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# Fund Returns and Net Redemptions under Incomplete Information in China

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## ABSTRACT

This paper delves into the nonlinear flow-performance curve under incomplete information both theoretically and empirically. We find positive slope and negative convexity in the curve of China. These results imply that funds with bad performances are more heavily punished with outflows, compared with the reward to funds with good performances.

## 1. Introduction

The relation between fund return and net redemption is highly controversial. Some scholars verify a straightforward investment strategy, notably, to buy winners and sell losers. Others argue that this simple investment strategy may not be capable of generating sustainable profitability from following three perspectives: persistence of performances of open-end funds (Carhart, 1997); ex post examination of effective investment (Elton et al. 2003; Nanda et al., 2004); and ex ante effective investment models

(Palomino and Uhlig, 2007; Dangl et al., 2008). These studies shed lights on the complicated investment behavior than previously supposed.

In the real world, the relation seems even more intricate. In mature market like the U.S., the flow-performance curve is far from positive linearity, often convex (Barber et al., 2000). In China, the fund market has seen redemption puzzle (Lu et al., 2007), where funds with top performance have experienced striking high net redemptions. Some studies simply attribute the occasional spurious puzzle to the irrational investment behaviors of

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fund investors, while we try to explain the phenomenon with incomplete information and rational investors. We are highly skeptical that the behavior effect are strong and freaked enough to drive investors to drop the best funds and meanwhile maintain the others.

Following Palomino and Uhlig (2007), we build a dynamic game-theoretic model between fund investors and fund managers with incomplete information, which suggests that the relation between fund returns and redemption decisions can be nonlinear. To verify the implications of the model we apply fixed effect and quantile regression on the panel daily data of 47 funds from 2004 to 2010. The empirical results confirm positive slope and negative convexity of flow-performance curve in China. These findings indicate that despite the anecdotal evidence on the redemption puzzle, funds with higher returns on average experience higher fund inflows; besides, investors tend to punish bad funds than reward good funds in China, and Chinese fund market are more punishment-oriented than incentive-driven.

Our research complements existing literature by explaining the redemption puzzle from a longer period. To our knowledge, we are the first to use long daily data of open-end funds in China to study the properties of flow-performance curve. In addition, our research contributes to the understanding of the relation between fund returns and net redemption from the aspect of incomplete information and rational investors.

## 2. Dynamic Game between Investors and Managers under Incomplete Information

Following Palomino and Uhlig (2007), we build the dynamic Bayesian game between fund investors and fund managers. We identify the three categories in each of which investors prefer funds with different return intervals, depending on the ex ante expected return of funds relative with that of stock market.

### 2.1 Assumptions

We assume two types of funds, index funds (henceforth IF) and actively managed funds (henceforth AMF), in the market. The AMF are managed by either a good manager (with binary unconditional probability  $\varphi$ ) or a bad one. An investor can not directly observe the quality of the AMF. Instead, he can only infer the manager types based on observed previous performance.

Specifically, we assume that the IF return is  $\mu_0$ , and the AMF returns  $R_i$  are normally distributed:

$$R_i = \mu_i + \sigma_i \varepsilon, \varepsilon \sim N(0;1), i = \text{good}, \text{bad}; \quad (1)$$

where  $\mu_i$  denotes the expected returns of AMF with

manager  $i$ . Without loss of generality, we assume  $\mu_{\text{bad}} < \mu_0 < \mu_{\text{good}}$ . Managers can choose risk level, captured by volatility  $\sigma_i$ , but cannot choose expected return, a reflection of their capability.

### 2.2 Fund Managers' Optimization

Assume the equilibrium risk level is  $(\sigma_{\text{bad}}^*, \sigma_{\text{good}}^*)$ . The likelihood ratio of investors is,

$$L(R, \sigma_{\text{bad}}^*, \sigma_{\text{good}}^*) = \frac{P(R | \mu_{\text{good}})}{P(R | \mu_{\text{bad}})} = \frac{\sigma_{\text{good}}^*}{\sigma_{\text{bad}}^*} e^{\frac{(R - \mu_{\text{good}})^2}{(2\sigma_{\text{good}}^*)^2} - \frac{(R - \mu_{\text{bad}})^2}{(2\sigma_{\text{bad}}^*)^2}} \quad (2)$$

Upon the previous return  $R$ , investors use the Bayesian rule to compute the conditional probability of a good manager as

$$\begin{aligned} P(\mu_{\text{good}} | R) &= \frac{P(R | \mu_{\text{good}})P(\mu_{\text{good}})}{P(R | \mu_{\text{good}})P(\mu_{\text{good}}) + P(R | \mu_{\text{bad}})P(\mu_{\text{bad}})} \\ &= \frac{\varphi}{\varphi + (1 - \varphi)L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*)} \end{aligned} \quad (3)$$

The managers' objective is to maximize the probability, and

$$\text{Max}_{\sigma_i} P(\mu_{\text{good}} | R) \Leftrightarrow \text{Min}_{\sigma_i} L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*) \quad (4)$$

To reach a solution, we have

$$\begin{aligned} \frac{\delta L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*)}{\delta \sigma_{\text{good}}^*} &= \left( \frac{1}{\sigma_{\text{bad}}^*} - \frac{(R - \mu_{\text{good}})^2}{\sigma_{\text{bad}}^* \sigma_{\text{good}}^*} \right) e^{\frac{(R - \mu_{\text{good}})^2}{(2\sigma_{\text{good}}^*)^2} - \frac{(R - \mu_{\text{bad}})^2}{(2\sigma_{\text{bad}}^*)^2}} = 0 \\ \frac{\delta L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*)}{\delta \sigma_{\text{bad}}^*} &= \left( \frac{\sigma_{\text{good}}^* (R - \mu_{\text{bad}})^2}{\sigma_{\text{bad}}^{*4}} - \frac{\sigma_{\text{good}}^*}{\sigma_{\text{bad}}^{*2}} \right) e^{\frac{(R - \mu_{\text{good}})^2}{(2\sigma_{\text{good}}^*)^2} - \frac{(R - \mu_{\text{bad}})^2}{(2\sigma_{\text{bad}}^*)^2}} = 0 \end{aligned}$$

