from the new economic opportunities. On the other hand, in the post-liberalization period, there was an increasing divergence between the richer and poorer states of India. For example, Gujarat and Maharashtra secured rapid industrialization and inflows of investment whereas Bihar and Uttar Pradesh lagged far behind due to their poor infrastructure as well as weak governance that made their competitiveness in the liberalized economy difficult. Nayyar, 2008, asserts that such divergence has raised a number of questions concerning inclusiveness of India's model of economic growth as well as effectiveness of government policies which are supposed to reduce inequalities across regions.

Research Objectives and Key Questions

This paper investigates the impact of economic liberalization on regional disparities in India. More precisely, it will analyse how the states with varying levels of infrastructure, governance, and human capital fared under the liberalized economic regime. Based on the discussion above, the important questions this study seeks to investigate include:

- How has economic liberalization influenced regional disparities in income in India?
- What are those aspects that accounted for the success of a few states and failure or stagnation of the rest in the post-liberalization era?
- What are the influences of the government's policies, both at the Centre and states, on the development of lagging regions?
- What is the role of political, economic, and institutional factors in shaping regional economic outcomes? With answers to these questions, this study will be better placed to offer an all-rounded understanding of the challenges as well as opportunities which economic liberalization has so far created for India's regions.

Importance of Studying Regional Inequalities in a Developing Country like India

Regional inequality can thus be considered a critical issue in developing countries like India, given its grave implications for social stability, political cohesion, and long-term economic growth. In fact, in a country that is as diversified as India, with its wide variation in geography, culture, and resources, unequal economic development may further create conditions for social unrest, migration, and political marginalization. Secondly, regional disparities make it hard to attain national development goals since such disparities concentrate wealth and opportunities in a few states while others lag behind. In all, it is important to study regional disparities in India with a view to designing policies for inclusive growth in all regions of the country. On the other hand, reducing regional disparities is essential to the sustainable development of people's poverty reduction and social and political stability of the country.

2. Historical Context of Economic Liberalization

The pre-1991 economic structure of India was characterized by a heavy state control with an inward-looking orientation and a mixed economy essentially relying on the public sector. Just after independence in 1947, India adopted an economic

model inspired by socialism based on central planning to achieve higher industrialization along with poverty reduction. The operating economic philosophy at the time laid immense stress on the role of the state in key industry control, plus the regulation of private enterprises through a “License Raj” system. Businesses were made to obtain licenses from the government for setting up and expanding their operations. This results in superfluous bureaucratization and inefficiencies. Private investment, domestic and foreign, was also restricted by the pervasive trade and industrial policies. Although this model succeeded in establishing a rudimentary industrial base and improved social indicators such as literacy and life expectancy, it also ensured stagnation in economic growth as well as productivity and innovation (Bhagwati&Panagariya, 2012).

As for the period preceding 1991, the regional economic structure of India exhibited divergent development patterns in each category. Relatively better-off states included Maharashtra, Gujarat, and Tamil Nadu, with comparatively stronger industrial bases with better infrastructural support, while more agrarian and less developed states included Bihar, Uttar Pradesh, and Odisha. Even in these relatively more industrially advanced states, full realization of potentiality was constrained by the centrally planned nature of the economy and restrictive policies inhibiting competitiveness and innovations.

By the late 1980s, this economic model had more obvious limitations as India faced increasing fiscal problems. The economic growth during this period was slow, popularly termed the “Hindu rate of growth,” averaging not more than approximately 3.5% per year. Besides, the fiscal deficit was unsustainably mounting and peaked at 8.4% of GDP in 1990-91. Large public sector losses, along with weak productivity and falling export performance, accentuated this fiscal crisis. Incidence of the Gulf War in 1990-91 further saw oil prices shoot upwards and started to place pressure on India’s foreign exchange reserves, driving the country towards a balance of payments crisis. In fact, by the middle of 1991, the foreign exchange reserves were said to be inadequate to

cover imports beyond a period of three weeks (Ahluwalia, 2002). Faced with a severe economic crisis, India approached the International Monetary Fund for aid, which agreed to provide financial assistance but on the condition that India would undertake structural reforms aimed at liberalizing the economy.

