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Why the EU should not compare itself to the US when it comes to financial markets

Apostolos Thomadakis *

The development of financial markets has long been central to economic growth, innovation, and competitiveness. For decades, Europe has looked to the US as a benchmark for advancing its own financial infrastructure, especially in capital market development.

The Capital Markets Union (CMU) initiative, aimed at deepening and integrating EU capital markets, reflects this aspiration. While drawing inspiration from the US experience is understandable, Europe should not engage in a direct comparison or attempt to replicate the US model. The EU's distinctive institutional, structural and cultural characteristics necessitate a tailored approach to capital market development.

Instead, the EU should focus on developing capital markets that reflect its own values, priorities, and diverse financial landscape. This would foster sustainable growth, innovation, and integration in a way that suits the European context. By setting its own path and building on its strengths, Europe can ensure a thriving financial ecosystem that meets the needs of its economy and citizens.

Structural differences in financial systems

A fundamental distinction between Europe and the US lies in the structure of their financial systems. The US is predominantly market-based, with a strong reliance on capital markets to fund businesses, while Europe is traditionally bank-based, where businesses rely more on loans from financial institutions than on equity or bond markets. Although the EU has made strides in spurring capital market development, banks still play a dominant role in corporate financing, particularly in smaller economies.

* ***Apostolos Thomadakis*** *is Head of Research at ECMI and Research Fellow at CEPS. The French version of this article was published by Revue Banque November 2024.*

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This divergence is rooted in historical, institutional, and regulatory factors. In many European countries, banks have deep, long-standing relationships with firms and play an advisory role beyond mere financing. The US, in contrast, has developed a more transaction-oriented system where firms tap into capital markets for financing, allowing a wider pool of investors to participate.

Attempting to reshape Europe's financial system to mirror the US market-based system would require dismantling these deeply entrenched relationships, which is neither feasible nor necessarily desirable. Rather than comparing itself to the US, Europe should focus on how to enhance the complementary role of its banking sector alongside its capital markets. This can involve encouraging alternative forms of financing, such as venture capital or private equity, while preserving the strengths of its banking institutions.

A diverse economic landscape

The US, of course, functions as a single, large economy with a unified legal, tax and regulatory framework. This facilitates the growth of national capital markets, where companies can raise funds seamlessly across state lines. Europe, on the other hand, consists of a union of 27 sovereign Member States, each with its own legal, tax and regulatory systems. While the EU has made considerable efforts toward financial integration, significant regulatory fragmentation persists, particularly in areas such as insolvency law, taxation and investor protection.

This patchwork of regulatory environments makes it difficult for companies and investors to operate across borders with the same ease as in the US. Furthermore, Europe's diverse economies, ranging from advanced financial centres like Frankfurt and Paris to smaller, less developed markets in eastern Europe, mean that a one-size-fits-all approach to capital market development is unlikely to succeed.

Instead of benchmarking itself against the US, the EU should focus on reducing intra-European barriers to capital flows. Harmonising key areas such as taxation and insolvency law, while respecting Member States' sovereignty and economic peculiarities, would create a more conducive environment for cross-border investment and allow for the development of deeper, more integrated capital markets.

Cultural and institutional differences

Cultural attitudes toward risk, investment and corporate governance vary significantly between the US and the EU. The US has a culture that celebrates risk-taking and entrepreneurship, supported by a robust ecosystem of venture capital, private equity and public equity markets that reward innovation and high-growth businesses. Investors in the US are more willing to invest in start-ups and accept the inherent risks associated with such ventures, which fuels the dynamism of its capital markets.

In the EU, by contrast, there is a more cautious approach to risk, both among investors and regulators. European investors tend to prefer safer, long-term investments, while regulatory

frameworks often emphasise stability and protection over innovation. This cautiousness is reflected in Europe's relatively smaller venture capital and private equity markets.

While the European Commission has launched initiatives to stimulate innovation and high-growth sectors, including the CMU, Europe's cultural differences should be recognised and respected. Pushing for a US-style market may result in policies that are misaligned with European investors' risk appetite and investment behaviors. Instead, Europe should build on its strengths, such as its highly skilled workforce and strong tradition of corporate governance, to develop financial markets that cater to its unique characteristics.