Given  $\sigma_i^* > 0$ , the optimization is

$$\sigma_{\text{good}}^* = |R - \mu_{\text{good}}|, \sigma_{\text{bad}}^* = |R - \mu_{\text{bad}}| \quad (5)$$

Rational investors acknowledge this, and the posterior probability in Equation (3) is

$$P(\mu_{\text{good}} | R) = \frac{\varphi}{\varphi + (1 - \varphi)L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*)} \Big|_{\sigma_i^* = |R - \mu_i|} \quad (6)$$

### 2.3 Fund Investors' Optimization

Rational investors invest in an AMF rather than an IF only when

$$E\mu_{\text{active}} = P(\mu_{\text{good}} | R) \times \mu_{\text{good}} + P(\mu_{\text{bad}} | R) \times \mu_{\text{bad}} > \mu_0$$

This is equivalent to

$$P(\mu_{\text{good}} | R) > \frac{\mu_0 - \mu_{\text{bad}}}{\mu_{\text{good}} - \mu_{\text{bad}}} = \tau \quad (7)$$

Plugging Equation (6) into (7), we have

$$\frac{\varphi}{\varphi + (1 - \varphi)L(R, \sigma_{\text{good}}^*, \sigma_{\text{bad}}^*)} \Big|_{\sigma_i^* = |R - \mu_i|} > \tau$$

$$\text{i.e., } L(R, \sigma_{good}^*, \sigma_{bad}^*) \Big|_{\sigma_i^* = |R - \mu_i|} = \frac{|R - \mu_{good}|}{|R - \mu_{bad}|} < \frac{\varphi(1-\tau)}{\tau(1-\varphi)} \quad (8)$$

Let  $\lambda = \frac{\varphi(1-\tau)}{\tau(1-\varphi)}$ , then Equation (8) is equivalent to

$$\lambda |R - \mu_{bad}| > |R - \mu_{good}| \quad (9)$$

Equation (9) equals  $\lambda^2 (R - \mu_{bad})^2 > (R - \mu_{good})^2$ . After simplifying this equation, we can deduce that the return of the AMF must satisfy,

$$G(R) = (\lambda^2 - 1)R^2 + 2(\mu_{good} - \lambda^2 \mu_{bad})R + (\lambda^2 \mu_{bad}^2 - \mu_{good}^2) > 0 \quad (10)$$

The discriminant for Equation (10) is

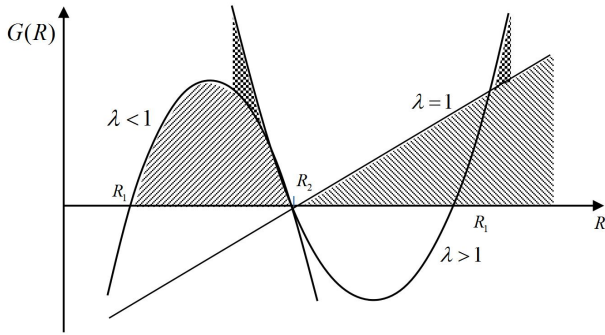
$$\Delta = 4(\mu_{good} - \lambda^2 \mu_{bad})^2 - 4(\lambda^2 - 1)(\lambda^2 \mu_{bad}^2 - \mu_{good}^2) = \lambda^2 \mu_{good}^2 - \mu_{bad}^2 > 0.$$

And two solutions to  $G(R) = 0$  are respectively

$$R_1 = \frac{\mu_{good} + \lambda \mu_{bad}}{1 + \lambda}, R_2 = \frac{\mu_{good} - \lambda \mu_{bad}}{1 - \lambda} \quad (11)$$

## 2.4 Return Intervals for Investors

Figure 1 shows the shape of  $G(R)$  and return intervals chosen by investors in three cases as  $\lambda$  varies.



**Figure 1.** Return Intervals Chosen by Investors Based on  $\lambda$

A. If  $\lambda > 1$

This means  $\varphi > \tau$ , which intuitively implies that the prior probability of good manager is higher than the proportion of the return difference between IF and bad AMF to the return difference between good and bad AMF. And the economic meaning is that randomly investing in AMF gains more than IF (with  $\mu_{good} > \mu_{bad}$ , we get  $\varphi \mu_{good} + (1-\varphi) \mu_{bad} > \lambda \mu_{good} + (1-\lambda) \mu_{bad} = \mu_0$ )

The parabola,  $G(R)$ , now opens up and  $R_2$  and  $R_1$  satisfy  $R_2 < \mu_{bad} < R_1 < \mu_{good}$ . Investors prefer funds with returns falling in  $(-\infty, R_2) \cup (R_1, +\infty)$ . Even if the fund returns pretty low previously, there is a chance that the AMF is still good. And a good manager tend to choose high risk (prestin far away from  $\mu_{good}$ ) while the bad choose low risk. All these factors compensate the low historical return and

make investment in such an AMF profitable. Similar induction holds for high historical return.

B. If  $\lambda = 1$

This means that  $\varphi = \tau$  and the returns of randomly investing in an AMF and IF are equal. In this vein,  $G(R)$  degenerates to a straight line and rational return interval is  $(\frac{\mu_{good} + \mu_{bad}}{2}, +\infty)$ .

