

Government Reorganization: Liu Mingkang and Financial Restructuring

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The Chinese government was in the midst of a major reorganization when the severe acute respiratory syndrome (SARS) epidemic exploded upon Beijing. That reorganization will go forward, but the suspension of much government activity because of SARS highlights the fact that this ongoing reorganization is still far from complete. The long gestation reflects the powerful competing interests that are at stake. This article examines the creation of one new agency, the China Banking Regulatory Commission (CBRC), and discusses the qualifications and personality of its head, Liu Mingkang. It uses the case of Liu to illustrate the emergence of a new kind of economic technocrat in China.

Government Reorganization

As of early 2003, the Chinese government was absorbed in a change of administration. Undoubtedly, this change of administration would have slowed the Chinese response to any unanticipated crisis—such as the SARS epidemic that in fact arose. Still, China's slow initial response to SARS has been widely noted and condemned, and that response's roots in China's secretive, authoritarian tradition have been frequently—and correctly—pointed out. An additional reason for the slow response, which has also been noted, is the gradual power transition that has been occurring at the very top of the Chinese Communist Party political structure. As Hu Jintao was moving slowly and deliberately to consolidate his own power and to ensure that Jiang Zemin's hold on power was gradually weakened, dramatic and decisive moves were delayed, and the top power-holders put off making essential decisions. The delay, and the attempt to cover up the disease, have already cost China enormously, and may impose huge further burdens on China and the world.

The fact that a new administration is just getting established in China will likely interact with the SARS epidemic in other costly ways. The government reorganization was in the early phases of implementation in March and April 2003. Just as China's new leaders had opted for a slow and methodical transition at the top, so they had opted for a thorough and methodical—and therefore necessarily also somewhat slow—reconstruction of operations in the administrative agencies of the government. These changes are incomplete, but the SARS crisis will inevitably lead to further delays and to the distraction of top administrators away from organizational transition. This consequence is an additional way in which SARS will result in a period of diminished government effectiveness in China.

The basic outline of the government reorganization, as expected on the eve of the 10th National People's Congress (NPC), was described in my contribution to *CLM* 6, "The Emergence of Wen Jiabao." The reorganization plan ultimately approved by the NPC conformed closely to expectations, with only a few minor variations introduced at the last minute. The new agency that replaced the State Development Planning Commission was named the State Development and Reform Commission, a bit of proreform atmospherics that involved dropping the word "planning" from the name altogether. A new "superministry," a Ministry of Commerce which brings together foreign and domestic trade regulation, was created as expected. A number of new commissions and regulatory agencies were created, the most important of which are the China Banking Regulatory Commission and the State Assets Regulatory Commission.

The overall purpose of governmental reorganization is to shift the functions and capabilities of the Chinese state toward greater compatibility with a market economy. The changes are designed to make the Chinese government significantly stronger as a regulatory body and to reduce direct government management of businesses. Reorganization is also a response to China's membership in the World Trade Organization (WTO). Repeatedly, concerns have been raised over China's administrative and regulatory capabilities, particularly whether they are sufficient to ensure compliance with the country's WTO commitments. Although China's WTO membership officially began on January 1, 2002, the most important commitments are being phased in over the next few years. The creation of new regulatory agencies, and of a superministry for commerce, constitutes an attempt to provide administrative muscle that can push through WTO commitments and provide the institutional underpinnings to a working market economy.

Competing Interests

The reorganization of regulatory agencies does not seem to be the most exciting of topics. But, reorganization does not merely involve reshuffling government functions. The establishment of the new regulatory agencies requires answers to fundamental questions about authority over public property, as well as new rules concerning the management of public assets. Inevitably, there is a great deal of backstage maneuvering and conflict over reorganization. For this reason—and because of the complexity of the issues involved—reorganization takes time. Uncertainty is created about the final shape of the new organizations and rules, which of course is of interest to bureaucratic insiders. In addition, uncertainty extends to the outcome of efforts to tighten oversight of public property, to claw back revenues that de facto have become privatized, and to initiate relatively transparent programs of privatization. In the short run, this uncertainty reduces the effectiveness of oversight and, in the worst case, may create a scramble to establish rights over various kinds of public property. Thus, protracted implementation almost inevitably brings about a short-run decline in government effectiveness.