Policy and regulatory focus

Another reason the EU should not compare itself directly to the US is the difference in policy focus and regulatory priorities. US financial markets benefit from a deregulatory environment that prioritises market efficiency and innovation. While the Dodd-Frank Act introduced more stringent regulations in the wake of the 2007-09 global financial crisis, US capital markets remain relatively flexible and less constrained by regulatory burden compared to Europe.

Europe, on the other hand, places a high premium on financial stability, consumer protection and prudence, which often translates into more prescriptive and complex regulations. The European response to crises (e.g. the Eurozone debt crisis) has been to tighten regulatory oversight, which, while enhancing stability, stifles market dynamism and innovation. The introduction of regulations like MiFID II (Markets in Financial Instruments Directive) and the General Data Protection Regulation (GDPR) has added additional complexity to operating in European markets.

Rather than mimicking the US deregulatory tendencies, Europe should focus on refining its regulatory framework to strike a balance between stability and market dynamism. Streamlining compliance processes, encouraging regulatory convergence and adopting a more principles-based approach to legislation, particularly in capital markets, could foster innovation while maintaining financial stability.

Global competitiveness and strategic autonomy

Europe's focus on global competitiveness and strategic autonomy also requires a different lens than the US model. The EU's capital market development is often viewed within the broader context of its global role, where it seeks to compete with other financial hubs such as New York, London, Hong Kong and Singapore. The EU's ambitions for strategic autonomy, particularly in the face of geopolitical challenges and shifting global power dynamics, require Europe to craft policies that reduce its dependence on foreign financial institutions and markets.

The US, as the dominant global financial hub, does not face the same external pressures as Europe. European policymakers must therefore prioritise policies that promote resilience, sustainability and autonomy, rather than pursuing a strategy aimed solely at emulating the scale and scope of US financial markets.

A real alternative: Europe’s unique financial model

Europe should not merely avoid comparisons with the US but should actively assert itself as a distinct and compelling financial ecosystem. While US financial markets are characterised by their sheer size, liquidity and the dominance of large institutional players, Europe can leverage its unique strengths to offer a competitive alternative.

One of the most promising areas where Europe can lead is in sustainable finance. The EU has already made significant strides through initiatives such as the EU Green Deal, the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, which collectively position Europe at the forefront of integrating environmental, social and governance (ESG) considerations into capital markets. By setting ambitious targets for carbon neutrality and mandating robust sustainability disclosures, Europe is not just following global trends but shaping them. This approach caters to the growing demand for sustainable investments and positions European financial markets as leaders in the global transition to a low-carbon economy.

Europe’s regulatory framework, though sometimes seen as complex, offers a level of protection, stability and predictability that can be particularly attractive to global investors, especially in times of economic uncertainty. The EU’s efforts to create a CMU aim to create a more integrated and efficient financial market across the continent, enabling easier cross-border investments and ensuring that smaller and emerging markets can benefit from the scale and depth of a unified financial space. The success of these efforts would not only deepen Europe’s capital markets but also make them more resilient and accessible, providing a solid foundation for sustained economic growth.

Additionally, Europe can capitalise on its strong tradition of corporate governance and its emphasis on long-term value creation stakeholder engagement. Unlike the US market, which often prioritises short-term profits and immediate shareholder returns, Europe’s approach to corporate governance integrates social responsibility and ethical considerations into business practices. By fostering an environment where businesses are encouraged to consider the interests of employees, customers and communities, Europe can build a more inclusive financial system that supports broad-based economic growth.

In the realm of digital finance, Europe is also setting itself apart. The EU has been proactive in establishing frameworks for digital finance, such as the Digital Finance Package and the proposed Markets in Crypto-Assets (MiCA) Regulation. By creating a clear and supportive regulatory environment for fintech innovation, Europe can become a global hub for digital financial services, offering a regulatory model that balances innovation with consumer protection and financial stability. This approach not only supports the growth of the digital economy but also enhances Europe’s competitiveness on the global stage.

Conclusion

While the US will inevitably remain a benchmark, Europe's aim should be to position itself not in comparison but as a leader in areas that align with its unique strengths and long-term goals. This strategy is not about avoiding competition but about redefining the terms of competition on Europe's own terms.

By focusing on sustainability, regulatory stability, corporate governance, financial inclusion and digital innovation, Europe can offer a financial model that is not just an alternative to the US but a preferable one for investors, businesses and societies alike. This approach demonstrates a confident assertion of Europe's distinct financial identity, capable of setting global standards and driving innovation while advancing a more resilient and equitable global economy.

European Capital Markets Institute

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