C. If  $0 < \lambda < 1$

This means  $\varphi < \tau$  and randomly investing in an AMF is unprofitable. The parabola,  $G(R)$  now opens down and  $R_2$  and  $R_1$  satisfy  $\mu_{bad} < R_1 < \mu_{good} < R_2$ . In this case, Investors choose AMF with returns satisfying  $R \in (R_1, R_2)$ . Intuitively, the low possibility of good AMF make it unprofitable to investing in AMF even if the previous return is high, regardless of the low risk taking of good fund and the otherwise high risk taking of bad fund sequently.

Under incomplete information, rational investors will choose high performing funds if  $\lambda = 1$ , and won't respond linearly to the returns of AMF elsewhere. To summarize, the return intervals chosen by investors are respectively,

$$\begin{cases} R \in (-\infty, R_2) \cup (R_1, +\infty), & \lambda > 1 \\ R \in (\frac{\mu_{good} + \mu_{bad}}{2}, +\infty), & \lambda = 1 \\ R \in (R_1, R_2), & 1 > \lambda > 0 \end{cases} \quad (12)$$

## 3. The Effect of Fund Returns on Net Redemptions

Bailey et al. (2011) figure out that net redemption decisions of investors are determined by market news, tax rates, fund family, behavioral and demographic characteristics of investors, and other factors than solely by fund returns. Different from their research, we also incorporate the influence of asset allocation, including both asset proportion and investment concentration, which is believed to proxy for the unobserved fund risk level and manager ability. More specifically, the asset proportion in the funds reveals the risk level of funds and the investment concentration is closely related to the fund managers' ability.

### 3.1 Variables and Data

In this paper, we employ several redemption indicators as dependent variables, including net purchase amount (NPA), net purchase ratio (NPR), and purchase to redemption ratio (PRR) for robustness. The most important independent variable is undoubtedly the fund returns. Other important independent variables include asset allocation indicator measured with asset proportion and investment concentration, which are also directly observable like NGR and may signal other properties of the fund manag-

ers. Asset proportion characterizes asset diversification, measured by *SAR* and *CAR*. Investment concentration signals hidden information about investment strategies and manager ability, measured by *SFR* and *IFR*. The calculation method of the variables are shown in Table~.

variables	Calculation method
NPA	daily purchasing amount minus the redemption amount
NPR	NPA divided by net fund value
PRR	daily purchasing amount divided by the redemption amount
NGR	growth rate of net value
SAR	stock value held by fund divided by total asset value
CAR	cash held by fund divided by total asset value
SFR	top-ten-stock value held by the fund divided by the total asset value
IFR	top-three-industry value held by the fund divided by the total asset

To lower the confounding influence of the fund market structure<sup>①</sup>, we restrict our sample to stock funds and partial stock funds<sup>②</sup>. We select as our sample a total of 47 stocks and partial stock funds listed in the open-end fund market in China from the second quarter of 2004 to the second quarter of 2010. We exclude the trading data of the first quarter of listed funds for that redemptions are abnormally high shortly after the funds are listed. Some firm-level specific factors may still exert influence on the redemption behavior, and therefore, we apply following fixed effects model in this paper<sup>③</sup>.

$$NPA_{it} = \beta NGR_{it} + \gamma_1 SAR_{it} + \gamma_2 CAR_{it} + \gamma_3 SFR_{it} + \gamma_4 IFR_{it} + c_i + \varepsilon_{it} \quad (13)$$

### 3.2 The First-order Effect

Table 1 shows the first-order effects of fund returns on net redemption, which present two appealing results:

First, the significantly positive coefficients of *NGR* indicate that the increase of return of the funds overall induces more net purchase from the investors, and the results are robust with *NPA* reflecting the absolute value of net purchase, *NPR* reflecting the relative purchase, and *PRR* reflecting trading activity. Therefore, in overall open-end fund market in China, higher returns tend to increase cash inflow to the funds. In other words, we don't observe

the “redemption puzzle” on individual fund level.

**Table 1.** Regression Results of the Fixed Effects Models

	NPA	NPR	PRR
NGR	15997483*** (0.0001)	2.1913*** (0.0000)	0.0125*** (0.0000)
SAR	14335877*** (0.0038)	1.3066** (0.0175)	0.0046*** (0.0003)
CAR	72360806*** (0.0000)	7.1763*** (0.0000)	0.0144*** (0.0000)
SFR	-20708328*** (0.0050)	-2.1342*** (0.0092)	-0.0035* (0.0625)
IFR	1.95E+09*** (0.0024)	130.6255* (0.0671)	0.2744* (0.0923)
R <sup>2</sup>	0.12	0.13	0.18
Prob(F)	0.0000	0.0000	0.0000
DW	1.9892	2.0566	1.9475

Notes: The cells show coefficients with robust standard errors in parentheses. \*, \*\* and \*\*\* denote significance at 10%, 5% and 1% level, respectively.

Second, the asset allocation demonstrate a significant impact on investors' redemption. The coefficients on *SAR*, *CAR*, *SFR*, and *IFR* are distinguishable from zero, indicating that they do make a difference to net cash-flows to the funds. In terms of asset proportion, the positive coefficients on both *SAR* and *CAR* show that investors are in favor of funds with more stocks and cash assets in hand, which may result from investors' preference for higher professionalization and liquidity. Nonetheless, *SFR* is negatively correlated with redemptions whereas *IFR* is on the contrary positively related to redemptions. This suggests that investors hope that the funds invest in some particular industries but not in few specific stocks in the industry.

### 3.3 The Second Order Effect

To verify the non-linear relation between returns and net redemptions put forward in our game model, we conduct a quantile regression (Carhart, 1997), which is applicable by our daily data.