The deeply contentious issues about control of public property are most obviously in play with respect to the establishment of the new State Assets Regulatory Commission

and the new China Banking Regulatory Commission. The State Assets Regulatory Commission must sort out thorny questions such as: (1) Who has the right to appoint managers and corporate board members of public companies? (2) Who has control over profit streams? (3) Who has the right to privatize public firms? and (4) Who has the responsibility to audit public firms' performance? The new head of the State Assets Regulatory Commission, Li Rongrong, is a rising star who will have significant influence on this process. The new China Banking Regulatory Commission faces similarly challenging questions. In the process of cleaning up the problem of nonperforming loans, for example, critical decisions have to be made about control of wealth. Will regulators be empowered to go after government insiders who have directed loans to pet projects, or into their own pockets, and who now claim to be unable to repay the banks? Will banks be allowed to sell control of public firms with bad debts to the highest bidder? Who will bear the costs of cleaning up the bad loans? Regulators will have to mobilize substantial political authority behind their choices, and the ways in which their regulatory agencies are established will affect the degrees of success they ultimately achieve.

The Case of the CBRC

The creation of the China Banking Regulatory Commission, and the appointment of Liu Mingkang to head it, were important outcomes of the 10th National People's Congress. The CBRC formally opened its doors on April 28, 2003. But in fact, the reorganization had been widely reported since early 2002, when it was discussed at a meeting of the Central Financial Work Commission (CFWC). Moreover, Liu Mingkang's name had been widely circulated in speculations about the identity of the commission's head. Thus, in a sense, the establishment of the CBRC has been in progress for over a year, and it is not yet completed.

The CBRC is often characterized as the independent agency that results from the extraction of the current regulatory functions of the People's Bank of China (PBC) from that institution. In addition, however, the CBRC will absorb functions from the Central Financial Work Commission. The CFWC—created under the previous Zhu Rongji administration and headed then by current Premier Wen Jiabao—served as an authoritative instrument of government oversight of the banking system. The CFWC was a powerful body, but it was created in a rather informal, ad hoc way. Merging its powers with the PBC's regulatory functions will be a complex process. Among other things, the CFWC exercised authority over personnel appointments in the state-run banks down to the provincial level. The CFWC also appointed a board of supervisors for each of 16 state-run financial institutions. These exceptional personnel powers really derived from the government's role as owner of the state banks, so they are not fully consistent with the CBRC's mission of acting as a purely regulatory agency. A difficult challenge will be to strengthen the CBRC's regulatory oversight while somehow reducing its direct management control over state bank assets and personnel. Of the CBRC's initial total personnel of about 400, roughly 200 will come from the PBC, and 120 will come from the CFWC.¹

The CBRC also lacks a straightforward legal charter. The CBRC is not sanctioned by any of the main laws that govern the banking system. But, the NPC has neither the time nor the space on its infrequent meeting agenda to rewrite the banking laws expeditiously. Instead, the NPC Standing Committee will pass a kind of “continuing resolution” to allow the CBRC to start work. This distinction is quite significant because the CBRC has been given a fairly broad supervisory mandate, incorporating nonbank financial institutions as well as banks narrowly defined. Many issues of jurisdiction will have to be hammered out over the next few months. The creation of this new structure will continue to be a work in progress for the foreseeable future. As such, the state of the CBRC’s development is emblematic of the nature of the government reorganization in general: deliberate, delayed, and complex, yet still moving forward.

Technocrats

Liu Mingkang and Zhou Xiaochuan, the new head of the People’s Bank of China, exemplify new leadership trends in the economic bureaucracies. Both men are consummate technocrats, both are well educated and experienced, and both approach issues from an analytic and intellectual standpoint. The use of the term “technocrats” in this context must be distinguished from its common use to describe the top leadership in China. The summit of political power, the Standing Committee of the Politburo of the Chinese Communist Party, is a surprisingly uniform group, of similar age and similar educational experiences: all were trained as engineers before the Cultural Revolution. In a sense, these political leaders are “technocrats,” by virtue of possessing university degrees in technical subjects and perhaps sharing a certain worldview. But, no members of the top leadership rose to positions of authority practicing the professions in which they were educated. Every one of them shifted to a “political” career track early on and rode a political promotion track to attain the heights of power.