Indeed, as a response to the crisis, came a set of bold economic reforms that the then-Indian government under Prime Minister P.V. Narasimha Rao and Finance Minister Manmohan Singh unleashed in July 1991. The reforms had aimed at changing India from a state-controlled economy toward one more market-driven, based on deregulation of industries, competition, and private and foreign investment. One of the major reforms carried out was the industrial deregulation policy that marked the end of the License Raj regime and freed the private enterprises from inhibiting restrictions. It allowed businesses to function freely and gave a fillip to competition and efficiency Bhagwati&Panagariya, 2012. The other major reform involved promoting Foreign Direct Investment: the government removed restrictions on foreign ownership in various sectors. It attracted a lot of the foreign capital, technology and expertise that was badly needed for higher industrial development and the attendant jobs creation.

Significant financial sector reforms were also introduced. Controls on interest rates were relaxed, and this was combined with sanctioning the operation of private banks as well as encouraging competition in the financial markets. According to Ahluwalia, 2002, it was supposed to be in modernization of banking in India and also a way of enhancing efficiency in resource allocation in its financial system. It was during the same period that the government initiated the trade liberalization policy by reducing import tariffs, dismantling quantitative restrictions and promoting export-oriented industries. The far-reaching trade reforms were aimed at integrating India with the international economy, making it more competitive and reducing its dependency on imports Joshi & Little 1996.

The economic liberalization reforms which were initiated in the year 1991 were quite contrary to earlier economic policies of India and formed the foundation for rapid development of the Indian economy. While these reforms undoubtedly helped modernize the Indian economy and promoted higher growth rates, they have also caused uneven development across regions, as states with better infrastructure and governance succeeded more in capitalizing on the new opportunities. Thus, even while the liberalization reforms were transformative of India's economy, at the same time they underlined the relevance of addressing regional disparity for inclusive growth.

3. Understanding Regional Disparities in India: A Detailed Analysis

Since regional development began, regional disparities have been an overarching concern in India, as these are indicative of differential growth among its different parts. This gets demonstrated on a number of dimensions-economic, social, and infrastructural. The paper does a detailed examination of regional disparities in India, which covers the definition, the major pointers, and the historical background more specifically before 1991.

Defining Regional Disparities

Regional disparities in India refer to unequal development across the different regions of the country. These could be categorically represented across three dimensions, namely:

- **Economic Disparities:** These are more pronounced in differences related to income levels, availability of jobs or employment opportunities, and industrialization. Some regions might enjoy higher per capita income compared to others, with more industries and job opportunities.
- **Social Inequalities:** These include differences in education, health, and social welfare within regions. Some have high literary rates, better availability of health facilities, and a low percentage of below poverty levels.
- **Infrastructural disparities** mainly reflect differences in infrastructure facilities related to transportation, energy,

and communication. Some regions may boast better roads, proper electricity supply, and telecommunication networks compared to other regions.

Some Key Indicators of Disparity

Following are some of the key indicators to estimate regional disparities in India:

- **Per Capita Income:** It simply represents the average per capita income of a region. The regions that have a higher per capita income have normally been found to report greater levels of development (Mishra & Kumar, 2019)

- **Infrastructure:** This refers to the roads, railways, airports, ports, and supply of electricity. Therefore, the better the infrastructure, the more significant would be the availability of economic opportunities within those regions.

- **Literacy:** The proportion of people aged 7 years and above who can read and write. In general, the higher the level of literacy in a region, the better the educational and economic performance. (UNICEF 2023)

- **Poverty:** The percent of a population that lives below the poverty line of a region. Generally, a region with a high level of poverty has lower development.

- **Industrial Development:** It is an indicator that serves to convey the level of industrial development in a region; it encompasses variables like number of industries, employment in industries, and value added by industries. The more highly industrially developed states would, in the usual course, present greater growth in GDP per capita (Singh & Kumar, 2018).
Pattern of Disparities across States Before 1991
India, before 1991, followed the path of a centrally planned economy that sought to reduce disparities within its wide diverse regions through state intervention. In practice, this policy was hardly fully implemented and large differences between various states remained. Some of the main inequalities that did exist prior to 1991 include:

- **Development Disparities**-Relatively speaking, one could say that the states of Maharashtra, Gujarat, and Tamil Nadu were more developed with a higher industrialization rate, better infrastructure availability, and higher per capita income, while states like Bihar, Uttar Pradesh, and Madhya Pradesh were less developed due to low levels of industrialization, poor infrastructure, and lower per capita income Chakravarty (1987).

- **Social Disparities:** States like Kerala and Himachal Pradesh had relatively higher literacy rates and better health indicators compared to their respective counterparts in Rajasthan and Bihar (Sen, 1999).

