

# *Research on the Mechanism of Internal Circulation of Funds in Financial System and Its Solution*

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**Abstract**—Through a large number of field research and the constructivism grounded theory method, this paper studies the financing status of China's real economy. It is found that the internal circulation of funds in the financial system can be realized through financial management, bills and other means. Funds are not flowing into the real economy. This paper analyzes the mechanism of internal circulation of funds in the financial system. And the causes and paths of capital circulation are studied. Aiming at the current predicament, this paper gives the solutions from the perspective of financial institutions and real economy.

**Keywords**—*financial system; internal circulation of funds; virtual economy; the real economy*

## I. THE INTRODUCTION

In the 19 big report clearly pointed out: "Finance is the blood of the real economy. Serving the real economy is the first duty of finance and the purpose of finance." Under the restriction of benefits and risks, the funds in the financial system often circulate within the financial system, which makes it difficult to flow into the real economy. This phenomenon not only seriously affects the financial support for the development of the real economy, but also expands investment risks and increases the difficulty of supervision. In order to make finance better serve the development of the real economy, it is necessary to crack the mechanism of capital circulation in the financial system and introduce the capital of the financial system into the real economy.

This paper explores the internal circulation of funds in the financial system by means of financial management and bills. It is found that capital of the financial system, driven by profit maximization, often flows within the financial system. Funds are not flowing into the real economy. This is not only affected by the decline in real economic returns, but also by the false high profits of financial capital. In order to better promote the financial capital to serve the real economy, this paper gives relevant policy suggestions from the perspective of the real economy and financial institutions.

## II. THE LITERATURE REVIEW

Domestic scholars' discussion on capital "from solid to virtual" is firstly reflected in its causes. For example, Shu Zhan (2017) pointed out that the root cause of the problem was the increase in labor costs, overcapacity in backward industries and the decline in real economy profits caused by redundant taxes

<sup>[4]</sup>. Li pengfei (2017), through long-term research on domestic economic data, concluded that the bottleneck in improving the competitiveness of the real economy is the fundamental reason for the economy to shift from real economy to virtual economy. The lack of competition in the financial industry leads to high profit margins, which is an important incentive. Secondly, it is to discuss the research path of "internal circulation of funds". Li pejia (2017) discussed the path of "idling in the system" of financial capital from the perspectives of financial arbitrage, illegal bills and Internet financial chaos <sup>[2]</sup>. Based on the analysis of the problem and the discussion of the path, a large number of scholars have given Suggestions on governance. Li pengfei (2017) believes that top-level design solutions not only should be adopted to break upstream monopoly, but also should promote balanced development, accelerate innovation and break bottlenecks<sup>[5]</sup>. However, Li Pejia (2017) and other scholars believe that the fundamental way to governance is to create a social environment conducive to entity exhibition. We should optimize the structure of virtual financial assets, improve the matching degree between finance and the real economy, and strengthen the effective supervision of the combination of industry and finance <sup>[6]</sup>.

## III. INTERNAL CIRCULATION MECHANISM OF FUNDS IN THE FINANCIAL SYSTEM

### A. Causes of internal circulation of funds in the financial system

The causes of the internal circulation of funds in the financial system are relatively complex. They are not only affected by the increase in labor costs and the decline in real economic benefits caused by excess capacity, but also closely related to the excessive speed of financial innovation, lagging regulation, liquidity bias and soft budget constraints. First, the decline in real economic benefits caused by the increase in labor costs and excess capacity has low ability to absorb capital. Second, financial innovation is too fast and financial regulation lags behind the development of financial markets. Third, the ample liquidity and soft budgetary constraints have exacerbated the imbalance in the allocation of financial resources.

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## *B. The mechanism of internal circulation of funds in the financial system*

### *1) Internal circulation of financial management*

Financial management is an important way of the internal circulation of financial funds, which is mainly reflected in the following aspects: Banks use excessive financial management funds to invest in some non-underlying assets such as credit and bonds; Banks hold financial products with each other; Excessive flows of wealth management funds into capital markets. The specific performance is as follows:

a) A large amount of wealth management funds are invested in non-underlying assets. Trust channel is an important way for Banks to evade supervision of financial management funds. Later, it is also widely used by securities companies and fund companies to circulate funds among different subjects in the financial market, so as to realize infinite circulation within the financial system.

b) Financial management funds are invested in inter-bank financial management and outsourced financial management. This mode can be directly reflected in the way that different actors in the banking industry hold financial products with each other, or flow to inter-bank certificates of deposit through money market funds, which is ultimately reflected in inter-bank financing.

c) Wealth management funds are invested in the capital market. With the economic crisis in 2008, the world economy has been in a weak state. Although China's economy has maintained a medium-high growth rate, the continuous decline of the real economy yield has also caused a series of problems. Wealth management funds began to flow into the capital market in this context, including the purchase of some bond products.

### *2) Internal circulation of funds in the form of bills*

The circulation mode of bills in the financial system is mainly achieved through affiliated enterprises. Through affiliated enterprises, the acceptance bill of exchange of the bank is reflected, and the discounted capital is returned to the drawee. The drawer continues to issue the bill after getting the funds, and the affiliated enterprises continue to discount.