We classify the observations into 7 groups according to the quantiles of the lagged return in the previous day. Weighted averages of the dependent and independent variables in each group are computed to conduct the quantile regression (13). The results where *NPA* and *NPR* are employed as dependent variables respectively are shown in Table 2 and Table 3.

The impacts of fund returns on net redemptions of investors are apparently different in different groups. Net redemptions are influenced by the profitability of funds whatever levels the returns are at, although coefficients on *NGR* in groups High (2), High (3) and Low (3) are negative

① The Chinese fund market consists of four types of funds: stock funds, bond funds, money market funds and hybrid funds. Returns, risks, and investment strategies vary a lot among them and thus investors may respond quite differently.

② Partial stock funds refer to hybrid funds with more than 50% stock asset.

③ We also conduct the Hausman test, the result of which support the application of fixed effect.



**Table 2.** Results of Quantile Regressions on NPA

	High (1)	High (2)	High (3)	Middle	Low (3)	Low (2)	Low (1)
NGR	15020256*** (0.0027)	-3982721** (0.0366)	-5801712* (0.0952)	20715095*** (0.0004)	-4567113** (0.0425)	20364231** (0.0393)	11165208* (0.0669)
SAR	-2086629 (0.7057)	11101441*** (0.0026)	6115447*** (0.0001)	11347856* (0.0991)	-6503724* (0.0673)	26215558** (0.0259)	12553221 (0.2030)
CAR	12416265** (0.0280)	16811094** (0.0217)	8031948** (0.0421)	9658886*** (0.0000)	11076818 (0.1835)	50697583* (0.0508)	45933941*** (0.0000)
SFR	4343248 (0.6067)	1677585 (0.6813)	4511214 (0.2132)	-25621653** (0.0154)	760207.9 (0.8515)	-30444706* (0.0563)	-11986712* (0.0516)
IFR	8.79E+08 (0.1604)	1.10E+09*** (0.0016)	-7.39E+08 (0.2130)	1.69E+09** (0.0235)	-1.38E+08 (0.6637)	2.89E+09* (0.0542)	3.49E+08 (0.5320)
R <sup>2</sup>	0.12	0.19	0.11	0.31	0.10	0.11	0.21
Prob(F)	0.0544	0.0010	0.0807	0.0000	0.1993	0.0407	0.0002
DW	2.0251	2.1578	2.0275	1.9351	2.0682	1.9528	1.998

**Table 3.** Results of Quantile Regressions on NPR

	High (1)	High (2)	High (3)	Middle	Low (3)	Low (2)	Low (1)
NGR	1.2144*** (0.0003)	-0.2531** (0.0253)	-0.2236** (0.0475)	2.3439*** (0.0003)	-0.3473* (0.0527)	1.8594** (0.0406)	1.6970** (0.0206)
SAR	-0.3946 (0.1029)	0.6751*** (0.0003)	0.0558*** (0.0066)	1.7662*** (0.0040)	-0.0541* (0.0604)	0.4513 (0.3736)	0.6422 (0.1779)
CAR	1.5665*** (0.0059)	0.6900 (0.1218)	0.1888** (0.0790)	8.5660*** (0.0000)	0.6211 (0.3825)	5.7455*** (0.0000)	3.1494** (0.0104)
SFR	0.1729 (0.6099)	-0.4869** (0.0230)	0.0030 (0.1953)	-3.0906*** (0.0000)	-0.3738 (0.3712)	-1.1234* (0.0910)	-0.1200 (0.8495)
IFR	-35.9373 (0.2170)	60.2998*** (0.0007)	21.2185* (0.0912)	139.4713** (0.0173)	-2.5610 (0.9287)	64.2149 (0.3143)	-85.8251 (0.1584)
R <sup>2</sup>	0.16	0.17	0.12	0.34	0.10	0.27	0.16
Prob(F)	0.050	0.0029	0.0320	0.0000	0.09273	0.0000	0.0064
DW	2.0576	2.0381	2.0818	2.0163	2.0663	1.9581	2.0386

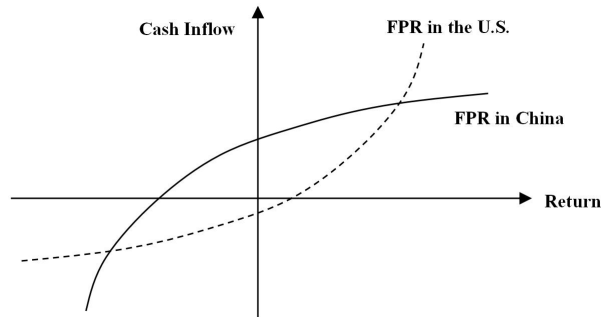
However, we believe this reflects the rational choice of investors rather than a puzzle. As previous studies find that open-end funds as a whole underperform the market index,  $\lambda$  is larger than 1 in China according to its economic implication, and our dynamic model indicates rational investors will prefer higher return in some situations while lower return in others. Therefore, we ascertain that even the occasionally observed “redemption puzzle” may not be an irrational investment behavior in China.

Nevertheless, the impacts of asset allocation on net

redemptions also differs in different groups of funds in the following three aspects. First, the insignificant coefficients on *SAR* in high(1) and low(1) imply that the fund returns dominate in the net redemption decision-makings and that the asset allocation plays little role in terms of these funds. Second, the coefficients on *CAR* are consistently positive and significant in all cases except Low (3), indicating that higher liquidity of the funds is desired by investors. Third, the impacts of *SFR* and *IFR* on net redemptions varies significantly in the groups.