- **Infrastructural Disparities:** States like Maharashtra and Tamil Nadu were relatively more developed in terms of transport and communication infrastructure compared to Uttar Pradesh and Bihar (Dhar& Roy, 2002). These were essentially partial outcomes of historic factors such as colonial legacy, geographical location, and consequently, government policies.

One of the biggest challenges has been the regional disparities in India. Though a few positive changes have occurred since 1991-the year of economic liberalization-imbalances are still palpable. Understand the causes and consequences of disparities for devising policies to ensure viable equal development across different parts of the country.

4. Impact of Economic Liberalization on Regional Growth

The policy turn of 1991 truly revolutionized the economic policies in India. It was represented by deregulation, privatization, and globalization. Its impact on the regional development was manifold and varied as it caused rapid growth in some states while stagnation in the rest. This was quite reflective of the dissimilar effects of economic liberalization. The paper deals with the impact of economic liberalization on regional growth in India, covering issues related to the states that benefited and those that lagged, and the role of FDI in regional development.

States that Benefited

There were a number of states in India where considerable economic growth was recorded after the liberalization in 1991. Maharashtra, Gujarat, and Tamil Nadu became the leading performers. The following were the important factors behind their success:

- **Infrastructure:** Relatively better infrastructure in the form of transport networks, power supply, and communication facilities ensured less friction in economic activities and attracted investment into the states.

- **Governance:** Good governance translated into efficient bureaucracy, political stability, and investor-friendly policies that created an enabling climate for businesses and investments.

- **Human Capital:** In general, the states possessed skilled and educated human capital, crucial for attracting industry and driving innovation. Economies That Fell Behind Notwithstanding above general attainment of economic liberalization, some states were falling behind in economic development. Among such states are Bihar, Uttar Pradesh, Odisha, and a few others. Their retarded state of development may be attributable to the following causes:

- **Poor Infrastructure:** Most of them had as poor infrastructure-like bad roads, low power supply, and inadequate transport facilities-which deterred economic activities and investors.

- **Governance Issues:** Corruption, political instability, and inefficient bureaucracy created a non-conducive environment for businesses and investors. This discouraged them from investing and eventually slowed the pace of economic development.

- **Lack of Investment:** These states received relatively less investment-both domestic and foreign-on account of the foregoing reasons. This meager investment confined their economic development.

Case Studies: Comparative Analysis

The case study comparison will be useful in order to put in perspective the divergent experiences of the success stories and laggards.

- **Maharashtra vs. Bihar:** The leading state of Maharashtra enjoys its rich industrial base, developed infrastructure, and favorable business environment. It has led to rapid economic growth due to the fast pace of investments in this state, both domestic as well as foreign. On the other hand, a poor state, Bihar, is still battling poverty, undeveloped infrastructure, and problems in governance. But in recent times, though there has been an effort to have a better economic situation, many obstacles are yet to be crossed over.

- **Gujarat vs. Odisha:** In India, another successful state is Gujarat, which has been experiencing an unprecedented growth of rapid industrialization and economic development due to its favorable business climate, governance efficiency, and quality manpower. Odisha, therefore, had challenges concerning infrastructure development, issues related to governance aspects, and almost an underdeveloped industrial base. Odisha has been performing better over the last few years but is really behind compared with most of the other states on economic performance.

Role of Foreign Direct Investment (FDI)

FDI has played a significant role in the regional development of the country. States with better investment climates have secured much higher FDI inflows as compared to other states, such as Maharashtra, Gujarat, and Tamil Nadu.

This investment has created jobs, transferred technology, and generally spurred economic growth. The distribution of FDI across regions has been very uneven. States with poor infrastructure, governmental administration, and low human capital end up receiving very meager FDI.

The impact of economic liberalization on regional growth in India has been uneven. While states such as Maharashtra, Gujarat, and Tamil Nadu have raced ahead, many others, including Bihar, Uttar Pradesh, and Odisha, are underperformers. Physical infrastructure, good governance, and human capital have become important factors that have contributed to success or failure across regions. The FDI has also played a major role: states receiving more FDI are recording higher rates of growth. The need to address the

gaps in regional development is multidimensional in nature, pertaining to investment in areas such as infrastructure, governance, and policies stimulating inclusive growth.