### *3) Intra-bank circulation of funds*

The internal circulation of inter-bank funds mainly concealing the non-underlying assets of financial subjects by the same trade, and then achieving the regulation of regulatory indicators through the conversion of different subjects. Or through their own fund management plan to invest in the inter-bank financial industry, which is similar to inter-bank financial management method of capital circulation.

### *4) The internal circulation of credit funds*

The internal circulation of credit mainly includes: (1) Loan replacement. The debt coverage of an enterprise can be achieved through the replacement of old and new loans in the balance sheet and off-balance sheet loans. (2) Divert loans. These include over-extended companies and individuals. In the regulatory vacuum of lending, banks put their loans into wealth management, trust and capital markets rather than the real economy.

### *5) Arbitrage mode of money within the cycle*

It is mainly reflected in the use of fake trade background financing to carry out cross-border capital speculation and arbitrage. At present, with the improvement of China's financial market opening to the outside world and the development of RMB internationalization, the forms of the offshore RMB and the onshore RMB market have begun to take shape. On the other hand, interest rates in developed countries remain low under the policy of quantitative easing, which made price fluctuations increase under the market-oriented mechanism. In these two cases, cross-border arbitrage and arbitrage of capital will have the motivation and approach. Some enterprises obtain foreign exchange settlement and sales by falsely reporting export prices and import prices. They also carry out arbitrage by making use of foreign exchange differences and interest margins both at home and abroad, or even enter speculative fields such as the stock market.

## IV. SOLUTIONS

### *A. From the financial system perspective*

#### *1) Promote the development of financial innovation*

Innovation that is divorced from the real economy will not help the development of the real economy, but will increase its hidden dangers. In view of the new phenomenon of financial business integration and cross-business increase in recent years, we should guide financial innovation and development.

#### *2) Pay attention to the management of inter-bank business*

The current model of separate industry supervision in China is difficult to adapt to the development of inter-bank business. Therefore, it is necessary to accelerate the transformation to "functional" supervision. It is necessary to strengthen the control and management of the capital investment and scale of commercial Banks' inter-bank business. It is suggested to increase the risk weight of inter-bank assets in the statutory reserve and capital adequacy ratio of inter-bank deposits so as to re-establish the weight ratio of bank products. More attention should be paid to the establishment of liquidity risk management of inter-bank business. The degree of maturity mismatch and leverage ratio should be strictly monitored, and the excessive expansion of inter-bank business should be restrained.

#### *3) Manage the circulation of Internet financial funds*

Internet finance has changed people's way of life and is the development direction of finance in the future. We should give enough support. However, it is necessary to put an end to the deterioration of Internet finance into "shadow banking". Due to the regulatory vacuum, such funds often become the source of many social problems. On the premise of unified supervision by the people's bank of China, the communication and coordination mechanism between different supervision departments should be established to strengthen the coordinated supervision of Internet finance by different departments.

#### *4) Strengthen the financial regulation*

In China's banking market as the main body, the government's policies play an important role in guiding the development of finance. Therefore, it is necessary to strengthen

the top-level design and strengthen the supervision of the financial market through the introduction of laws, regulations and government policies. First, we will improve laws, regulations and regulatory bodies to reduce the regulatory vacuum and over-regulation. Second, the people's bank of China should take the lead in establishing a comprehensive supervision and evaluation system to strengthen supervision over financial entities and financial behaviors. We will strengthen monitoring of the scale, path and operating mechanism of "internal circulation" of funds. We also should focus on tracking cross-industry and cross-industry financial capital flows to accurately grasp the direction and path of capital flows.

#### *B. From the perspective of the real economy*

##### *1) Optimize the industrial structure*

First of all, we should deepen the reform of the tax system, optimize the tax structure, standardize the tax collection mode and effectively reduce the tax burden on the real economy. So that real enterprises can fully participate in the market competition. Second, we should formulate industrial policies, increase financial support for high-tech industries. Government should take restrictive and guiding measures for enterprises with serious pollution, large energy consumption and weak market competitiveness to promote industrial upgrading and transformation.

##### *2) Promote the integration of industry and finance*

We should coordinate the development steps of finance and real economy to promote the coordinated development between them. We will make finance the driving force for the development of the real economy. We will make the real economy a strong support for financial development. At present, China's economy lags behind the development of finance in the development of real economy, which leads to the separation between financial innovation and real economy.

##### *3) Promote economic transformation and upgrading*

The development of finance depends on the overall environment of the national economy. It is necessary to improve the overall environment of financial development, so

that the financial industry can meet its own market-oriented and sustainable nature of operation.

#### V. PROSPECT

Through the reform of the financial system in financial innovation, inter-bank governance, regulatory mode and other aspects, the top-level design should be strengthened to better promote the flow of funds within the financial system to the real economy. Through the supply-side reform of the real economy, production capacity can be reduced, industrial structure can be optimized, and capital utilization rate can be improved. All this matters can make us achieve the purpose of high returns. In this way, the hollowing out of the real economy can be avoided and funds from the financial system can better serve the real economy. We will give better play to the role of finance as the core competitiveness of the country. We will enable the financial system to play a more important role as a basic system in economic and social development. We will promote sound economic and financial development in a virtuous circle.

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