Notes from 2005 Berkshire Hathaway Annual Meeting

April 30, 2005

By Whitney Tilson

Note: This is not a transcript. No recording devices were allowed at the meeting, so this is based on many hours of rapid scribbling, combined with my memory. I have reorganized the content of the meeting by subject area. All quotes are Buffett's unless otherwise noted. Words in [brackets] are my comments or edits.

For my columns and notes on previous Berkshire and Wesco meetings, click here.

OPENING REMARKS

Current Investigations

We're happy to answer all questions, but we can't talk about 2 ½ things:

1. Last year's Nebraska football season (Laughter)
2. What we're buying
3. The current investigation into insurance matters. There may be some broad things we can talk about, but I can't talk about what I or other people at Berkshire have said to investigators. This is the case with all investigations; to protect the integrity of the investigation, the investigators don't want the witnesses to talk about what they said to other witnesses, or potentially communicate with them via public statements, because it could signal other witnesses what to say. Because of the potential for this, the investigators work fast.

Berkshire's Q1 Results

[To see the related transcript on Q1 results attached to Berkshire's recently-filed 8-K, click here.]

We will release our Q1 earnings and 10Q at the end of next week, but I can share some of the highlights. Particularly in insurance underwriting, it was a better quarter than I would have anticipated. But keep in mind that there's some seasonality here. Not with GEICO, but with our super-cat insurance, the biggest risk is hurricanes, which are concentrated in September. About 50% of all major hurricanes occur in September, and 17.5% in August and October, so it's nearly all in the third quarter. But when we write a hurricane policy, we recognize the premium throughout the year, but all of the risk is in the third quarter.

Even allowing for this, it was an unusually good quarter. Barring anything unusual, I'll stick with what I wrote in the annual report – that our cost of float this year will be less than zero.

In the first quarter, we had underwriting income of $500 million, up $200 million from last year's first quarter. GEICO had a very good quarter. The number of customers rose by 245,000, up 4% in a single quarter, due in part to a boost from New Jersey. [GEICO recently started writing policies in New Jersey after a long absence.] GEICO earned a 13% underwriting profit, considerably better than last year and an extraordinary performance.

During the quarter, we had investment income of $100 million, financial income of $50 million, MidAmerican earned $50 million, and our other businesses earned $50 million. Johns Manville did especially well.

We had some unrealized losses that flowed through the income statement. For example, we own more than $21 billion in foreign exchange contracts and we had a mark-to-market loss of $310 million on this investment in the first quarter. Due to accounting rules, this loss runs through our profit and loss statement, unlike when, say, our Coke stock goes up and down.

To us, these gains or losses mean nothing. For example, if Gillette and Procter & Gamble merge later this year, we will show a $4 billion gain on our Gillette stock. But to us, it's just a swap since we plan to hold P&G for a long time.

We've had a good start on our operating earnings this year. The rest of the year will likely not be as good.

Acquisition to be Announced

We will announce very soon – in the next few weeks – an acquisition of a bit less than $1 billion of an insurer. We love the insurance business.

Desire to do More Acquisitions

We would love to buy something for $5-$10 billion – and our check would clear. We ended the quarter with $44 billion in cash, not including our finance operations. Right now, we have more money than brains.

COMMENTS ON BERKSHIRE HATHAWAY

Suppliers' Culpability When Customers Abuse a Legal Product

[In comments that related to the finite reinsurance transactions that have touched Berkshire, Munger commented:] The issue is whether there is knowing participation. The standards are not uniform and can change over time. Consider a bartender [who serves alcohol to people, some of whom may later abuse it]. Or radio stations, who sell ads for perfectly obvious fraudulent products. It's hard to know how standards might change when it comes to suppliers being blamed for customers' behavior.

Finite Reinsurance

All reinsurance is finite – it's not the right descriptive term. When the SEC sent out its first inquiry, it used the term "nontraditional". We issue finite insurance daily.

There's nothing wrong with retroactive insurance. A few years ago, when CNA sold [one of their insurance businesses], we said we'd pay $2.5 billion in claims and got paid $1.25 billion for it. We made a guess about how much would be paid and when. There was value to both parties and to society.

In the first quarter of last year, in the 10-Q, we recorded a $100 million loss because we had to pay claims faster than we'd expected.

We'd do more of these deals.

The authorities are looking at contracts where there was no purpose, that were misused.

When we sold Pepsi a $1 billion policy [in a sweepstakes promotion a few years ago], there was certainly risk.

Munger: I agree with your characterization of the word “finite” insurance – it would be hard to invent a worse word. We’ve traditionally issued nontraditional insurance. (Laughter)

There’s no question that the corporate world has turned to low volatility, so insurance companies are selling more of this type of insurance.

Buffett: Insurance is perfectly proper – $400 billion is paid each year – and is used to smooth expenses in some cases. Think about your auto insurance. You can pay a small premium every year, or can go without insurance, pay nothing most years, but might have to pay $25,000 one year if you have an accident.

Acquisition Criteria

We look for people who have a passion for their business. We frequently buy businesses the owners still manage, where they are monetizing a lifetime of work. They often don’t want to sell but need to for estate planning or other reasons.

They need to have a passion because we don’t have any employment contracts – because we don’t think they work – we don’t stand over them with whips, and they’re already rich. We just try not to kill or dampen their love for their business.

We also look for three things: intelligence, energy and integrity. If you don’t have the latter, then you should hope they don’t have the first two either. If someone doesn’t have integrity, then you want them to be dumb and lazy. (Laughter)

We look them in the eyes and ask, “Do they love the business or the money?” If someone wants to cash out, then we have a problem because we only have 16 people at Berkshire’s headquarters and can’t run it ourselves.

Munger: The interesting thing is how well it [our acquisition strategy/process] has worked over a great many decades, and how few people copy it. (Laughter)

Keys to Berkshire’s Success With Acquisitions

We criticize it [acquisitions], but then we do it. But we have different motivations.

We’ve been reasonably successful in having people run their businesses with the same passion as before we bought them.

Gillette, the oil companies, etc. all went out and bought a lot of businesses and tried to run them themselves. We’re under no illusions that we can do that. We think that having lots of Executive Vice Presidents, directives from headquarters, centralized Human Resources etc. can destroy the incentives of the people who’ve already gotten rich, and we’re counting on them making us rich.

The successor to me will come from Berkshire, knows our system, has seen that it works, and will be surrounded by people who believe in it. So it’s not going to be so hard to keep this train going down the tracks at 90 miles per hour.

Munger: Our success has come from the *lack* of oversight we've provided, and our success will continue to be from a lack of oversight. (Laughter)

But if you're going to provide minimal oversight, you have to buy carefully.