**Table 4.** Results of 1/2 Quantile Regressions on NPA

	NGR	SAR	CAR	SFR	IFR	R <sup>2</sup>	DW
High (1)	10922721*** (0.0006)	10138265*** (0.0026)	17360723*** (0.0021)	2134690* (0.0813)	1.07E+09*** (0.0012)	0.14	1.9328
Low (2)	16139738*** (0.0017)	23758936*** (0.0057)	57326558*** (0.0052)	-12689237 (0.0106)	1.73E+09*** (0.0035)	0.13	1.9893



**Figure 2.** The Flow-performance Relations (FPR) in China and the U.S.

To further examine the convexity in the flow-performance relation in the open-end fund market of China, we run a 1/2 quantile regression on NPA and the results are presented in Table 5. Obviously, the coefficient on NGR in the funds with high returns is less than that in the funds with low returns, i.e.,  $\frac{\partial \text{flow}}{\partial R} \Big|_{R_{\text{low}}} > \frac{\partial \text{flow}}{\partial R} \Big|_{R_{\text{high}}}$ . Hence we have  $\frac{\partial^2 \text{Inflow}}{\partial R^2} < 0$ , which implies the negative convexity in the flow-performance relation in China. On the contrary, researches on the mutual fund market in the U.S. (Barber et al., 2000) uncover positive convexity in the relation, albeit the impact of return on cash inflows is also non-linear.

The difference between the flow-performance relations in China and the U.S. in Figure 2 indicates that cash inflows are more sensitive to the high returns of funds in the U.S., showing an incentive-driven pattern, while cash outflows are more vulnerable to low returns in China, showing a punishment-oriented pattern. The difference may stem from excessively risk-averse of investors with incomplete information: (1) information disclosure about the asset allocation is not in time in China; (2) the ranking system is in its infancy; and (3) the information transmission mechanism is not well established.

#### 4. Conclusion

In this paper, we first build a theoretical model of the dynamic game between fund investors and fund managers under incomplete information to investigate the relation between fund returns and net redemptions. Then, using the panel data of a total of 47 stock funds and partial stock funds and fixed effects model, we empirically investigate the first-order and second-order effects of the fund returns on net redemptions in the open-end fund market in China.

We find: (1) the Bayesian equilibrium of dynamic game between investors and fund managers verify a nonlinear impact of returns on redemption; (2) the net purchase are positively correlated with the performance and asset allocation of funds in overall market of China; (3) the flow-performance curve is nonlinear and negative convex, which exactly contrasts with the positive convexity in the flow-performance relation in the U.S. These

findings don't provide evidence for redemption puzzle in the overall market of China. Besides, the positive slope and negative convexity of the flow-performance curve demonstrates a punishment-oriented pattern of investment behavior in China.

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## ARTICLE

# Research on the Theory and Practice of the Property Declaration System of the Communist Party of China

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### ABSTRACT

The property declaration system of the Communist Party of China is an important means of legal and institutional supervision, playing a non-negligible role in fighting against corruption. This paper, starting from the two dimensions of theory and practice, systematically sorts out the basic concepts, development process, and international experience of the property declaration system, and analyzes the current situation and challenges of China's property declaration system for leading cadres. Meanwhile, through comparative research and historical research methods, it compares the differences and connections of relevant property declaration systems in different countries worldwide, combines China's basic national conditions and practical experience, and explores how to construct a civil servant property declaration system and its supporting measures that are in line with China's reality. The aim is to understand the impact and significance of China's property declaration system through comprehensive and in-depth research, consolidate the anti-corruption achievements since the 18th National Congress of the Communist Party of China, promote the continuous deepening of China's anti-corruption work, and accelerate China's legalization process.

## 1. Introduction

Corruption, as a chronic disease in society, has existed to varying degrees both domestically and internationally, at all times and in all places throughout history. It not only seriously undermines social fairness and justice, disrupts the healthy development of the economy, but also causes immeasurable damage to the government's credibility and

ruling image. Especially in China, with the continuous deepening of economic and political system reforms, during the transition period between old and new institutional mechanisms, if various supervisory mechanisms are not well-established, corruption may exhibit characteristics of being phased, frequent, and high-incidence. Since the 18th National Congress of the Communist Party of China, the Party Central Committee and the State Council have

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always attached great importance to anti-corruption work, continuously intensifying anti-corruption efforts, and anti-corruption and integrity work has achieved phased results. In this context, how to consolidate these achievements has become a crucial issue. The property declaration system for leading cadres, as an important means of legal and institutional supervision, is increasingly receiving high attention from all sectors of society due to its significant role as a “terminal anti-corruption” measure.

## **2. Research Background and Purpose of the Property Declaration System**

The property declaration system, specifically referring to the property declaration system for civil servants or public officials, is known as the “Family Properties Declaration System” in the West, also dubbed the “Sunshine Law” or “Blazing Sun Law”.<sup>[1]</sup> It is a system that requires specific individuals to truthfully declare their property and income status, aiming to strengthen supervision over the property of public officials through openness and transparency, effectively preventing and punishing corrupt behaviors. The property declaration system has been widely proven internationally as an effective tool for fighting corruption and promoting integrity. Therefore, conducting in-depth research on the theory and practice of the Chinese Communist Party’s property declaration system not only holds significant theoretical value but also has practical significance in promoting the in-depth development of anti-corruption work in China.

### **2.1 Research Background and Significance of the Property Declaration System**

#### **2.1.1 Severity of Corruption Phenomena**

The situation of China’s anti-corruption struggle is grim and complex. With the continuous expansion of the civil servant workforce, some civil servants, as they rise in position, cannot resist the temptation of benefits and abuse their power for personal gain, amassing wealth and becoming corrupt parasites within the civil servant ranks. In China, while there are ample measures to punish corruption, the mechanisms for preventing corruption have certain limitations. As the ancient saying goes, “Be cautious when alone and in small matters; do not commit corruption because it is small. Be cautious from the beginning to the end; do not neglect integrity because it is small.” In September 2007, the National Bureau of Corruption Prevention was established, indicating that the Chinese government also recognizes that prevention is more important than punishment. As property declaration

legislation in various countries and regions highlights its importance, the role of China’s property declaration system in preventing corruption should be obvious.