By contrast, the group of professional bureaucrats just below this level—such as Liu and Zhou—is composed of true technocrats, individuals with higher-education specialization in the professional fields in which they have made their careers. They are technocrats not simply by virtue of a generalized background as technically educated individuals, but rather in the sense that they are genuinely specialized, well trained, and experienced. For the first time, many in the top bureaucratic positions have studied abroad in the West or in Japan.² As one account puts it, “[T]he 16th Party Congress established that engineers run the party; now the [10th] NPC has determined that overseas returnees have entered the cabinet.”³ Many members of this group—even those who have not studied abroad—have excellent English-language skills. In general, a relatively small proportion of those who have studied abroad have doctoral degrees; most have professional degrees, or have spent a year or two as visiting scholars. This trend indicates something about their ages and career paths: this group was already in line for important posts at the beginning of the Reform Era. Rather than pulling up stakes entirely for long-term residence abroad, they have tended to remain focused on their careers while adding one or two years of training abroad.

These new technocrats have moved up to positions of considerable personal influence, but they have primarily been promoted through their own functional bureaucracies, particularly those having to do with finance. Liu Mingkang has made virtually his entire career in the banking system. Similarly, the recent NPC ratified a basic continuity of personnel within the Ministry of Finance, as individuals within that system were reshuffled and moved upward. The head of the State Administration of Taxation, Jin Renqing, became the new minister of finance, while the intellectual and policy-oriented Vice Minister Lou Jiwei moved over to replace Jin as head of the State Administration of Taxation. Furthermore, a few months later, former minister of finance Xiang Huaicheng was named the new head of the Social Security Pension Fund. Thus, a very experienced and specialized team remained in the key posts of the financial system.

What makes this pattern especially interesting is that top technocratic officials can also move out of the specialized systems into general political jobs. This potential is particularly strong for finance technocrats. Thus, Dai Xianglong, the popular and generally successful head of the People's Bank of China, became mayor of Tianjin at the 2003 NPC meetings after he graduated from the PBC. Wang Qishan, who has just become the acting mayor of Beijing, served for a decade in the banking system, including a stint as head of the Construction Bank of China. Before being called in to replace the disgraced Beijing leadership, Wang had just been appointed governor of Hainan Province.⁴ A slightly different pattern is displayed by Hua Jianming, the new secretary-general of the State Council. Hua moved from a general political job (vice mayor of Shanghai under Jiang Zemin!) to a financial post (secretary-general of the Central Finance Work Group) before moving back to his most recent general administrative post.

The increasing political importance of bureaucrats with economic responsibilities is especially evident in the Chinese Communist Party Central Committee. Lots of attention was paid to the party's decision in 2002 to admit entrepreneurs, but only a tiny handful of independent businessmen became Central Committee members. By contrast, many managers of state-controlled firms became Central Committee members, including all three heads of the "big three" oil companies. Similarly, the heads of the state banks, including Liu Mingkang and Jiang Jianqing, are alternate Central Committee members, as is Shang Fulin. Zhou Xiaochuan, the new PBC head, is a full Central Committee member. These patterns clearly show the increased importance of economic technocrats, and especially finance bureaucrats, at the top of the political structure. A technocrat such as Zhou Xiaochuan has a possibility of moving higher, and his name is mentioned in discussions of possible future premiers. But, Zhou has political liabilities as well: during the NPC session, Zhou received the lowest total of votes of any ministerial nominee ("only" 92 percent of the votes), reflecting continuing resentment over stock market losses incurred while Zhou was the head of the market regulatory agency.

The New Head of the CBRC: Liu Mingkang

Liu Mingkang's career reflects many of the characteristics of economic technocrats described in the previous section. Born in August 1946, the son of a law professor, Liu joined the Bank of China in 1979. He was posted to London with the bank in 1984. He received an M.B.A. from the City University of London in 1987. He speaks excellent English and is well known in international finance and economic circles. While he has a strong management record, he clearly has also been seriously studying, thinking, and writing about financial issues for a long time.⁵

Liu's career has been predominantly with the Bank of China since 1979. He worked his way up through the bank, and was assigned to the Fuzhou branch in 1988. In 1993, in a somewhat unusual move, he was appointed vice governor of Fujian Province. Soon thereafter, he returned to the banking system and continued moving up. He was appointed vice governor of the State Development Bank in 1994 and vice governor of the People's Bank of China in April 1998. He has also served as a member of the PBC's Monetary Policy Committee (along with new PBC Governor Zhou Xiaochuan).