It's a different model from GE's. GE's works – it's just very different from ours.

Buffett: We *are* a conglomerate – and we hope to become more of a conglomerate.

We're successful because of simplicity itself: We let people who play the game very well keep doing it. Our successor won't change this. The big worry is that the culture is tampered with and there's oversteering. But our board and owners won't allow this.

We've Picked Great Managers By Only Picking Proven Winners
It would be tough to evaluate a class of MBAs and pick which ones would prove to be the best managers, just like it would be tough to pick the best golfer by watching them hit on the practice range.

We haven't tried to evaluate, before they have a record, who will be superstar managers. Instead, we find people who've batted .350 for 10-50 years. We just assume we won't screw it up by hiring them. We take people who play the game very well and allow them to play.

I recall a study that correlated business success with the age at which a manager started. It turns out that those who started young did best. Of course, if you work with what you have, you can develop over time, but a lot of it is wiring – I've come to believe more so than I did 4-5 years ago. I've *never* heard Charlie say anything dumb about business – except when he disagrees with me. (Laughter) And I've never heard [GEICO CEO] Tony Nicely say anything dumb about business, *ever*.

Munger: Part of it is intelligence, partly temperament. Rick Guerin, for example, wanted to be rich, he was smart and had the right approach [so I knew he would be very successful]. [Guerin was one of the Superinvestors of Graham and Doddsville that Buffett profiled is this speech.]

Buffett: It's interesting to think about the odds that the NCAA basketball Final Four will be cancelled [referring to his comment elsewhere that Berkshire had written a $75 million policy on the Final Four being cancelled]. Some people like thinking about this. My dad wouldn't let me be a bookie, so I went into investing.

Selling Businesses
We won't sell a business just because it's underperforming.

It's Hard to Buy Businesses in the Current Environment
We are positioned very badly in terms of buying businesses. Berkshire will not do as well as long as this persists.

Munger: A lot of buying is fee motivated. Managers want to earn the extra fees on the extra assets. I have a friend who buys warehouses, but he stopped bidding recently because he's always being outbid. Howard Marks sent a lot of money back to investors, which is the right way to behave [I assume he's referring to one of the Principals of Oaktree Capital Management]

Buffett: Five or six years ago, I got a call from a well-known investor who asked me a lot of questions about reinsurance. He didn't know much about the business, but he was considering buying a reinsurance company because, as he explained to me, he would have to send his investors' money back to them if he didn't invest it in the next few months, and he was earning 2% [annually] on it.

We [unlike this gentleman] have all of our net worth on the downside as well. If we have 2 and 20 [2% management fee and a 20% performance allocation] on the upside and nothing but a goodbye kiss on the downside…

The competition right now is tough, so our efforts to buy businesses are likely to be futile. But there are 1-2 deals we might get done…

Munger: I don't think there's any business that we've bought that would have sold itself to a hedge fund. There's a class of businesses that doesn't want to deal with private-equity and hedge funds…thank God. (Laughter)

Buffett: We don't see any deals [recently] that we wish we'd made – this wasn't true in the past – even if the price had been 10% lower. We're in a different world right now…

Berkshire's Asset Allocation
Munger: Berkshire doesn't do much conventional asset allocation. We just search for good opportunities and don't want to put up artificial barriers. In this sense, we're totally out of step with modern portfolio management, but we think they're wrong.

Buffett: Well over 80% of our assets are in the U.S.

Munger: When have you ever done a big asset allocation?

Buffett: Never. But if junk bonds had stayed low for longer, we could have invested $30 billion instead of $7 billion.

Paying a Dividend
One reason not to pay a dividend is taxes, but we've always said that even if we could have paid a tax-free dividend, we would not have done so. Our test has been whether, if we retain a dollar, will it be worth more than a dollar in present value. So far we've always passed this test.

But it's no fun sitting on $40 billion, which earned less than 1% last year after tax. The burden of proof will shift in the next few years. We always ask, "Can we use the money effectively within our business?" So far, the answer has been yes. This will be discussed at our board meeting on Monday.

What Can Go Wrong at Berkshire and the Importance of the Right Incentives
We don't worry about our businesses. We have a diverse group of good businesses with great managers. What we worry about is something going wrong. We have 180,000 employees, so it's guaranteed that something will go wrong. We know it will happen. We just try to have – we *do* have – the right incentives in place.

For example, when I get on a NetJets flight, even if I'm in a hurry, I don't say to the pilot, "Hey, I'm in a hurry. Can you speed it up." The last thing I want is a pilot rushing through his pre-flight checklist, etc.

But companies do this all the time in the way they incent people. They should not have a system that encourages a focus on quarterly earnings. Our managers have no quarterly budgets – I don't know what our numbers are going to be next quarter. I'm also careful not to communicate anything to the contrary via body language.

Insurance companies in particular can report pretty much any numbers that they want. With $44 billion of reserves, it would be easy to adjust the reserves to show whatever profit was desired.

Even if quarterly numbers weren't tied to our managers' compensation, if I went to Wall Street and promised X, the managers, who wouldn't want to let me down, might play some games to achieve X.

Munger: What we don't like in modern capitalism is the expectations game. It's not the kissing cousin of evil; it's the blood brother.

Buffett: People who predict precisely are either kidding themselves or others. We've seen people get their egos involved. And everyone in the organization knows what the CEO has promised in public. It's setting up a system that sets up financial or psychological pressure for people to do things they probably don't want to do. It's a terrible mistake.

Berkshire's Board and Corporate Governance

Munger: We're out of step. We don't feel the need to have directors from every diversity category and pay everyone $100,000-$200,000 per year.

Our directors are all rich, own Berkshire stock, and don't have any company-provided Directors and Officers insurance coverage.

We've been waiting for our system to spread and we've been losing. (Laughter)

Buffett: The real issue is mediocrity – there are too many .240 hitters on boards. Businesses often settle for a notch or two above mediocrity – there are strong human instincts at work.

For many directors, the director's fees are an important part of their [total annual] compensation, and they want to be recommended for other boards, so this makes it difficult to arrange a rump meeting to say, "The guy at the end of the table [the CEO] is no good." This is mediocrity that is tough to combat.

We've been on boards and they can only tolerate a certain amount of obnoxiousness, so we have to ration it out. (Laughter) It's hard to overrule someone [the CEO] and we're likely to lose anyway. Occasionally we fire a bullet, but it often does no good.

We have real owners on our board – they bought it just like you. [In contrast,] the boards I've been on just hand me stock and stock options.

