Obama's Showdown With Wall Street: my comment in Forbes

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I'm aware I blogged Obama's attack on Wall Street here this morning. But I also did so for Forbes. This is what I said there:

President Obama has achieved something few politicians manage: catching Wall Street off guard. His timing is late. Machiavelli would have suggested action a lot sooner. What is beyond doubt though, is that in the plan for banking reform he announced Thursday, Obama has set out an agenda for changes on Wall Street that will be the making or breaking of his Presidency, and maybe the rest of us as well.

His objective is simple: ensuring banks never hold taxpayers hostage again. To achieve that he has to cut them down to size; none must be too big to fail again. That involves the new "Volcker rule," which stipulates that banks that take deposits will not be allowed to use their own money to trade on speculative markets, run hedge funds or make private equity investments. In addition to prevent banks getting too big, the U.S. will ban takeovers and mergers among American deposit-taking banks.

Amazingly, Wall Street did not see this coming. In fairness, whilst Tim Geithner was in office, backed by Larry Summers who did so much to dismantle Wall Street regulation under the Clinton administration, few could have anticipated such a turn of events. They've been the obvious obstacle to reform; the best friends Wall Street will now realize it ever lost. So surprise is on Obama's side.

The debate now moves to whether the plan is good enough, and whether it will be contagious and spread to the U.K. and elsewhere. The second question is easiest to answer: around the world the excuse on the lips of all politicians has been that without bank reform in the United States, nothing could be done elsewhere.

Now there is to be reform in the U.S., everything can be done anywhere. There is no excuse for London, and for whoever is in power after the forthcoming general election this year, not to follow in Obama's wake, and for exactly the same reasons that Obama has done this: it is overwhelmingly, politically popular. I have no doubt at all that this will happen.

If London and New York are reformed, the rest of the world follows suit, unless (and there's an outside chance) we see the world’s banks all move to Cayman. This battle is going to be long and bloody. Bankers are fighting for what they see as their cash after all (whether or not that’s true), and nothing is a stronger motivator.

Offshore has always been their “get out of regulation free” card, the place to which they have said they will run when a politician threatens them. They might try it again. If so, this battle will change. The very nature of the state itself will come into question as countries like the U.S. and U.K. seek to protect themselves from catastrophic damage at the hands of banks located in small states whose legislatures they have already effectively captured for their own gain.

So, is this the right fight, for the right reason, taken to the right battle lines? I have no doubt banks need reform. I have for a long time argued that bank profits have been made by capturing for their own benefit massive financial resources that are not theirs to use.

Those resources include our pension funds, life-assurance funds, our savings and now our tax revenues, all of which are intended to be used for our long term benefit, not for the purpose of being churned in excessive trading from which banks make enormous profit with all risk and cost being passed to someone else—-us again. If you’re wondering why your 401K has not performed for years, this is exactly the reason.

So the fight is the right one to take and it’s being taken for the right reason. It may be populist, and there’s no doubt Obama is exploiting that, but for once this is a politician riding a populist wave that reflects an underlying sentiment of something being wrong that, whether explicable or not by those who feel it, is wholly justified by the facts. They feel they are being ripped off exactly because they are being ripped off, and Obama’s right to say so.

How far can the President push the banks? Like many I would have liked to have explicitly seen a new Glass Steagall Act. This was the 1933 legislation, abandoned in 1999, that meant commercial and investment banks had to be separate. It worked: we had nothing like the current crisis whilst we had it. We had crises before it. We’ve had them after it.

We do, however, have to be realistic. Going back to the status quo ante is just not possible sometimes. Obama’s new rule will radically alter the risk profile of banks. The Bank for International Settlements suggests 43% of all foreign exchange trading is on bank’s own account, for example. Almost all of this will now have to be ring-fenced from deposit taking. And hedge funds and private equity are massively volatile. However the risk will not be ring-fenced if the deposit-taking banks simply lend their capital to the risk-taking banks in future, leaving them exposed second hand.

The rules have also to require that those who will be trading, hedging and private-equity dealing do so out of their own capital, and not the capital of deposit-making citizens. Only then will the risk be segregated.

The details will be diabolical work, as ever. But for now Obama deserves applause for at last following his instinct and showing the courage to tackle the biggest crisis of our time: the takeover of our economies and well being, by banks motivated by their own well being. It’s a battle he has to win.