5. Factors Contributing to Regional Disparities

Governance: The Role of State-Level Political Leadership to Policy Implementation

Governance has played a very significant role in the growth and development of regions. The role of state-level political leadership goes a long way in terms of how resources are utilized and mobilized. In many instances, good governance ensures good policy implementation, which also engenders economic growth and development. Such states that are characterized by dynamic leadership usually develop region-specific strategies in line with the needs of the region, while ensuring that such development actually becomes inclusive (Rodríguez-Pose & Gill, 2004). On the contrary, weak governance encourages mismanagement and corruption, hence widening the gap in regional disparity. Decision-making authority of state leadership in India determines industrial policies, land reform matters, and even social welfare programs. The leaders who are more receptive to inclusiveness and regional development foster greater equality in economic growth.

Infrastructure: Availability and Quality of Transport, Energy and Industrial Infrastructure

Availability and the quality of infrastructure—roads, railways, ports, energy supply, and industrial zones—are highly important in determining the economic potential of a region. The more developed the infrastructure, the greater the possibility of attracting industries and encouraging trade that could generate adequate employment and income. Poor infrastructure, on the other hand, is a barrier to growth. Poor infrastructure inflates operational costs for firms and acts to limit market access. **Infrastructure Development:** According to Fan and Zhang, 2004, infrastructure makes it easier for the government to reduce poverty and create more regional balance through connectivity and accessibility to resource points. Many developing regions of India have inhibiting

constraints in transportation and energy conditions that hamper developmental potential. The uneven distribution of physical capital, therefore leads to regional imbalance.

Human Capital : Education, Skill and Labour Market Dynamics across States

These inequalities in education and skill development quality, along with labour market dynamics, have a very important implication for regional growth. Regions with high-calibre educational institutions and better skill development programs possess a more competent labour force; hence, they attract investment in high-skill industries. The productivity of a region is enhanced by a skilled and educated population, and it fuels innovation. Areas with poor literacy levels and weak educational infrastructure become incapable of generating skilled labor; therefore, such areas are less attractive to prospective investors. For example, states in India that have higher educational awareness, such as Kerala and Tamil Nadu, have shown greater socio-economic growth compared to the states with a very low level of literacy, such as Bihar and Uttar Pradesh. The dichotomy of human capital has caused a spiraling difference in regional development.

Policy Implementation: Variation in How States Implement Central Policies and Economic Reforms

In most cases, policies are initiated from the Centre to attain a balanced regional development in the country. However, how such a policy is implemented matters a great deal in the state's contribution to its success. States that implement such reforms efficiently gain more economically. For example, in the early 1990s, India adopted policies promoting industrial liberalization, which have since created various growth trajectories in the various Indian states. Economically, in states that adapted rapidly, such as Gujarat and Maharashtra, rapid industrialization and economic development took hold. States slow to implement reforms, such as Bihar, were far slower to grow in their economies (Ahluwalia, 2000). This divergence in policy implementation has formed one of the significant driving forces behind regional disparities.

Investment Climate: Ease of Doing Business and State Policies Attracting/Detering Investments

The investment climate in a state contributes to determining the level of private sector participation and hence regional economic growth. States that establish investor-friendly policies, effective regulatory frameworks, and have lower bureaucratic hurdles tend to enjoy more foreign and domestic investments. For example, states like Karnataka and Maharashtra have developed an investment-friendly climate; multinational companies get attracted, thus developing innovation clusters like Bengaluru and Pune. On the contrary, states that have inconvenient or too-lengthy regulatory procedures or exhibit political instability have a tendency to discourage investors, thus slowing down their economic growth. According to the World Bank, 2020, the factor of variation in the investment climate among regions is what enables the explanation of regional differences in economic development.

6. Policy Recommendations for Reducing Regional Disparities

6. 1. Infrastructure Development in Lagging Regions

Infrastructure development in underdeveloped areas is one of the most effective methods of trying to iron out inequalities among regions. Indeed, the lack of even just plain basic infrastructure, such as road and transport networks, sources of energy, and telecommunications, is a high-order obstacle to economic growth in lagging regions (Fan & Zhang, 2004). In particular, the relevant authorities must make special efforts at developing transport corridors, energy grids, and industrial parks that promote trade and attract investment. Better connectivity between rural and urban areas would help in easy access to the market, a reduction in transportation costs, and regional integration. Also, selected infrastructure development will provide employable opportunities in those regions, thereby reducing poverty and inequality. In collaboration with the private sector, governments should spend a higher share of the budget in order to bridge these infrastructural gaps in the said regions to ensure efficiency and innovation.