Independence is a state of mind. We think we have the best board in the country, but people who evaluate boards by a checklist disagree.

Munger: A director who gets $150,000 per year from a company and needs the money is *not* independent.

[The new law requiring a majority of independent directors] is typical government intervention.

Buffett: I've been on 19 boards and I've *never* seen a director who needs the money oppose an acquisition or executive compensation. They just don't behave as if they own it.

Munger: Someone once said that no man who needs the salary that a politician receives should be allowed to hold office.

Buffett: One of our directors was asked to leave two compensation committees for having the temerity to question pay packages. They're looking for Chihuahuas not Great Danes or Dobermans. (Laughter) I hope I'm not insulting any of my friends on compensation committees. (Laughter)

Munger: You're insulting the dogs. [The biggest laugh of the day.]

Managing Insurance Risk

We are doing some things in insurance that have some correlations. For example, we have insured a lot of things in California and if you have the right earthquake at the right time, not only could National Indemnity and GEICO incur losses, but See's and Wells Fargo would as well. And we used to own Freddie Mac [which would get hit as well].

I think about this a lot – it's my job to think about the absolute worst-case scenario. No matter what happens, we'll be OK.

The most likely mega-cat is a hurricane. In Long Island, there's huge exposure [by the entire insurance industry]. The last big hurricane hit there in the 1930s [and insurance is being priced accordingly]. But everything that can happen *will* happen.

The most powerful earthquake in U.S. history – 9.0 – was in New Madrid, Missouri.

It's Berkshire's job to be absolutely prepared for the very worst. A few years ago, we didn't have nuclear/chemical/biological risk exclusions [in our insurance policies] – we had huge risk, but it's gone now.

We wrote a policy for $500 million in excess of $2.5 billion, *not* caused by a nuclear/chemical/biological attack, on a major international airport. There was a cap of $1.6 billion for business interruption, so there would have to be more than $900 million of property damage [before we'd have to pay anything].

We insured the [NCAA basketball] Final Four against being cancelled (not moved or postponed), excluding nuclear/chemical/biological attacks. We would have paid $75 million [in this event]. We also insured the Grammy's in a similar way. We're OK with losing a lot of money, as long as we're being paid appropriately for the risk.

Nuclear/chemical/biological attacks are excluded from virtually all of our policies. We write it only when we're specifically getting paid for it.

Munger: We care more about thinking about things that have never happened. Think of a 60-foot tidal wave hitting California. Can you imagine?

Is there any other company that has attacked [reducing the insurance risk of] nuclear/chemical/biological attacks as well as us?

Buffett: No-one has attacked it more vigorously than we have. It's Armageddon here every day. (Laughter)

My aunt, who died last year, had everything she had in Berkshire [stock. With investors like this,] it would be crazy to take any risks to jeopardize this [company] to make an extra $100,000 or add a point to the track record. Maybe if I had a 2/20 [incentive fee structure; 2% management fee and 20% promote], I'd behave differently, but I sure hope not.

Comments on Investing in Europe

One disadvantage to buying a stock in the UK is that you have to report your holding once you reach the 3% level. So, for a stock with a $5 billion market cap, we'd have to report [and likely run the stock up] once we'd acquired only $150 million. But in the past, we've owned Guinness, which is now owned by Diageo, so this is not an overwhelming disadvantage. We'd be very comfortable owning many UK companies.

Incidentally, contrary to what's been reported, we do *not* have to report a 5% position within 10 days [referring to reports in *The Wall Street Journal* and elsewhere that Berkshire would have to file on its recently disclosed purchase of Anheuser-Busch stock if it held more than 5% of the shares outstanding].

Munger: Recently we've preferred the currencies of socialized Europe over the U.S. dollar. A queer occurrence…

Buffett: I remember when I'd come back from Europe and couldn't wait to convert my euros back to dollars.

Europe isn't doing as badly as you might think. Its growth rate is lower than ours, but our population is expanding a lot faster, so on a per capital basis, the gap is not as wide as you'd think.

COMMENTS ON BERKSHIRE HATHAWAY HOLDINGS

Berkshire's Stock Holdings

We're at the lowest percentage of public holdings ever [relative to all of Berkshire's assets], except for when we were winding down [in the early 1970s].

We're not unhappy with our public holdings like Coke, Wells Fargo and Moody's, but would we buy more? Well, we're not, so there's your answer. But due to taxes, the size of our positions, etc., we're not selling either.

We're not in an attractive time.

Munger: It's not a permanent state of affairs, but it's not going away.

We will still put large amounts of money to work at good rates, whereas now we're only able to invest small amounts – where small is still billions.

Best Investments Ever (and Avoid Credit Card Debt)
See's was very important to us to learn about [running a] business, and to provide cash for a lot of other things.

[Also,] buying the first half of GEICO for $40 million, given what we've gotten out of it and its future potential. (We later paid $2 billion for the 2nd half.) GEICO still has enormous possibilities for growth.

In the past I've touted the American Express card – well today, I'm going to tout the GEICO credit card. That being said, I advise you to pay off your credit card. It's a terrible mistake to get hooked on revolving credit at high interest rates.

I met with 21 groups of students last year and what I tell them is, even if you don't remember anything else I say, please don't get hooked on credit card debt.

GEICO is a great, great business model, run by a superb person and businessman, Tony Nicely.

Munger: The search expenses that brought us Ajit Jain – I cannot think of a better investment.

This is a good life lesson: getting the right people into your system is the most important thing you can do.

Anheuser-Busch
Most of the time, our actual decision [to buy] takes about two seconds. In the case of Anheuser-Busch, I bought 100 shares 25 years ago so that I would get the annual reports (you get the annual reports a little quicker if you own the stock in your own name). So, I've been reading the company's annual reports for 25 years. Recently, beer sales have been flat. Wine and spirits are growing, at the expense of beer, and Miller has been rejuvenated to some degree. So, Anheuser-Busch has been experiencing very flat earnings; they've had to spend more to maintain share and even do a bit of promotional pricing. They are going through a period that is certainly less fun for them than was the case a few years ago.

It's been a fascinating industry over the past 50 years. Omaha used to be a brewing town and Storz beer had 50% of the local market, but then the national brands took over.

Anheuser-Busch will have a strong position for a long time. The beer business is not going to grow significantly in the U.S., but worldwide beer is popular in a great many places, and Anheuser-Busch has a very strong position. I would not expect the earnings to do much for some time, but that's fine with us.

Munger: In our situation, it's rare that we can buy into a good company – we almost need a little unpleasantness.

Buffett: That's true for Berkshire too.