The highly visible phase of Liu's career began in August 1999. He left his position at the PBC to become head of China Everbright, succeeding Zhu Xiaohua. China Everbright is a "red chip," a Hong Kong-based corporation with People's Republic of China (PRC) ownership and a complex and highly personalized past. Zhu Xiaohua was arrested for corruption, and Liu Mingkang was sent in to clean up the mess. Although China Everbright was certainly a nest of questionable business practices, it remains unclear to this day whether Zhu Xiaohua was personally guilty of significant corrupt practices. Zhu Xiaohua had been a favorite of Zhu Rongji since the late 1980s when they worked together in Shanghai, and he was also well known as a serious policy intellectual within financial circles. There is ongoing debate as to whether Zhu Xiaohua was personally corrupt or was simply a sacrificial victim of personal jealousy and power politics.⁶

In any case, Liu was successful in stabilizing the foundering China Everbright, and in refocusing it on investment and commercial banking. He also moved it tentatively into insurance and other financial services, keeping the firm consistent with the image of a comprehensive financial services provider. However, he was soon called upon to step into a much larger, and potentially politically more explosive, scandal. In February 2000, Liu was called upon to succeed Wang Xuebing as head of the Bank of China. Liu's return to the Bank of China was made necessary by the spectacular implosion of Wang Xuebing, which was triggered by the discovery by U.S. regulators of improper practices at the New York branch of the Bank of China. Wang Xuebing had himself been a highly regarded, rapidly rising star within China banking circles, albeit one with substantially more taste for the high life than the careful bureaucratic survivors who are the subjects of this discussion. (In contrast to the case of Zhu Xiaohua, it has never been suggested that Wang Xuebing was innocent of the abuses of which he was accused.) The Bank of China was ultimately fined \$20 million by regulators in the United States and China for cronyism in placing loans out of the New York office. Through June 2000, Liu concurrently held the head jobs at China Everbright and the Bank of China, amazingly dealing with the aftermath of major scandals at both—nor was that the end of it. By

October 2001, Liu had to deal with a case at the Kaiping, Guangdong, branch of the Bank of China, in which the bank manager and his cronies disappeared (perhaps to Canada) after embezzling at least \$480 million.⁷ As a result of these cases, Liu gained a reputation as something of a cleanup batter, capable of resolving messes left to him by earlier managers.

For three years leading up to March 2003, Liu was the most important individual shaping the Bank of China, and his activities went far beyond simply cleaning up after scandals. Liu compiled a good record at the Bank of China. The Bank of China is in a unique position. Like the other “big four” banks in China, the Bank of China is state-owned. However, the Bank of China is clearly a better-run bank for a number of different reasons. First, for years the Bank of China was China’s financial window to the world, possessing a monopoly, and then a semimonopoly, on international financial transactions. As a result, bankers at the Bank of China have traditionally had much more exposure to international best practices than have other bankers within China. Moreover, the Chinese and foreign companies dealing with foreign trade are typically of a higher grade than the average Chinese domestic firm, and the Bank of China has little to do with the especially troubled financial institutions in China’s rural areas. Finally, the Bank of China existed even before 1949, and the bank picked up overseas branches in places such as London and Singapore, as well as Hong Kong, that had significant expertise and significant autonomy. All these factors quite understandably imply that the Bank of China had more capability, and a lower level of problem nonperforming loans (NPLs), than did other state-run banks. Of course, even if it is in a relatively advantageous position compared to China’s other state-owned banks, the Bank of China still has many serious problems, including substantial NPLs.

Liu Mingkang inherited, and then systematically advanced, a program to make the Bank of China a pacesetter for China’s entire financial reform program. If the Bank of China could transform its own corporate governance system, and control its NPL problem, it could serve as a model for the other banks. Liu Mingkang threw himself into this process. His first challenge was to restructure the Bank of China group itself. The Hong Kong operations of the Bank of China group, the source of the bulk of Bank of China profits, had developed over the years through a sprawling series of takeovers and start-ups. The historical legacy of multiple, semiautonomous branches in different countries clearly had to be changed, particularly after the Wang Xuebing scandal emerged. Thus, Liu’s first job was to restructure 13 different affiliated banks into a coherent unit by streamlining the Bank of China’s Hong Kong operations.

