

The Differences between the Chinese and US Security Market

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Abstract. The United States and China are widely recognized as the two largest economies in the world, and their securities markets together account for a significant portion of global financial activity. As such, studying these markets provides valuable insights into the structure, efficiency, and development of international finance. This paper aims to examine and compare the key differences between the Chinese and U.S. securities markets, with particular attention given to their institutional frameworks, regulatory mechanisms, and trading practices. By introducing several representative cases from both markets, it seeks to illustrate how each system operates in practice and to highlight the strengths and weaknesses inherent in their mechanisms. The research indicates that while the U.S. market has generally established stronger investor protection systems, including stricter disclosure rules and more mature legal enforcement, determining which country possesses the superior trading mechanism remains a complex issue. Both markets demonstrate unique advantages and limitations shaped by their economic environments, government policies, and levels of market maturity. Ultimately, analyzing these mechanisms is crucial not only for understanding the distinctive paths of development taken by the U.S. and Chinese markets but also for guiding investors, regulators, and policymakers toward making more informed decisions in the future.

Keywords: Securities Markets, Market Mechanisms, Investor Protection.

1. Introduction

Security markets had many important basic functions for an economy. According to Levine, stock markets may contribute to economic growth by mobilizing savings, facilitating investment in productive projects, and promoting corporate control [1]. Basically, it provides a way to raise capital quickly, reflect the investment opportunity, and give the information about price fairly. Even though the basic mechanisms of security markets were similar which could be found out from many textbooks, differences between the markets in different countries were obvious. In most cases, the differences were not caused by the market itself. Instead, they were the results of other factors. Therefore, it is really worthwhile to discuss the situation by discussing the security market in the US and China to find out the reason behind those differences.

The US and China are the biggest two economies in the world. Meanwhile, their securities markets dominate the essential positions. By 2024, the American security market took up 40% of the

global market value. The Chinese A-share market is the second largest security trading platform in the world. These revealed the leading characteristics of the two securities markets.

However, a lot of differences existed between these two markets because of the different backgrounds of the 2 countries. The passage will focus on the regulation, market structure and the investor's behavior and the mechanism to deal with the crisis. For the regulation part, SEC and CSRC will be introduced. The discussion will focus on the comparison of the function of these two organizations and the evaluation of their drawbacks. For the market structure and the investor's behavior, the analysis of the structure of the investors will be introduced. The comparison of mechanisms will be focused on in this passage by giving direct illustrations of the securities in different countries. For the mechanism of dealing with a crisis, the case analysis will be introduced in this passage to illustrate the different methods that the two countries would use when facing a crisis in the market. In today's research, many researchers were still focusing on explaining differences verbosely instead of combining typical cases. Also, for dealing with the crisis, many people did not compare them thoroughly in order to find out the differences, instead, they were focusing on comparing the current situation with the previous one. Actually, the vertical comparison cannot bring out the most foundation for the phenomenon in the security markets. Analyzing some similar situations in the two different markets will tell us the difference directly. Most current research were focusing on explaining certain situations by explaining them

2. The market structure

2.1. The difference between individual investors and institutional investors

As it can be seen that different investors were in the two different markets. In China, individual investors are the major part of the security markets. However, in the US, institutional investors make up the biggest part of the security markets. Their behaviors were totally different from some perspectives. Basically, the turnover rate of individual investors is much higher than institutional investors. The frequency of trading is much higher. For themselves, the penalty is unavoidable because the cost of trading, like the slippery cost, was a necessary part for every trading when they decide to sell or buy the stock. According to Barber, Lee, Liu & Odean, the annual 3.8% of penalty was caused by the aggressive trading pattern with extremely high turnover rate (nearly 300%) [2]. In contrast, for institutional investors, their investment will be relatively stable. The reason behind this is that the organization who chose to enter the market will pursue long term investment instead of pursuing a quick return. The portfolio management will be more professional because of the more all-encompassing analysis for the financial report so that the investors will not be influenced by the so-called breaking news or the emotion spread in the market.