6.2. Improvement in Education and Skill Development Programs

Addressing human capital disparities is another very relevant element of any strategy for reducing regional inequalities. Investments in education and skills development can go a long way in raising the productive powers of lagging regions. States that are better educated and technically trained are attractive for investments in high-skill industries, propelling growth. As Becker says, “Policymakers have to make sure that all states, more so the underdeveloped ones, get enough resources to upgrade their systems of education.”. This involves increasing the budgetary allocation for schools, teacher training programs, and technical institutions, with easy accessibility for vocational and skill development training programs for workers from the disadvantaged areas. This sort of thing can help equip the workforce with the kind of skills that will be needed in new industries and reduce unemployment and underemployment in less developed regions. A focused nationwide effort at improving both primary education and higher education in all states is necessary to balance the economic opportunities across states.

6.3. Strengthening Governance and Political Accountability within States

Governance is basic and intrinsic to any attempt at reducing regional imbalances. Poor governance and weak institutional structures often further exacerbate regional disparities through mismanagement of resources and/or non-implementation of development policies. Governance within states has to be strengthened through developing a sense of political accountability, enhancing the level of transparency, and reducing corruption (Rodríguez-Pose & Ezcurra, 2010). At the same time, decentralization can also help in improving the mode of governance by giving greater leeway to local governments to make decisions according to the particular needs of their respective regions. State governments have to work out mechanisms that ensure greater equality and fairness in the sharing of resources so that the benefits of development are shared by all sectors of society. Therefore, introducing accountability-enhancing

measures such as periodic audits, public reporting systems, and enforcement of anti-corruption laws can bring efficiency in the realm of public administration. In this way, the doing of development policies can be effectively practiced, which further minimizes regional disparities.

6.4. Tax Incentives to Encourage Regional Investments Pursue Ease of Doing Business Reforms and Establishment of Regional Development Funds

In the process, in the case of stimulating economic growth in lagging regions, governments should create an enabling environment through targeted tax incentives that would encourage private investment in setting up industries in underdeveloped areas. Tax breaks and subsidies can thus lower the cost of doing business, hence making the regions attractive to investors. (World Bank, 2020). These other reforms entail making it easy to do business, such as by simplifying regulatory procedures, easing land acquisition, and reducing bureaucratic delays. The setting up of regional development funds in particularly lagging regions also forms part of these tasks that governments ought to carry out. In this respect, such funds can be utilized for encouragement of entrepreneurship, support for SMEs, and financing of public infrastructure projects that benefit regional economic development. Policy makers can play their role in reducing these disparities between and within states by incentivizing investors towards backward areas through financial support and an enabling regulatory environment. It will indeed require a multi-faceted approach toward the reduction of regional disparities by addressing root causes of economic inequalities. Strengthening infrastructure, improvement of education and skills, governance, and pro-regional investment policies form the core of recommended policy prescriptions for bridging gaps in development between leading and lagging regions. With these measures in place, governments can make growth more inclusive-so that all regions both contribute to, and benefit from, overall economic development.

Conclusion: The Impact of Economic Liberalization on India's Regional Disparities

Undoubtedly, economic liberalization changed the face of the Indian economy as it started growing rapidly along with accelerated industrialization. But it also resulted in increasing regional imbalance as certain states like Gujarat, Maharashtra, and Karnataka benefited at the expense of others such as Bihar, Odisha, and Uttar Pradesh. The key findings indicate that regions with comparatively better infrastructure, skilled labour, and investment climates have witnessed accelerated growth, while the underdeveloped regions-with major governance-related challenges and generally weak human capital-remain far behind in the catching-up process. It is such regional disparities that call for immediate and urgent attention if India is to achieve long-term economic stability and social cohesion. If allowed to persist, such disparities would eventually result in social unrest, eventual uneven development, and, in general, a stifling of growth for the entire nation. After all, balanced growth by the states means that no region lags in economic expansion at the same time as contributing towards it. This leads towards an equitable society. What is required in the relatively backward regions of India are development strategies that strike a balance: an inclusive approach with fast infrastructure investments, skill development, and governance reforms. Similarly, policies that spur private investment and innovation in underdeveloped areas are urgently needed for balance in growth. Future studies should, therefore, look at decentralized governance, the impact of sector-specific investments, and more detailed effectiveness studies concerning current policies being pursued as remedies for regional disparity. These will help policymakers to make more focused interventions so that they can come up with a more balanced economic landscape in the country.

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