#### **2.1.2 Strong Demand from the Public**

With the development of socio-economic conditions and the improvement of citizens’ education and cultural levels, the political participation awareness of Chinese citizens has significantly increased. National civil servants, as the image spokespersons of various government agencies, represent the credibility of the state. Therefore, comprehensively supervising the property status of civil servants to effectively prevent corruption and improve national credibility is of great significance and has become an important social impetus for establishing the property declaration system.

#### **2.1.3 Strategic Requirement of Governing the Country According to Law**

Since the Central Committee of the Communist Party of China first proposed the strategy of “governing the country according to law” in 1996, China has continuously promoted the construction of a country ruled by law. In 1997, the 15th National Congress of the Communist Party of China incorporated “governing the country according to law and building a socialist country ruled by law” into the party constitution. In 1999, the Amendment to the Constitution of the People’s Republic of China clearly stipulated that “the People’s Republic of China governs the country according to law and builds a socialist country ruled by law.” This strategic requirement provides a solid legal foundation for the establishment of the property declaration system.

#### **2.1.4 Drawing on International Experience**

Currently, nearly 100 countries worldwide have established official property declaration systems, promoting the standardized operation of public power and the construction of clean politics in the country. The United Nations Convention Against Corruption also requires each contracting state to formulate measures and establish systems requiring public officials to declare outside activities, positions, investments, and valuable gifts or significant benefits that may conflict with their official duties. As a contracting party to the convention, China must fulfill its international commitments, learn from international advanced experiences, and establish and improve the property declaration system.



## **2.2 Research Purpose and Problem Identification of the Property Declaration System**

The property declaration system for civil servants aims to combat corruption, enhance credibility, promote integrity, improve the legal framework, draw on international experience to enhance governance standards, and build a fair, transparent, and efficient government. In China, the framework of this system has been initially established, with effective pilot implementations and high levels of public attention. Many people support its improvement, and relevant legal provisions are already in place, albeit requiring further refinement. The system faces challenges in design, supporting measures, privacy protection, corruption prevention, and enforcement, necessitating further enhancements.

## **3. Theoretical Foundations and International Experience of the Property Declaration System**

The property declaration system is a system that requires specific individuals to truthfully declare their property and income in accordance with relevant state laws. Since its inception, the property declaration system has played a positive role in effectively constraining and regulating the behavior of government officials, combating corruption and promoting integrity, and establishing a good image for the government and public officials.

### **3.1 Theoretical Basis of the Property Declaration System**

**Theory of Power Restraint:** The property declaration system embodies the people's right to supervise the exercise of public power, safeguards the realization of people's sovereignty, and reflects the democratic spirit of "all power belongs to the people" enshrined in China's Constitution, which aligns with the contemporary spirit of constitutionalism. Civil servants represent the government in exercising public power, which is derived from the rights transferred by citizens. Any public power has the potential to be abused; therefore, to prevent such abuse, effective supervision and restraint on the exercise of power are essential.

**Principle of Rule of Law:** The rule of law signifies that law holds the highest authority in a country, and all political parties, groups, and individuals must operate within the legal framework. To establish a country governed by law, it is not only necessary to supervise power and oppose the misuse of public power for private gain but also to actively advocate for the protection of human rights. The property declaration system for civil servants is based on this principle, supervising and restraining civil serv-

ants' property through legal means.

**Balance between Citizens' Right to Know and Privacy Right:** While safeguarding the public's right to know, the property declaration system also needs to balance civil servants' personal privacy rights. The design of this system requires finding a reasonable balance between maintaining public interests and protecting individual privacy, ensuring that the system can operate effectively without infringing upon the legitimate rights and interests of civil servants.

The theoretical basis of the property declaration system provides solid theoretical support and a legal foundation for its establishment and implementation.

### **3.2 International Experience and Reference for the Property Declaration System**

The system of public disclosure of civil servants' property originated in Sweden. As early as the 18th century, Swedes had the right to view the tax records of the prime minister. The United Kingdom was the first country to legislate on the public disclosure of officials' property. In 1883, the British Parliament passed the Corrupt and Illegal Practices Prevention Act, which stipulated that candidates for parliamentary elections must disclose their funds. The widespread promotion of the officials' property declaration system globally began in the 1970s and 1980s. As governments around the world increased their intervention in the economy and officials' power expanded, countries launched a wave of "sunshine laws." The United States passed the Ethics in Government Act in 1978, which uniformly regulated officials in legislative, judicial, and administrative agencies, requiring all officials to fill out a unified property registration form and truthfully report their property and income. France enacted the Transparency of Politicians' Assets Law in 1983. Canada formulated the Public Servants' Conflict of Interest and Post-Employment Behavior Act in 1994. In 2008, Russia passed the Anti-Corruption Law, which was officially implemented the following year. Then-President Medvedev personally took the lead in disclosing his own property<sup>[2]</sup>, promoting the implementation of the system.

The anti-corruption laws in most countries in the Americas and Europe emphasize "property publicity" rather than just "declaration", with the aim of allowing the public to supervise the property of civil servants and detect any concealment or discrepancies. Although the United Kingdom values privacy, there is a consensus on the public disclosure of officials' property, believing that entering politics requires serving the public, and integrity and openness are essential. The media also pays attention to the public disclosure of MPs' and officials' property.