In beer, you don't see the rise of generic brands, as we've seen in so many other categories. But beer consumption per capita is going nowhere.

Americans drink about 64 ounces of liquid per day. 27% of that is soda (11 ounces are Coke products), beer is about 10% and, despite the rise of Starbucks, a fine company, coffee has gone down and down over time.

Munger: There used to be hundreds of brewers. I think the trend toward giant companies [dominating the beer industry] is permanent.

Buffett: Schlitz used to be the #1 brand of beer.

There's a great book on the history of the beer industry [he didn't give the title, though mentioned it was written by a *Wall Street Journal* reporter. Most likely it is *Travels with Barley: A Journey Through Beer Culture in America*, by Ken Wells.]

PetroChina
We bought it a few years ago, investing $400 million. It was my first investment in a Chinese stock.

I read the annual report. They produce 3% of the world's oil, about 80% as much as Exxon Mobil. Last year, it earned $12 billion in profit – only maybe five US companies earned as much last year.

The total market value when I bought it was around $35 billion, so I paid only three times last year's earnings. The company does not have unusually large amounts of leverage and – this is unusual – has a stated policy of paying out 45% of its earnings in cash, so that's a 15% cash yield [based on last year's earnings, since Berkshire bought it at 3x those earnings].

The Chinese government owns 90% and we own 1.3%, so if we vote with them, together we control the business. (Laughter)

Unfortunately, we don't own the same shares [as the Chinese government]. [We own another class of shares such that] we had to report our interest [in the company] at 1.3%. We would have liked to buy more, but the price jumped up [after our ownership stake was disclosed].

Munger: It would be nice if this [finding really cheap stocks] happened all the time. Unfortunately, it doesn't.

Buffett: I simply read the annual report. I had no contact with management nor did I attend any management presentations. I just sat in my office and invested $400 million, which is worth $1.2 billion today.

I also looked at Yukos, the big Russian oil company [at the time I bought PetroChina] and compared the two at the time. PetroChina was far cheaper and I thought the economic climate was likely to be better in China. Yes, there was risk of tax laws or ownership rights changing, but the price was ridiculous.

HomeServices of America
We don't think the way homes are bought and sold will change very much. Some will disagree, but we don't think the internet will change this. [Buying and selling a home] is the biggest financial decision most people will make] and people will continue to want to have a 1-on-1 relationship with a real estate broker. [It also will be] a local business, so we've retained the local identities.

It's almost certain that we'll be a lot bigger [in this business] in 5-10 years. It depends on how many acquisitions we make, but we're a good buyer and owner.

Munger: As to whether we'd prefer to buy brokerages or real estate, obviously we like brokerages better.

Use Bill Gates to Invest in Tech Stocks?
Charlie and I put money in things we understand and think we'll know what it'll look like in 5, 10 or 20 years. Bill being on the board doesn't change this. I'll listen to any idea of his and, in fact, our investment ideas overlap quite a bit. I still wish I'd bought Microsoft when I'd first met him. (Laughter)

COMMENTS ON FINANCIAL COMPANIES AND RISKS IN THE FINANCIAL SYSTEM

Comments on Financial Companies
Financial companies are more difficult to analyze than other companies. They can report whatever earnings they want – it's an easy game to play. For banks, earnings depend on loans and the reserves set aside. It's easy to change and manipulate the reserves.

With a company like WD-40 or a brick company, the financials are easy to analyze. But with financial [companies] it's tough, especially when you throw in derivatives.

There were very high grade, financially sophisticated people who were on the boards of the GSEs [Government-Sponsored Enterprises, such as Fannie Mae and Freddie Mac] and they were not negligent, but it's very tough [to detect the shenanigans that went on].

Charlie and I were on the board of Salomon and Charlie was on the audit committee, and [it's just impossible to evaluate thousands of transactions]. You'll just have to accept that with insurance companies, banks and other financial companies – it's just a more dangerous field to analyze.

With GEICO it's easier because the statistics are quite accurate – it's short-tailed insurance. It's not like asbestos.

I wouldn't fault the ratings agencies. Even the big-name auditors didn't catch it.

Munger: Where you have complexity, by nature you can have fraud and mistakes. You'll have more of that than in a company that shovels sand from a river and sells it. This will always be true of financial companies, including ones run by governments. If you want accurate numbers from financial companies, you're in the wrong world.

Bad Accounting and Derivatives
Any accounting that gives people a rationale to reduce reserves even further is bad. There's such a tendency to reduce reserves for long-tailed [insurance] policies – to understate them – especially if the CEO is retiring or options are vesting.

In derivatives, both sides book a profit; this is especially true of traders who are on commission.

We're three years into unwinding Gen Re's derivatives book and you would not believe the complexity. Most of it was marked to market, so you'd think it would only take a few days to unwind.

I don't think any regulator or auditor [has any hope of getting a handle on any big derivatives book].

Munger: The stupid and dishonest accountants allowed the genie of totally inappropriate accounting to descend on derivatives books. And once this has happened – people get status, etc. – it's impossible to get it back into the bottle.

The housewife preparing her toast in the morning just isn't worried about a derivatives blowup.

The people with vested interests in the status quo are very powerful. If you're going to try to fix this, you're going to have a very interesting life.

Risks in the Financial System
I think our currency will weaken, but I'm not the Armageddon type. I think most of our citizens will be better off in 10 or 20 years.

I'm concerned about our political leadership, but as Peter Lynch once said, "Invest in businesses any idiot could run because someday one will." (Laughter) We've had all sorts of bad Presidents, but have still done well. Our real GDP per capital rose seven-fold in the last century, which is remarkable.

Sure, the big consumer debt load and trade deficit could cause some financial market distress – there are great investment opportunities in dislocations – but the country will survive.

Eventually the country will do fine, but there's a significant possibility of a chaotic situation.

Munger: We don't have any great record making macroeconomic predictions. It's obvious that we could have some kind of convulsion however.

Buffett: Far greater sums in one asset class after another are on a hair trigger. We're piling up huge financial assets at intermediaries, which lend themselves to huge dislocations. We've turned over huge amounts of money to people who want to beat the S&P in the short term, and while they may appear to be independent, their actions are not independent. They can all try to head to the exits at the same time. But if you're selling, you must find a buyer. The only way to sell a burning seat in the theater is to find someone else to buy it.

Munger: There's way heavier leverage by hedge funds and [others] today.

I knew a guy who had $5 million and owned his house free and clear. But he wanted to make a bit more money to support his spending, so at the peak of the internet bubble he was selling puts on internet stocks. He lost all of his money and his house and now works in a restaurant.

