Is This Warren Buffet or Thomas Piketty?

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Thomas Piketty's book *Capital in the Twenty-First Century*" isn't only the No. 1 bestseller on Amazon. It's also the hottest debate item among economists and pundits in financial newspapers and blogs.

On the left is the camp that believes that Piketty has proved that the money concentrating in the hands of the 1% or 0.1% is a sign of capitalism's failure.

On the right is a camp that is not impressed with the numbers and sees the book as Piketty's failure to understand that the people at the top, including the highly compensated CEOs, are reaping the fruits of their efforts and talent, which is as it should be.

The question if top management compensation reflects market forces and talent or is mere "rent seeking" - expropriation of money from investors - has long divided economics scholars

The Piketty book revived the debate. But he's a Frenchman with ties to the socialist party in his country. True American Capitalists can't really trust his ideas. Let's hear what a true American Capitalist thinks about management compensation.

Ten days ago Warren Buffett sat down again with Becky Quick from CNBC to chat about investments. Among other issues she asked him about the compensation plan approved by the Coca Cola board, which triggered a lot of criticism for its size and structure.

Let's read what Buffett tells CNBC:

BUFFETT: We abstained (in the vote on the pay package) because-- we didn't agree with the plan. We thought it was excessive. And-- I love Coke. I love the management, I love the directors. But-- so I didn't want to vote no. It's kind of un-American to vote no at a Coke meeting. So (LAUGH) that's-- but We-- I didn't want to express any disapproval of management. But we did disapprove of-- of the plan.

The plan-- compared to past plans was a significant change. And-- there's already a 9 percent or so overhang in terms of options outstanding relative to the amount of sh-- shares outstanding, 8 percent-- 8 percent-- 8 percent to 9 percent. And-- this authorization of another 500 million shares. Not all of which would've gone on options. But that's another 11 percent of the company. And-- and-- I thought it was too much. And-- I talked to my partner Charlie Munger, and he thought it was too much. So we abstained...

BECKY: Well, David Winters (the hedge fund activist who opposed the plan) -- was just out with a statement, I guess he jumped the gun a little bit, because he criticized you. He said-- in his statement, that we are surprised Warren Buffett had the opportunity to take a stand against excessive management compensation and failed to seize it. Why are you telling us this now instead of before the vote?

BUFFETT: I-- I-- I-- I would not want to be in a position of-- of-- campaigning for either side in respect of-- we were gonna cast our vote, it would become known how we cast our vote. But-- but-- I have enormous respect for Muhtar Kent (Coke CEO). He is the man to be running Coca-Cola. And-- we never sold a share of Coke-- never had any plans to s-- sell any Coke. I-- I respect the Coke organization. I just don't like the plan.

BECKY: Your-- your son is on the board of Coca-Cola. He voted in favor of this plan.

BUFFETT: That-- that's true. The-- I-- I've been on boards for 55 years-- 19 public boards-- I've never heard of a vote against the compensation plan voted by compensation committee. What happens in a board, I-- I think people sometimes have a mistaken notion of how boards act. But-- the compensation com-- committee comes in, they've worked for a few hours, maybe a few days, they've had consultants. And-- and they say, "We've approved this plan." I've never yet heard at any of the 19 boards I was on, anybody say in the meeting they were against it. And I've had-- heard a few say it outside of the meeting. But-- but taking on a committee that's reported, you've assigned-- the job to the committee, and they -- taking them on it is-- is-- is a little bit like belching at the dinner table. I mean, you can't do it too often. (LAUGH) If you do, you find you're eating in the kitchen pretty soon".

End of quotes. There you have it from the Oracle of Omaha himself.

Let's summarize what we just read: Coke comes out with an "excessive" compensation plan that will dilute shareholders quite badly. Mr Buffet, a long time shareholder in the company with a stake worth tens of billions, thinks it's excessive. But he is not going to do anything about it.

First he says, sort of jokingly that it is not Aamerican to vote against Coke, than he says that he likes Coke and the CEO, then he goes further and explains that most of us don't really understand how compensation committees "work" - in his 55-year tenure he never encountered a committee that voted against a management plan.

And than he winds up, explaining that critiquing management compensation is like belching in the dinner table. Do it too much and -you'll find yourself eating in the kitchen.

Rent seeking

Most scholars claiming that high pay for CEO is rent seeking or appropriation from stockholders explain that the problems is that most big public corporations in the US have a dispersed ownership: The board members have a principal agent problem - they are "captured" by management and have no real incentive to negotiate the compensation at arm's length. Shareholders, they explain don't have a real voice in the board. Professor Lucian Bebchuk from Harvard together with Professor Jessie Fried from Harvard Law school articulated those ideas 10 years ago in a series of papers and book "Pay without performance".

But here is a company that has one big significant shareholder - Berkshire Hathaway that is controlled by Mr Buffet. Buffett has the expertise, the clout and everything that is needed to voice his discontent with the size of the compensation package. Yet he tells us that he is not

going to do that, that boards (his son is in the board) don't really do such things and that who ever tries to do this end up eating in the kitchen.

If this is the case with a company that has one big significant shareholder (a principal, not an agent) what kind of balance do you think exists in most american corporations boards where the ownership is really dispersed and all shareholders are institutions that are agents themselves acting on behalf of investors that are never in "The Rooms" where the "negotiations" on management compensation are happening.

An important part of Piketty's book is the discussion on the reasons for the accelerating accumulation of wealth by the "rentiers" class. Piketty stresses the important of "compounding" returns over long periods of time. Here again Buffett was first to promote this idea; On many occasions he explains that a lot of his success in amassing a huge fortune has to do with the long time that he has been investing and the power of compounding.

4 years ago, when I interviewed Buffett I asked him the question about the excessive pay to CEO. He told me that it is "Natural". not because this is "Market forces" but rather because "For the CEO it is very important. he prepares a lot of the negotiation. For the board members it's not important at all. they dedicate a very short time and effort for this negotiation".

On that occasion I asked Buffett if he thinks that the US is a democracy or a plutocracy. He did not wait before he answered: "We are still a democracy, but we have moved in my lifetime towards a plutocracy. We do not have a plutocracy, I want to emphasize that, but the distribution of wealth and the influence of wealth have moved in that direction".

Professor Piketty uses the word "Oligarchy" - but overall I think that on the reasons for concentration of money at the top 1% or the true political structure of the US - there is not a huge difference between the french socialist and the American capitalistic hero.

Perhaps, the only big difference is that Buffett concludes that the current form of capitalism "is great" and eventually the problems will be "solved" while Piketty is less enthusiastic about the current state of capitalism and urges us to solve those problems.