Most countries and regions publicly disclose property declarations, allowing public access, enhancing government transparency and credibility, and deterring corrupt behavior.

It is evident that the property declaration system has been implemented in numerous countries, providing valuable experience and reference for the reform and improvement of similar systems in other nations. With the continuous deepening of reform and opening up in China, drawing on international experience and carrying out localized reform and innovation based on China's specific national conditions can offer useful insights for China's civil servant property declaration system. This holds great significance for the establishment and improvement of China's property declaration system.

## **4. Historical Evolution and Current Status of the Property Declaration System within the Communist Party of China**

### **4.1 Historical Evolution of the System**

The historical evolution of the property declaration system within the Communist Party of China (CPC) can be traced back to early discussions and proposals, with specific implementations and regulations evolving and changing over different time periods.

#### **4.1.1 Early Discussions and Proposals**

The system of declaring and disclosing the property of leading cadres has long been proposed, reflecting the Party's emphasis on anti-corruption efforts. The precursor to property declaration can be seen in Xu Shiyu's telegram titled "All Captured Goods Should Be Attributed to the State" <sup>[3]</sup>, which outlined principles for collecting, handling, and distributing goods to ensure fair distribution, maintain unity, suppress negative tendencies, uphold military traditions, reduce the burden on the masses, alleviate financial difficulties, and lay the foundation for the economy of a new democratic country.

#### **4.1.2 Issuance of Relevant Regulations**

In 1995, the Central Office of the CPC and the General Office of the State Council jointly issued the "Regulations on Income Declaration by Leading Cadres at the County (Department) Level and Above in Party and Government Organizations" <sup>[4]</sup>. This regulation clarified the subjects, content, timing, and relevant supervision mechanisms for declaration, laying the foundation for subsequent property declaration work.

### **4.1.3 Gradual Promotion and Implementation**

With the promotion of the central government, pilot programs for the property declaration and disclosure system were implemented in places such as Altay Prefecture in Xinjiang. In early 2009, Altay Prefecture took the lead in implementing the system, using a "two-account" approach to publicly disclose partial property information, thereby reducing resistance to its implementation. This system attracted social attention and discussion, was regarded as an important measure for anti-corruption, it provided valuable experience for promotion and held great significance for the nationwide popularization of the officials' property declaration system.

### **4.2 Current Status of the System**

Firstly, China's property declaration system has been established and is continuously being improved, with increasingly detailed declaration content and requirements for public officials such as leading cadres. The "Regulations on Income Declaration by Leading Cadres at the County (Department) Level and Above in Party and Government Organizations" issued in 1995, along with a series of subsequent policy documents, have continuously refined this system.

Secondly, the scope of declaration has gradually expanded and the declaration subjects have become more clearly defined. Initially, the main content of the declaration was income, but over time, it has gradually expanded to include a wider range of property forms such as real estate, vehicles, savings, securities, investments, etc. The declaration subjects have also gradually expanded from initially covering leading cadres at the county (department) level and above to include a broader range, including family members such as spouses and children.

Lastly, the supervision and verification mechanisms are being continuously strengthened. Although the declaration materials are currently mainly supervised and verified internally, relevant departments are continuously enhancing supervision efforts and improving verification efficiency to ensure the authenticity of the declarations.

Despite achieving certain results in its implementation, the property declaration system still faces some challenges and issues, such as how to ensure the comprehensiveness and accuracy of declarations, and how to effectively supervise and verify the declaration situation. Over time, the relevant property declaration system has undergone continuous pilot testing and improvement in various regions to adapt to new anti-corruption situations and task requirements. At the same time, more regions have joined in the practice of

this system, forming a good interaction between top-down promotion and bottom-up implementation.

The property declaration system of the Communist Party of China has undergone a process from theoretical discussion to practical pilot testing, and then to gradual improvement and promotion, ultimately forming a unified, complete, and systematic system.

## **5. Achievements and Issues of the Property Declaration System within the Communist Party of China**

The property declaration system within the Communist Party of China has continuously improved and developed, playing a positive role in the national anti-corruption campaign. This system has enhanced the transparency of public officials' assets, facilitating public oversight of their financial situations and consequently reducing the incidence of corruption. From the perspective of the evolution of the Party's innovative theories, in 2013, President Xi Jinping explicitly proposed the "Three Non-Corruptions," emphasizing the need to "form a punishment mechanism that makes officials dare not to be corrupt, a prevention mechanism that makes them unable to be corrupt, and a safeguard mechanism that makes it difficult for them to be corrupt." In 2019, President Xi further proposed to "simultaneously promote the goals of officials daring not to be corrupt, being unable to be corrupt, and not wanting to be corrupt," emphasizing that "these three aspects form an organic whole." The 20th National Congress of the Communist Party of China in 2022 stressed the importance of "persistently promoting the goals of officials daring not to be corrupt, being unable to be corrupt, and not wanting to be corrupt simultaneously." At the Third Plenary Session of the 20th Central Committee in 2024, it was proposed to "improve the mechanisms for simultaneously promoting the goals of officials daring not to be corrupt, being unable to be corrupt, and not wanting to be corrupt." The progression from the "Three Non-Corruptions" to the simultaneous promotion of the "Three Non-Corruptions," and further to the improvement of the mechanisms for this simultaneous promotion, fully reflects the deepening understanding of the Central Committee of the Communist Party of China, with Comrade Xi Jinping as the core, of the laws governing the anti-corruption campaign. It is also a vivid practice of the continuous enrichment and improvement of President Xi Jinping's important thoughts on the Party's self-revolution.