How does this contribute to the fluctuations in the market? Basically, the emotion among the gregarious investors will spread quickly because of an imprecise analysis. The overreaction may lead the price of the securities to deflect from the intrinsic value. Barber argued stocks that receive a lot of attention, in most cases, cannot lead to ideal results for those investors [2]. Barber's analysis could reflect how imprecise analysis will lead to wrong decisions or even panic emotion in the market. Since the emotion is extremely infectious, the information given by some of the media or newspapers may cause the irrational decision further caused by the misunderstanding. Therefore, the fluctuations in the Chinese market were difficult to predict because of the ability to analyze information which is different from the US market.

2.2. The categories of the companies in the market

The main part of the Chinese market was made up by state-owned companies which relied on the subsidy of the government to a great extent. In the US, many of the companies were private with a little government interference. The industries that those companies belonged to are also different to a great extent. In recent years, companies that developed chips and green energy were really welcomed in the security markets. However, those are not very common in the US market. In fact, companies which provide medical services, financial services and high-tech are the popular ones in the US market which is totally different from China. The reason behind this is the different stages of these two countries. China is one of the biggest developed countries in the world. This means that it is still in the post-industrial period. In contrast, the US stepped into a highly-developed stage which means it did not need to deal with the industries that were related to heavy industry to a great extent.

2.3. The mechanism designed for fluctuations

When the trend of the whole market was going down, the protection mechanisms were totally different. For the Chinese market, when the single stock fluctuated over 10%, the trade of this single stock will break. This protected the interest of retail investors by cooling down the market in order to limit the level of panic in the market. The definition of the circuit breaker needs to be introduced here. According to Subrahmanyam, while circuit breakers may help mitigate panic selling, they can also interfere with the price discovery process [3]. For the US market, when the index of the whole market went down, the trade would be stopped temporarily to cool down the market and the mechanism was divided into different levels in order to deal with the different levels of the trend. The drawbacks of those markets are obvious, too. In the Chinese market, this limited the natural trend of a stock so that investors could not rely on the market trend to make rational decisions. In the US market, the extent of the freedom may make the situation worse even when the whole market is in a controlled situation, which will hurt investors more. To evaluate those mechanisms, it was not easy to tell which one is better for the whole stock market. Instead, they were designed according to the different situations of the two countries.

In 2020, the pandemic spread. The US stock market has halted the trade 3 times in a month in order to relieve the emotion of the investors. However, similar mechanisms were introduced into the Chinese market before 2020. The effect was not satisfactory enough. In 2015, the Chinese market halted the trade in order to relieve the pressure in the market. However, because of the large proportion of individual investors, the panic emotion spreads quickly in the market which produces the adverse effect of the mechanism. According to Zhou and Zhu, the possibility of a trading halt can induce a rush to trade as prices approach the threshold, a phenomenon known as the ‘magnet effect.’ This can lead to self-fulfilling crashes [4]. Therefore, it is difficult to tell which one is better without considering the structure of these two different markets

3. The trading mechanisms of the two markets

3.1. The timing of trading

The trading time of the two markets are different from each other. In the Chinese market, the “t+1” mechanism prohibits the immediate trade at the day when investors decide to buy in the stock. This hides the emotion of the whole market at the day of trading because this makes the outbreak of the market lagged behind. In the US market, the “t+0” mechanism protects the freedom of the market to

a great extent, which gives the investors the opportunities to make better decisions of making investment. Since there is nearly no regulation of the timing of the trading, the fluidity of the stock was much higher than the stock in the Chinese market. Therefore, from this perspective, it could say the US market has more freedom than the Chinese market.

However, quant was introduced into both of the markets to a great extent which changed the pattern of trading to a great extent. According to Baradehi, Bernhardt and Davies, regulatory changes, including decimalization, combined with massive increases in computer power have led to algorithmic trading, explosions in sub-second (low-latency) order submissions and cancellations, and large increases in trading volume [5]. Basically, it is more probable that the institutional investors would have a more structured trading combination to deal with the alternations of the market. Therefore, the “t+0” mechanism actually provides the opportunities for those institutional investors in the market to develop their trading strategies because they can respond to the change of the market immediately instead of thinking too much of the delayed fluctuation. That’s also the reason why a large proportion of quant trading originated from the US stock market. In fact, the cooperation of freedom and computer power developed the best environment for the development of quant trading.

