GERMAN COUNCIL
of Economic Experts

PRESS RELEASE

The potential of capital markets is underutilised

- Well-developed and liquid capital markets can promote long-term growth, diversify risks and offer households high-return investment opportunities.
- European capital markets are highly fragmented and market-based funding is insufficient.
- In Germany, companies rely heavily on banks rather than accessing capital markets. There is also a lack of venture capital. Institutional investors such as pension funds should contribute more to market-based financing.

Wiesbaden, 08.11.2023 – Developed and liquid capital markets are essential for long-term growth. They help allocate capital to its most productive uses. Market-based financing fosters investment in new, riskier technologies and in research and development. It is thus critical for the success of the digital and green transformation. In Germany, however, companies rely largely on bank loans. Although venture capital funding has increased, there is still little late-stage financing for start-ups. In Europe, large institutional investors rarely invest directly in companies, whether via stock markets or venture capital.

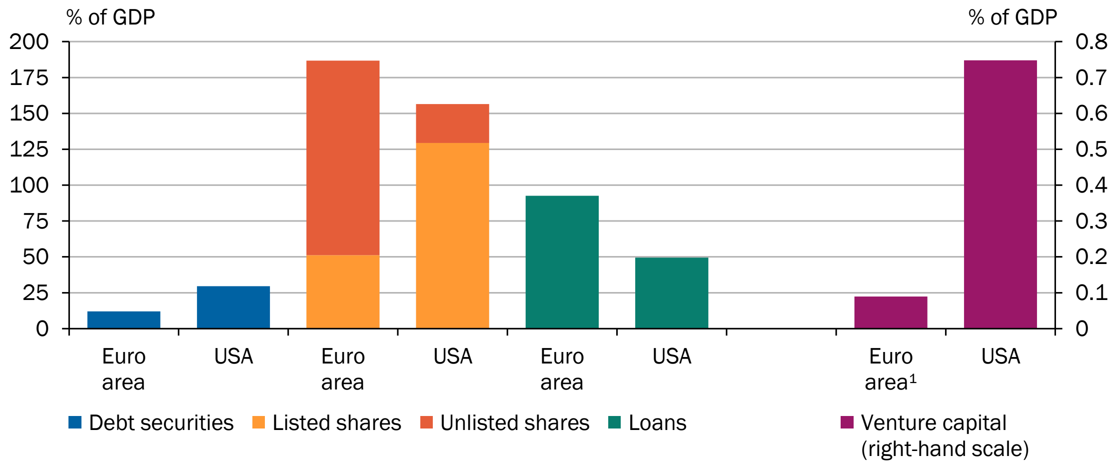
Government co-financing can help stimulate such investment but needs to be designed to mobilise private capital in order to provide this market segment with the necessary volume in the long term. At the same time, exit options for venture capitalists need improvement. Venture capital investors often earn the highest returns from selling their ownership stake through initial public offerings (IPO). This remains difficult in Germany where the IPO market is comparatively small. “In Germany, large institutional investors continue to invest little in venture capital. The country would benefit from more large investors providing capital during large financing rounds in the late- stage. Another issue is that capital markets lack sufficient depth for IPOs to generate attractive proceeds,” explains council member Ulrike Malmendier.

Pension funds in Germany are much smaller than in comparable economies, thus providing less liquidity. Moreover, pension funds are constrained by regulatory investment limits. Relaxing and standardising these limits would enable them to allocate larger amounts to riskier asset classes like equities or venture capital.

Expanding privately funded pensions in Germany to levels similar to those in Scandinavian countries can significantly strengthen the development of domestic capital markets. The establishment of a publicly administered pension fund could encourage more households to invest directly in the capital market and to learn about diversified investment opportunities. This would contribute to improving households’ financial literacy and help increase stock market participation. In order to familiarise children and young adults with capital markets, it would help to provide an initial endowment that, for example, could be invested in a broadly diversified fund as the default investment. In addition, integrating financial literacy training into the curricula of primary, secondary, and vocational schools would help improve the literacy of teenagers and young adults.

More integrated European capital markets can diversify risks and offer companies a wider range of financial sources, especially in the form of equity. This reduces their dependence on the health of the local banking sector. Despite the absence of legal restrictions on the free movement of capital, European capital markets remain highly fragmented. Regulatory standards, for example in financial reporting, and of taxes on cross-border investments need to be harmonised to reduce fragmentation. Strengthening common European supervision through the European Securities and Markets Authority (ESMA) could drive such harmonisation and integration and would thus be an important step towards completing the Capital Markets Union.

Financial instruments of non-financial companies in the euro area and the USA in 2022



1 – Excluding Cyprus and Malta.

Sources: EZB, OECD, own calculations

The German Council of Economic Experts (GCEE) provides support to policymakers and the general public on questions and matters of economic policy. It was founded as an independent body in 1963 and currently consists of the council members: Professor Dr. Veronika Grimm, Prof. Dr. mult. Dr. h.c. Ulrike Malmendier, Professor Dr. Dr. h.c. Monika Schnitzer (chair) Professor Dr. Achim Truger, Professor Dr. Martin Werding. By publishing regular reports, the GCEE aims to help the general public and decision-makers in politics, business and society to form a reasoned opinion on economic policy developments in Germany.

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