The reorganization of the Hong Kong business of the Bank of China, undertaken over about 18 months, and the control of the damage from the earlier scandals were sufficiently successful that by July 2002 Liu could proceed with the previously planned flotation of Bank of China Hong Kong (BOCHK) shares on the Hong Kong stock exchange. The listing was successful, as the Bank of China (the parent of BOCHK) sold 22 percent of its ownership stake in BOCHK for a total of \$2.63 billion. The flotation of BOCHK stock is seen as a trial run for future stock market listings of the Industrial and Commercial Bank, the country’s largest lender, the Construction Bank of China, and the

main Bank of China itself. All these have declared that they plan to sell shares by 2005. (The fourth main state bank, the Agriculture Bank, has too many problem loans and troubled affiliates to be talking about listing on the stock exchange at this time.)

Listing on the stock market—even the Hong Kong stock market—is just an external indication of changes in the corporate structures of the firms cited. In the short history of the Chinese stock market, we have seen many cases of listed firms that turned out to have chaotic or nonexistent systems of internal control. Liu Mingkang, however, gave serious consideration to the internal system of corporate governance at the Bank of China, and made some significant progress. He instituted a board of directors at the Bank of China with several independent directors, and established independent audit and other committees under the board of directors. Liu also recognized the importance of a complete restructuring of the incentive system within the banks, calling the needed reforms a program of “carpet bombing.” Liu introduced a system of grades for bank branch heads, who were assigned a grade of A through D based primarily on profitability and progress in cleaning up NPLs. He then posted the grades quarterly on an internal Bank of China web site. Managers who received too many Ds were demoted, and in somewhat over two years, demotions affected six of the 31 provincial branch heads.⁸

Liu Mingkang has been involved in attempts to address the problem of NPLs over the years. He was a participant in the design of the asset management companies that took over a portion of the NPL burden from the banks in 2001. The Bank of China was the first of the state banks to reclassify its loans according to standard international categories, a step that increased the apparent share of NPLs. Today, the Bank of China has the lowest NPL ratio among the state banks. Primarily, no doubt, these achievements are due to the advantages with which the Bank of China started, but improved governance may also play a role. According to the bank’s own figures, the share of NPLs—according to the new, internationally comparable classification—dropped from 27.5 percent at the end of 2001 to 22.4 percent at the end of 2002. The bank asserts that among new loans issued since 2000, fewer than 0.5 percent have been classified as nonperforming.⁹ In other words, Liu Mingkang is well positioned to lead the next wave of efforts to reduce the NPL burden in China.

Financial reform is near the top of the agenda in contemporary China, and it is universally felt that banking reform will be the focus of activity in the second half of 2003. Liu Mingkang has strong, publicly expressed views on the principles for financial restructuring. He strongly advocates the need for transparent systems of information revelation, in order to provide market credibility. He strongly supports market-based solutions for resolving problems, when feasible. Thus, he is likely to push for additional efforts to repackage and sell NPLs, as securities or in swaps for equity in or control of a firm. Liu also has a strong belief in financial innovation and in the need for regulators to cross the boundaries separating traditional banking from nonbank financial institutions. His tenure as head of the CBRC is likely to be marked by movement in these directions. Liu Mingkang’s first appearance as head of the CBRC was on April 20, 2003, in a speech in which he stressed the importance of increasing lending to small and medium-sized enterprises.¹⁰

Character and Personality

Employees of the banking system in China describe Liu Mingkang in consistent terms. He is described as a stickler for rules, a methodical and diligent worker. He is comfortable taking responsibility—to the extent that he is sometimes referred to as a “strong man” (*tiewan*)—but is also universally regarded as moderate and affable (*wenhe*).¹¹ Steady and deliberate, Liu Mingkang has an ability to respect the “face” of his coworkers and subordinates, even while inducing them to accept greater job accountability. Certainly, Liu does not possess the pungent personality of a Zhu Rongji.