3.2. Matching and auction

The price of the stock was also determined by different rules in the different countries. For one thing, the continuous auction was permitted the whole day in the US market. However, it was only permitted for almost 4 hours in the Chinese market. The time of auction was relatively limited in the Chinese market. Another thing about auctions is that the auction of the Chinese market was determined by the timing and the price of the auction. In the US market, the auction was determined by the quantity instead of timing and price. The continuous auction matches orders immediately when a matching counterparty exists, based on price and time priority [6]. Those mechanisms were the ones that Matching was based on. Order Matching depended on many different factors in the two markets which will lead to different results to a great extent.

To evaluate the difference between the Matching Mechanisms of the markets of the two countries, it needs to consider what is the basic motivation of those mechanisms. Ensuring fairness is the basic motivation of the Chinese market. This was designed to protect the small investors in the market. In contrast, since institutional investors took up a large proportion of the US stock market, the US market paid attention to efficiency. This was another factor that gave the great fluidity of the US market. Therefore, even though the name and definition of the mechanisms may be similar or the same, they represent the totally different processes in the two countries.

4. The law protection for the markets

4.1. The organizations

In the US, the SEC is the most important regulator in the market. Meanwhile, CSRC played a similar role in the Chinese market. The major roles were designed to regulate the behaviors of the buyer and seller in the market. When some abnormalities existed in the market, those organizations would intervene immediately. When institutions or individuals contravened the regulations, some penalties would be imposed in order to preserve the fairness of the markets. Also, they are the “controllers” of the markets. That is to say, when the whole market is at risk, those organizations

need to give some rational strategy to make the market become stabilized if needed. Theoretically, they are playing similar roles in the market.

4.2. The information disclosure

Even though these two organizations had similarities that were relevant to their roles, the extent of information disclosure may be different from each other. The timing of the disclosure was quite different. In the US market, the mechanism was relatively complete. The periodic disclosure was necessary in order to preserve the transparency of the market. However, this is the mechanism that is not mature enough in the Chinese market right now. According to Piotroski and Wong, given the relatively weak investor protection environment in China and the limitations in corporate disclosure and enforcement, individual investors often find it difficult to obtain reliable and timely information [7]. From this, it could know that the transparency of information need to be improved in order to relieve the pressure of investors. Another reason for the phenomenon is that the motivation of the policy alternations in China may be designed for macro-level policy. In contrast, the regulations of the SEC may be designed to improve the efficiency of the market. Therefore, in order to improve the efficiency of the whole market, the Chinese market needs to continuously complete the mechanism in order to protect the investors further.

4.3. The law protection

The laws in China and the US are both designed to protect the fairness in the market. According to Coffee, securities laws are essential to ensure that all market participants have equal access to material information and operate on a level playing field [8]. They were based on the local laws in order to adapt the differences of the two countries. However, laws were just a yardstick for regulators to make judgements in some situations. Their efficiency was also determined by the enforcement of the regulators. In the US market, the efficiency of the law was relatively higher, people could be educated to a great extent in order to understand what the limitations were. Also, the SEC would respond quickly according to the law. The cooperation between the SEC and the basic laws was effective. However, In the Chinese market, when the institutions and individuals have behaviors that disobey the law, it is the responsibility of CSRC to judge their behaviors. Therefore, this process was relatively subjective. According to Jackson and Roe, the more a government pays for the regulations, the higher return they can get with lower risk [9]. The corporations between the regulators and laws could be seen as an indicator to tell the efficiency of the markets. However, it was worth noting that the return of the market was related to the extent of the regulations [10]. Therefore, the execution of the law was the most basic but important factor to determine the operations of the whole market.

5. Conclusion

It is really hard to determine the trading mechanism in which country is better. The discussion above tells us the basic reason for this is the basic difference in the two countries in many perspectives. However, because of the regulations, the Chinese market is not mature enough to protect the investors. Compared with the US market, the Chinese market needs to have more innovations to protect the buyers and sellers in order to preserve the fairness in the market. It is worthwhile to do research on the differences in these two markets because the investors may devote themselves to different markets at the same time. It is also necessary to know how to deal with the differences

between these two markets. Therefore, it is really important to understand the basic logic behind these two markets. It is also important for the investors who chose to invest in different markets to protect themselves appropriately by considering the risk in different markets thoroughly. Risks exist in different aspects in these markets. This means investors need to consider multiple factors when making decisions in order to maximize their profit in the market. In recent days, under the trend of quant trading, it is really important to know what needs to be avoided when making an investment.

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