It's not a smart thing for the country to legalize gambling [in the stock market] and make it very accessible.

Buffett: Is there anyone we've forgotten to offend? We don't want to miss anyone. (Laughter)

Risks in the Global Financial System
Charlie and I are not as on board on this, so I'll answer it and then Charlie can share his thoughts.

We have a $618 billion trade deficit and an even larger current account deficit. As large as we are, something will change [for the worse] and the longer it goes on, the worse it will be. Most economists say a soft landing is likely, but they don't say what this [will look like]. *How* the numbers come down is quite significant. Paul Volcker has expressed apprehension about [the likelihood of] a soft landing.

There's as high a percentage as there's ever been fn money on a hair trigger – in foreign exchange, stocks, bonds, the carry trade… When people go to bed at night – an electronic herd – that can sell billions of dollars at the press of a key. I think this is at an all-time high. An exogenous event, like Long Term Capital Management – and it *will* happen – could trigger a stampede.

If you hold dollars, you can't get rid of them. You can't sell them to the U.S., because you'd get dollar-denominated assets in return. And you can't sell them to another country, like France [I forget the reason he gave].

[He read a quote from Paul Volcker's recent article in the *Washington Post* and concluded:] The situation is dangerous and intractable and is at an all-time high. But I can't predict the timing.

I would say that what's going on with the trade deficit will have serious consequences. But in the last Presidential race, neither candidate addressed it, which is understandable. 90% of the American people can't define "current account" and it's hard to describe in three minutes. And it's not the kind of issue that Betty [the average American voter], when she's making her toast in the morning, asks herself, "Gee, that trade deficit is really unsettling me today."

Charlie has a different view. Charlie?

Munger: If anything, I'm a little more repelled by the lack of virtue in how we as a nation run our financial affairs. Look at consumer credit… Things could get a lot worse.

Buffett: How do you think it will end?

Munger: Badly.

Buffett: We're like an incredibly rich family. We sit on the porch of our huge farm – so big that we can't even see the end of it – and each year, we consume 6% more than the farm produces. To pay for this, each year we sell or mortgage a little bit of the farm that we can't see, so we don't even notice. We're very, very rich and the rest of the world is happy to buy from us or lend to us, so each year they take a piece of our valuable assets – and they work very hard.

But we will have to service this. If it goes on for a long time, our children will pay. We're sending $2 billion per day [overseas right now].

[What will cause a crisis? I don't know.] Does it reach a tipping point, or will there be an exogenous event?

I have a hard time conceiving of any scenario in which the dollar appreciates.

Munger: The counter-argument is: what does it matter if foreigners own 10% of us over time, if the pie grows by 30%? [But I don't buy this. Taken to its logical extreme,] what if we had no manufacturing and our only businesses were hedge funds?

Imagine that if, instead of fighting the Revolutionary War, we'd instead agreed to give Britain 3% of our GDP each year. This might have looked good in 1776, but not to future generations. It's like taxation without representation.

Compliments for AIG
Munger: I'll go out on a limb and say the following about AIG: I think that whatever comes out, they will find a lot that was right about AIG. There's a lot of ability in that place.

Buffett: Oh yeah. Hank Greenberg was the #1 man in insurance. He built an incredible business. He took nothing and built the leading property and casualty insurer in the world.

Hedge Funds and Private Equity Funds
There's no doubt that there's far more money looking a deals now than in the past. They're willing to pay up to buy good but mundane businesses that we've historically bought and had success with. Now it's not just private equity funds getting in – hedge funds are too.

There's been a bit of a change in the past few weeks, as it's gotten a little harder to borrow money, but overall, we can't compete, which makes us feel distress.

But it won't go on forever. In the near term, we are not positioned favorably at all, but you'd be amazed at just how fast things can change. Things happen to change the landscape. At least three times in my career, there's been so much money sloshing around. It was so bad in 1969 that I closed my partnership. But only four years later, it was the best time to be a buyer in my entire life.

1998 Crisis
In 1998, there were incredible opportunities. Just like today, there were a lot of smart people with 150 IQs running around with lots of money, but there was a panic. For example, there was a 30 basis point difference in the yields of on-the-run and off-the-run 30-year Treasuries. Literally, a 29 1/2-year traded 30 basis points higher than a 30-year because of the slight liquidity difference. You could have made a lot going long one and short the other. You wouldn't have thought this kind of thing was possible, but it happened.

The high-yield market went crazy as well. In the span of only 14 months, you had yields go from 25%-60% to 7%. [Buffett put up the following chart:]

Company	Yield in late 2002	Yield later	# of months elapsed
Williams	75.4%	7.0%	14
Dynegy	62.7%	6.0%	14
Qwest	54.1%	8.5%	14
Crown Cork & Seal	48.5%	4.4%	17
[I missed a few in here]			
Corning	28.3%	4.4%	12
Tyco	26.5%	4.7%	6

We didn't own all of these.

Fannie Mae, Freddie Mac and Other Highly Leveraged Financial Institutions
The GSEs were a very logical development. For a fee, which used to average 25 basis points, they would allow someone 3,000 miles away to buy a mortgage [or portfolio of mortgages] and not worry. The GSEs were looked at as government guaranteed, so investors didn't worry.

They became all about leverage – they could access capital at a low rate and built a huge carry trade [borrow at low short-term rates and lend at higher long-term rates]. Then they got carried away when they promised high rates of steady growth. It was madness – you can't do that. If you lend for 30 years to someone who can repay in 30 seconds, as a practical matter you can't perfectly handle that risk. So, they first enlarged their portfolios and then engaged in financial shenanigans.

[I have written many columns about accounting shenanigans in: Corporations Favor Fudge, Where Has Corporate Integrity Gone?, More Earnings Shenanigans, IBM's Accounting Tricks, Lessons from the Enron Debacle, Lessons from Lucent's Cash Flow, Stocks to Avoid, More Stocks to Avoid, Another Financial Scandal? and Accounting for Non-Paying Customers.]

It boggles the mind how, with good auditors and board members, they misrepresented *billions* of dollars. They now have $1.5 *trillion* of mortgages and the Federal government is on the hook – markets believe it and it is – because two companies wanted earnings per share to go up. They acted like the two largest hedge funds in history.

People are now seeing the consequences of the government issuing a guarantee. Congress should be paying a lot of attention to this. You can't shut them down, but you can increase capital requirements and capital ratios. You could put them into run-off mode. There are plenty of other mortgage guarantee providers. It would not be the end of the world at all if the GSEs were put into run-off mode.