These qualities of steadiness, moderation, and diligence are not rare in the current group of leading government personnel. Wen Jiabao himself is seen in this way, and indeed presents himself this way. In his very first press conference after assuming the premiership, Wen mentioned that he had visited 1,800 of China’s 2,500 counties, certainly a demonstration of diligence in action. Indeed, Wen felt compelled to mention that although he was generally regarded as mild or moderate (*wenhe*) in temperament, he was also someone with strong beliefs and opinions who was willing to take responsibility.¹² Whether these characteristics will add up to an effective leadership style remains to be seen. But it may well be that if China is to develop a more responsive political culture to go with its increasingly market-oriented economy, leaders in the mold of Liu and Wen will be necessary to lead the way. Certainly in the first grave test of the new Chinese leaders, it appears that Wen’s behavior was, at a minimum, the “least bad” among those of the top leadership. According to the best accounts we have right now, Wen Jiabao was the first top leader to react strongly and honestly to SARS, when he met with Beijing health officials and demanded that the military stop covering up the extent of the SARS infection at their Beijing hospitals. That meeting, on April 7, came three days after the heroic retired military doctor, Jiang Yanyong, sent the e-mails that began the collapse of the SARS cover-up.¹³

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¹ Zhang Xiaocai, “Yinjianhui 15 si fang’an shano; Zhonghang xinren fuhangzhang renxuan teding” (The CBRC has reported its organizational plan; The vice PBC directors have been named), *Caijing shibao*, March 29, 2003, <http://finance.sina.com.cn>.

² The earlier generation of leaders has often studied in the Soviet Union or Eastern Europe.

³ “Zhongguo ‘haiguipai’ fenfen jinru neige” (China’s “overseas returnees” successively enter the cabinet), *Lianhe zaobao*, March 18, 2003, <http://wenxuecity.com/BBSview.asp?SubID=newsdirect&MsgID=17338>.

⁴ To be sure, Wang has other political assets besides experience in the finance system. He can be considered a princeling, since he is the son-in-law of former vice premier Yao Yilin.

⁵ For example, see his “Closing Remarks” at a seminar held by the Bank of International Settlements in Beijing in March 1999. See *Strengthening the Banking System in China: Issues and Experience*, Policy Paper no. 7 (Basel: Bank of International Settlements, 1999), 341–43.

⁶ Sheng Xue, “Zhu Xiaohua an yu Jiang Zhu quanli douzheng” (The Zhu Xiaohua case and the power struggle between Jiang and Zhu), *Kaifang*, 2002, no. 9: 16–18. There is no suggestion that Liu Mingkang benefited from Zhu Xiaohua’s problems. If anything, he may have been sent in to contain the damage that Zhu Xiaohua’s fall might potentially have inflicted on Zhu Rongji. On the China Everbright phase, see “Liu Mingkang,” <http://www.chinaonline.com/refer/biographies/business/Liu%20Mingkang.asp>.

⁷ Mark O’Neill, “Murky Scandals Cloud List Hopes; Industry Observers Wam of Possible Risks Attached to Bank of China’s Pending Hong Kong Issue,” *South China Morning Post*, April 1, 2002.

⁸ Lu Xiang, “Liu Mingkang: Yinhangye wenhe de ‘tiewan’” (Liu Mingkang: Affable Strong Man in Banking), *Jingji*, April 2003, <http://finance.sina.com.cn>.

⁹ Li Weiling, “Liu Mingkang shenqing huabie Zhongguo yinhang; Xiao Gang churen xinzhang menren” (Liu Mingkang bids an emotional farewell to Bank of China; Xiao Gang takes over as new boss), *Guoji jinrongbao*, March 24, 2003, <http://finance.sina.com.cn>.

¹⁰ Liu Wei, “Three Top Financial Officials on Financial Reform and Development,” *People’s Daily Online* (English), April 22, 2003, http://english.peopledaily.com.cn/200304/22/eng20030422_115598.shtml.

¹¹ Lu Xiang, “Liu Mingkang: Yinhangye wenhe de ‘tiewan.’”

¹² “Wen Jiabao tongguo ‘mianshi’ zhanshi ‘lushan zhen mianmu’” (Wen Jiabao undergoes a face-to-face exam to reveal the true face of things), BBC Chinese Service, March 18, 2003, <http://wenxuecity.com/BBSview.asp?SubID=newsdirect&MSGID=17339>.

¹³ John Pomfret, “Outbreak Gave China’s Hu an Opening: President’s Move on SARS Followed Immense Pressure at Home, Abroad,” *Washington Post*, May 13, 2003, 1.