Currently, the level of pilot projects for public disclosure of officials' assets in China is not high. In terms of the government levels promoting this disclosure, 80% are at the county level, while only 20% are at the prefecture

level, with no provincial-level pilots yet. Among the 20 pilot projects, there are only four at the prefecture level, namely Altay Prefecture, Qianjiang District, Yinchuan City, and Huaian City, while the remaining 16 are all at the county level. The administrative level of the pilot units directly determines the administrative rank of the officials involved in the disclosure. As most of the pilots are at the county level, their personnel jurisdiction is limited to officials at the section level, making them the primary group for asset disclosure. Among all the pilots, 85% (i.e., 17) target section-level officials for disclosure, while only six pilots disclose the assets of department-level officials, including Altay Prefecture, Qianjiang District, Xiangxiang City, Duodao District, Yinchuan City, and Huaian City. There are three pilots that disclose the assets of both department-level and section-level officials, namely Altay Prefecture, Duodao District, and Huaian City. The low level of pilot projects for public disclosure of officials' assets demonstrates the sensitivity and challenges of this reform. The reform can only proceed from easier to more difficult tasks, from lower to higher levels, starting with pilot observations and adjusting based on the situation.

The candidates for promotion are the main subjects of asset disclosure in the pilot units, with 80% of the pilots targeting candidates for disclosure. Among the 20 pilot projects, 16 require candidates for promotion (i.e., newly appointed or newly promoted officials) to disclose their assets. Only Altay Prefecture, Cixi City, Xiangxiang City, Duodao District, Jiawang District, and Xiangshan County require incumbent leaders to disclose their assets, among which only Altay Prefecture requires officials who have retired within the past three years to also disclose their assets. The pilot units supervise the assets of newly promoted officials as a measure to strictly enforce discipline in the selection of officials and avoid the phenomenon of "taking up a position with hidden problems," which helps to enhance the credibility of promoted officials.<sup>[5]</sup>

Through regular asset declarations, potential corrupt behaviors such as concealing or transferring assets can be promptly identified and exposed, thereby effectively deterring corrupt individuals. Facing the stringent asset declaration system and public scrutiny, public officials will pay more attention to their own integrity and self-discipline, thereby forming a good internal restraint mechanism.

## **6. Countermeasures and Suggestions for Improving the Property Declaration System of the Communist Party of China**

### **6.1 Strengthening Legislative Support and Elevating Legal Status**

Formulate specialized legal policies. The property

declaration system is related to the construction of the national integrity system and the stability and development of the country. It should be legislated by the National People's Congress or its Standing Committee, with the formulation of a unified "Civil Servants' Property Declaration Law," elevating the property declaration system of civil servants to the legal level<sup>[6]</sup>, clarifying all elements of property declaration, and providing legal safeguards; improve supporting laws, such as the financial real-name system, to ensure the authenticity and accuracy of declarations.

### **6.2 Expanding the Scope and Subjects of Declaration**

Comprehensively cover the property declaration system, extending it to all public officials, improving specific items, refining content, and incorporating new forms of property to ensure comprehensiveness.

### **6.3 Improving the Declaration and Disclosure Procedures**

Simplify the declaration process, optimize the form procedures, and improve efficiency. Reasonably stipulate the scope of disclosure, partially disclose property with conflicts of interest, and allow legal access. Establish a verification mechanism, set up an independent supervisory authority, grant investigative powers, and ensure authenticity.

### **6.4 Strengthening Supervision and Punishment**

Enhance social supervision by encouraging media, the public, and third-party oversight, and establish a reward mechanism for whistleblowing. Increase punishment severity and deal with false declarations and other such acts sternly to create a deterrent effect.

### **6.5 Strengthening Publicity and Education**

Improve supporting measures, provide education and training for Party members, strengthen education for public officials, and raise awareness. Government leaders should create a favorable atmosphere and guide public officials to consciously accept supervision.

### **6.6 Promoting Informatization Construction**

Utilize modern information technology to establish a unified national property declaration information system and achieve information-based management. Increase investment in science and technology, enhance system security, stability, and convenience, and provide technical support for property declaration.

## **7. Conclusion and Outlook**

The property declaration system of the Communist Party of China is crucial for anti-corruption efforts, promoting the integrity and self-discipline of public officials and preventing the abuse of power. It is an important measure for governing the country according to law and building a law-based government, embodying the principle of the rule of law and driving forward the process of legalization. Through practice, the system has been initially improved and has received positive feedback from all sectors of society. In the future, legislative safeguards should be strengthened, with clear regulations in all aspects to enhance its authority and execution. Additionally, the coverage of the system should be gradually expanded to include more public officials, achieving comprehensive coverage without any blind spots.

Conclusion: In summary, the theoretical and practical research on the property declaration system of the Communist Party of China is a complex and arduous task. As early as 1939, Comrade Liu Shaoqi made a profound statement: "The Communist Party of China is one of the best communist parties in the world." The report of the 19th National Congress of the Communist Party of China stated: "The Communist Party of China is a great political party that dares to struggle and dares to win." Facts have proven that in the current era, the Communist Party of China is not only deservedly "one of the best communist parties in the world" but also "the best ruling party in the world." "The most enlightened, progressive, sound, moral, and just individuals in the world are concentrated within the Communist Party, relentlessly fighting against all dark forces and striving for the bright future and ultimate liberation of human society." From the moment it stepped onto the historical stage, the Communist Party of China has set "striving for national independence, liberation of the people, and achieving national prosperity and well-being of the people" as its unswerving goal. We believe that under the great leadership of the Communist Party of China, we will remain confident, move forward bravely, continuously summarize experiences, and improve the system. We are certain that we can establish a property declaration system that aligns with China's national conditions and possesses Chinese characteristics, thereby promoting the construction of a law-based China.

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