Munger: I think their problems are due in part to their large derivatives books, which were sold to hem by silver-tongued salesman. As many of you know, I believe there's much wrong with derivative accounting and don't believe the full penalties have yet been paid.

Buffett: If you can have a $5 billion mismark in one direction and a $9 billion mismark in the other direction [as was the case with Freddie and Fannie, respectively], I would say we've come a long way from Jimmy Stewart in "It's a Wonderful Life".

INVESTMENT ADVICE

Invest in Yourself
It's hard for individual investors to successfully pick stocks or time the market. The best investment you can make is in your own abilities. Anything you can do to develop your own abilities or business is likely to be more productive than investing in foreign currencies.

If you own your own business in America [and you run it well, you'll do OK].

Avoiding Mental Mistakes
The first step is to recognize the traps. Charlie, in *Poor Charlie's Almanack*, talks about various traps, so read that book.

Our personalities are such that we're probably less prone to falling into these traps, but it still happens – just less than before.

Munger: You don't have to have perfect wisdom to get very rich – just a bit better than average over a long period of time.

Buffett: It reminds me of the story about the two guys being chased by the bear and one guy says to the other, “I don’t have to outrun the bear. I just have to outrun you!” (Laughter)

Poor Charlie’s Almanack
Munger: Peter Kaufman did it. He came up with the idea and Warren got excited about it. It’s a ridiculous name [the title]. (Laughter)

If you assimilate everything that’s in that simple book, you’ll be far ahead in the game.

Buffett: It’s a sensational book. You’ll learn a whole lot about life – and making money.

Learning to be a Good Investor
When I was seven years old, I first took an interest in stocks. My dad was in the business, so I’d go with him to the office and I saw interesting things. [When I was a little older,] I went to the library and read every book on markets and investing.

When I was 11, I bought my first stock – three shares. I was following charts. When I was 19, I read *The Intelligent Investor* and it changed my whole framework.

My advice is to read a lot. There are no secrets in the business that only the priesthood knows. It’s all right there.

It requires qualities of temperament way more than qualities of intellect.

Once you have a 125 IQ, much more doesn’t matter. Look for opportunities that fit your framework. Try to learn every day, but you can’t act every day. It’s important to enjoy the game, just as it is to enjoy bridge or baseball [if you’re going to play those games seriously].

Corporate Managers Should Learn Investing (and the Madness of Most Acquisition Activity)
Munger: I think corporate managers should learn to be better investors because it would make them better managers.

Buffett: Charlie makes a good point. Managers should learn about investing. I have friends who are CEOs and they outsource their investing to a financial advisor because they don’t feel comfortable analyzing Coke and Gillette and picking one stock vs. the other. Yet when an investment banker shows up with fancy slides and a slick presentation, an hour later the CEO is willing to do a $3 billion acquisition. It’s extraordinary the willingness of corporate CEOs to make decisions about buying companies for billions of dollars when they aren’t willing to make an investment for $10,000 in their personal account. It’s basically the same thing.

Money Management is a Low Calling – and an Ominous Indicator
Munger: I think money management is a low calling relative to being a surgeon. I don’t like the percentage of our GDP and brainpower and professional effort that’s in money management. I don’t think it’s a good thing for our country, and don’t expect it to end well.

The present era has no comparable precedent in the history of capitalism when so many people are trading pieces of paper. We have a higher proportion of the intelligent sections of society involved in buying and selling bits of paper and trying to make money doing it. There are more people doing this than at any time in history. A lot of this reminds me of Sodom and Gomorrah.

Buffett: When we've seen baby versions of this in the past, there have been future [very negative] implications [for the stock market].

Munger: When you get so much nonsense going on, it feeds on itself and creates a frenzy. [When this has happened historically,] there have been serious implications.

Untapped Pricing Power – The Measure of a Great Business
We like buying businesses with some untapped pricing power. For example, when we bought See's for $25 million, I asked myself, "If we raised prices by 10 cents per pound, would sales fall off a cliff?" The answer was obviously no. You can determine the strength of a business over time by the amount of agony they go through in raising prices.

A good example is newspapers. The local daily paper controlled the market and every year they raised the [advertising] rates and circulation prices – it was almost a big yawn. They didn't worry about losing big advertisers like Sears, JC Penney or Wal-Mart, or losing subscribers. They increased prices whether the price of newsprint went up or down.

Now, they agonize over price increases because they worry about driving people to other mediums. That world has changed.

You can learn a lot about the durable economics of a business by watching price behavior. The beer industry is able to raise prices, but it's getting tougher.

COMMENTS ON ECONOMIC MATTERS

Market Views
Regardless of the market, I will keep buying businesses. We like low prices.

We're not good at forecasting markets. Charlie and I spend no time thinking about where the market's going. We do know when we're getting good value [when we're buying a stock or business].

There are always going to be some good and bad things happening.

I've seen more people lose more money by getting focused too much on one factor. We've never not bought something due to macroeconomic concerns.

Market Calls and Current View
Very infrequently you can say something intelligent about the market as a whole – when circumstances are so extreme that you predict the next 5-10 years with some degree of certainty. This was the case in 1969 and 1974. But most of the time, we're in some in-between zone.

Obviously you can get more for your money now than in 1999 when I wrote that *Fortune* article ("Mr. Buffett on the Stock Market"; *Fortune* subscribers can click here to read it). I knew I'd be right.

If I had to make a choice today between long-term bonds yielding 4.5% vs. equities over the next 20 years, I'd prefer equities. But people who expect 6-7% after-tax or double digits [pre-tax] and think they can do it or hire someone else to do it will likely be disappointed.

I don't think we're in bubble times or bargain times.

I think you'll get a chance to do something screamingly intelligent within a few years, maybe much sooner, relative to current choices.

The Best Business

The best businesses can maintain their earnings without continued reinvestment, whereas in the worst you have to keep pouring money into a money-losing business.

The best business is being the best surgeon in town. You don't have to do any reinvestment – the investment was the education. The surgeon will retain his earnings power, regardless of inflation.

Likely Housing Bubble

Americans feel very good about home ownership – for many people, it's been their best-behaving investment. If it's a bubble and if it's pricked, it could affect some Berkshire businesses, but it would also let us put a lot of money to work [referring to a likely crisis that would depress stock prices and let them invest some of the $40+ billion cash hoard].

We've not made our money betting on macro stuff like foreign exchange; instead, it's from buying cheap stocks like PetroChina.

25 years ago, we saw the same thing [a real estate bubble] with Nebraska farmland. People fled cash, saying "cash is trash." A farm 30 miles north of here sold for $2,000/acre in 1980; I bought it later for $600/acre. People went crazy and the consequences were huge. Many banks failed, even ones that had survived the Great Depression.

I don't know where we are with housing – people may behave differently because they live in it. But when you get prices increasing at a far greater rate than construction costs or inflation [there can be problems].

Munger: In parts of California and in the Washington DC suburbs, there's a bubble.

Buffett: I sold a house in Laguna Beach, CA for $3.5 million. The house was only worth about $500,000, so the land was being valued at $3 million. It was only a fraction of an acre, so the land was being valued at $60 million per acre. That's a pretty fancy price for almost any land.

Munger: One of the Directors of Wesco told me that a modest house next to his recently sold for $27 million. There are some very extraordinary housing price bubbles going on and the consequences could be serious.

More on the Housing Bubble (and Why Foreigners Invest in the U.S.)

The financing terms have become easier and easier as prices have risen, which is contrary to normal [and prudent] practices. But the financing process has become so disintermediated that the mortgage buyer doesn't care. The easier financing has led to a boom in prices.

The Nebraska farm bubble was fueled by banks that historically had been conservative but went crazy. They said that a farm was an asset-appreciation investment, not an income investment – in other words, they were playing the greater fool game.

The rest of the world is saving. They're investing $2 billion/day in the U.S. Some say they have so much confidence in the U.S. that they want to invest, but this is silly. They invest because they *have to*.

Munger: It's obvious that easy financing [for houses] is fueling big price increases.

Buffett: Consider the following fanciful illustration. Let's say we had a fixed population in Omaha and no new houses were built, but each year everyone sold their house to their neighbor and moved. In year one, the price was $100,000. In year two, the price jumped to $150,000, but Fannie and Freddie guaranteed the mortgage and sold it to Asian investors. This is an influx of $50,000 to the family income. In year three, the price jumps to $200,000 and the same thing happens.

Obviously, it is transparent what's happening here, so it wouldn't really happen, but you can have accidental behavior that leads to certain aspects of this.

Munger: There are Ponzi effects in any economy, and you can see that here.

Bearish on REITs

Munger: In a corporation like Berkshire, a subchapter C, owning real estate is very disadvantageous.

Investing in real estate is having a bubble of its own. My friends who own real estate are selling their worst assets and getting better prices than they'd imagined.

Buffett: I have less than 1% of my net worth outside Berkshire and when the Nasdaq hit its high, I had nearly all of it in REITs, which were selling at a discount to their liquidation values. REITs are quite attractive now, especially compared with 5-6 years ago when they were very unpopular.

It's better to pay attention to something being scorned than championed.

Munger: And REIT accounting is phony.

Buffett: Other than that, we love REITs. (Laughter)

GM and Ford

[GM CEO] Rick Waggoner and [Ford Chairman] Bill Ford have both been handed, by past managers, extremely difficult hands to play. They're not the consequences of their own doing, but they have inherited a legacy cost structure, with contracts put in place decades ago, that make it very difficult for them to be competitive in today's world.

GM and Ford don't sign long-term contracts to pay high amounts for steel, but that's what they've done with annuity and healthcare payments to employees. The result is such expenses are far higher than that of competitors, so it's not a fair fight.

GM once had 50% market share, and it's fallen to 25%. Even if it was still 50%, they'd still be in trouble.

I'm not sure what I'd do if I was elected CEO of GM. It reminds me of what Bill Buckley said when asked what he would do if he actually won his race for New York mayor back in 1965 and he said, "The first thing I'd do is ask for a recount." (Laughter) Well, that's what I'd do at GM.

The UAW says, "We have a contract and we have a deal." GM has set aside $90 billion for pensions and another $20 billion or so for healthcare, yet has a market cap of only $14 billion. That's not sustainable.... Something will have to give.

If a company had to pay an extra $2,000 per car more for steel, everyone would realize there was a crisis and demand a quick solution, but that's not happening.

Part of the problem arose because [the actions of previous managements] bore no accounting consequences. Back in the 1960s, companies didn't have to account for pension costs on an accrual basis, and didn't have to do so for healthcare costs until the late 80s or early 90s. But those costs are very real…

Munger: Warren just gave a very optimistic prognosis in my view. Just because the full consequences haven't yet hit, doesn't mean there isn't a huge problem. It's as if someone jumped out of a window on the 42nd floor. As you go by the 20th floor, you're still OK, but that doesn't mean you don't have a real problem. (Laughter)

If I was the President of the U.S., Governor of Michigan or the CEO of GM, I wouldn't wait. I'd address the problem right now because no one's coming to save you.

Pharmaceutical stocks
That industry is in a state of flux right now. It's historically earned very good returns on invested capital, but it could well be that the world will unfold differently in the future than in the past. I'm not sure I can give you a good answer on that.

Munger: We just throw some decisions into the "too hard" file and go onto others.

Buffett: We get paid not for jumping over 7-foot bars but for finding 1-foot bars that we can step over.

Impact of Rising Commodity Prices on Margins
Our carpet business has been hit by rising commodity prices. Sometimes you can get into temporary situations in which you can't raise prices fast enough to keep up with rising input costs. But the main impact of the rising price of oil – it's an extra $200 million per day – is borne by American consumers.

Corporate Profit Margins Likely to Fall
Corporate profits are at an all-time high as a percentage of GDP. I'd bet that they go down in the next few years. Corporate taxes [as a percent of total taxes] are at an all-time low and there's likely to be reversion to the mean.

Bearish on Gold
We're not enthused about gold. People say it's a hedge against inflation, but that's also true of oil, land, Coca-Cola, See's Candies, etc. I'd much prefer to own land in Nebraska or an apartment house or an index fund as a store of value. We'd rather own an asset that will be useful even if the currency drops to 10 cents on the dollar. People will always need to drink and eat [referring to Coke and See's]. We wouldn't trade ownership of businesses for a hunk of yellow metal.

Munger: If you have the opportunities of Berkshire, an investment in gold is dumb.

More Bearishness on Gold

Gold would be way down my list as a store of value. I'd much rather own 100 acres of land in Nebraska or an apartment house or an index fund.

The Dow went from 66 to 11,000 or 12,000 during the last century, and you got paid a lot of dividends along the way. Gold went from $20 in 1900 to $400 in 2000, plus you'd have to pay insurance and storage costs, so it's not a good store of value.

I'm not advocating paper money – it's good to worry about this. But I'd rather sell one pound of candy. That will retain its value even if the currency is seashells.

Gold has done very badly [as an investment] in the past and I see no reason why it will work well in the future. All that happens is that it is taken out of the ground in South Africa and put back in the ground in Fort Knox. (Laughter)

Munger: Gold was good to have if you were a well-to-do Jewish family in Vienna in 1935 because of the situation [just before the Nazis took over]. But if you're in our position, gold has no interest.

NYSE's Merger with Archipelago
I personally think it would be better if the NYSE remained as a neutral, not-for-big-profit institution. The exchange has done a very good job over the centuries. It's one of the most important institutions in the world.

The enemy of investment success is activity. The exchange of yesterday will be better for the American investor. I know the American investor will not be better off if volume doubles on the NYSE, and I know the NYSE will be trying to figure out how to do that if it is trying to maximize its own earnings per share.

Trading is the frictional cost of capitalism. GM or IBM will not earn more money if their stock turns over more actively, but a for-profit NYSE will.

Munger: I feel the same, only more strongly. I think we have lost our way when people like the [board of] governors and the CEO of the NYSE fail to realize they have a duty to the rest of us to act as exemplars. I don't think you want to turn the stock exchange of the country into an even larger casino than it is already.

You do not want your first-grade school teacher to be fornicating on the floor or drinking booze in the classroom; similarly you do not want your stock exchange to be setting the wrong moral example. I am appalled.

Buffett: I wish I'd gone to first grade where he did. (Laughter)

Asbestos
Munger: There's been terrible behavior by doctors, terrible behavior by lawyers, gutless behavior by courts, and even more gutless behavior by politicians, who [he said something disparaging about them].

You keep hoping that it will get so bad that things will change, that reform will happen. And it can happen: for example, the Workman's Comp system in California. With the Schwarzenegger revolution in California, it's been partly – maybe 15% – corrected. If it gets bad enough, it's possible that it could be fixed.

It’s crazy that judges give money to people who smoked two packs of cigarettes a day for their entire lives, are dying, and have one little spot on their lungs.

Even asbestos will eventually go away, but who knows how much damage will be done before the storm passes.

But the behavior is so terrible   It’s that kind of behavior that makes me talk about [the U.S. being at] the apex of its civilization.

Inflation
The talk of deflation was total nonsense.

You would think that the trade deficit, which has resulted in a weaker currency, would have led to higher inflation.

The price of oil has risen far more in dollars than in euros.

So, inflation matters. It’s always there and is something we think about. But See’s Candies will do fine in an inflationary environment.

Munger: So far, the weak dollar has acted to restrain inflation.

Buffett: Yes. For example, we’re paying less for shoes, few of which are made in the U.S. anymore.

Interest Rates and Inflation
We don’t want to be long the long bond [e.g., he thinks there’s risk of rising interest rates].

But if you’d told me two years ago what the macro conditions would be today, I’d have been very surprised by where interest rates are today [i.e., he thought they’d be higher].

Munger: There won’t be an automatic correlation between interest rates and inflation – there will be weird things.

ADVICE ON LIFE AND OTHER

The Future of the United States
Overall, I’m an enormous bull on the United States. In 1790, we had a population of 3.9 million people vs. 290 million in China and 190 million in Europe. We’ve all had roughly the same conditions since then, yet 215 years later, we have 30% of the world’s GDP. This is one of the great all-time success stories.

Munger: I believe that we are at or near the apex of a great civilization.

Buffett: I don’t feel that way. You’ll know who’s right in 20 or 30 years.

America vs. the Rest of the World
What we do is no secret. The relative importance of America will diminish. The rest of the world is catching on and adopting our best practices. But our castle will grow. It’s good for us if the rest of the world does well, and they’re growing from a lower base. I don’t think their success comes out of our hide.

Munger: In 50-100 years, if we're a poor third to some countries in Asia, I wouldn't be surprised. If I had to bet, the part of the world that will do best will be Asia.

Comments on Social Security

I don't want to do anything to hurt the bottom 10-20% of the population. I've seen people who fear for the last years of their lives [that they won't have enough money].

We're worrying about a problem in 25 years, that's a fraction of our current $500 billion trade deficit. We're spending 4.5% of our GDP on Social Security now; if we have to increase it to 6% in 50 years, this is not a worry.

There are some things we should do, however: means test it, lift the $90,000 cut-off [there are no Social Security taxes above this amount each year] or eliminate it, and increase the retirement age. 2005 is a lot different from 1935 [in terms on longevity].

Munger: That's the perspective of the Democrat up here, so you might be surprised to hear from the Republican that I think the Republicans are out of their cotton-pickin' minds to be taking on this issue at this time. The thought that more of our GDP will be going to the elderly over time is not anathema to me.

Social Security is very successful. Apart from disability – a small part – there's almost no fraud; it's hard to fake being dead. (Laughter) It rewards work, it's low cost. It's one of the most successful government programs ever.

For the current administration, which needs to face down North Korea and Iran, deal with Iraq, etc., to waste political capital on this twaddle…

On Tough Decisions

I honestly can't think of any [investment] decision I've agonized with over a long period of time.

Public Education

A good public school system is a lot like virginity: easy to preserve, but not to restore. To succeed, well-to-do people need to be involved. I admire the fact that people like John Walton, Bill Gates and Ted Forstmann have gotten involved with this issue.

Next to the nuclear/chemical/biological weapon problem, the #1 problem we face is making sure our educational system is providing a good education to all children – and it's not. Dealing with the problem is complicated, as there are thousands of school districts and many unions as well.

A big problem is that in many places, the rich have opted out. I imagine that if I used the local golf courses, I'd care a lot about how they were managed and maintained – it's the same with schools. There's a two-tiered system right now.

I'm a big believer in public schools.

Munger: I met a guy whose wife teaches 8th grade in the local schools. He told me that, due to requirements of No Child Left Behind, for the numerous students who can't read, she records the books herself so that these students can listen to the books and follow along in class. This is [the best of] No Child Left Behind in a sense, but it's also a failure. It's very hard for a civilization to fix failure when 8th graders can't read.

It’s a very serious failure that we’ve allowed this to happen.

Buffett: Bill Ruane [of Ruane, Cunniff, managers of the Sequoia Fund] has an extraordinary program that teaches kids to read. It’s been going on for 10 years and the kids are enthusiastic.

A major reason for the success of the United States is the equality of opportunities compared to the rest of the world. It’s a bad situation when some kids have great families, caring teachers, good schools, etc., but less advantaged kids have teachers that just push their students through the system, in schools where other students are doing bad things…

This [failure of the educational system] shouldn’t be allowed in a country with almost $40,000 of GDP per capita.

Humor

[When he was asked if, now that Bill Gates is on his board, a Berkshire-Microsoft merger might be in the offing, Buffett replied:] I keep hinting, but it doesn’t work.