

Practice Note**Capitalism, Democracy and the Management Accountant**

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In 1942, in the middle of the second world war, Joseph Schumpeter (an economist) published his only bestseller, *Capitalism, Socialism and Democracy*. The book was popular for a good reason. It was a tour de force of economics, history and sociology. It coined memorable phrases such as “creative destruction”. But it was a notably dark book. At a time when people were looking for hope during their life-and-death struggle with the horrors of the war, Schumpeter offered only gloom. “Can capitalism survive?” he asked. “No, I do not think it can”, he answered himself (Economist, Dec 24, 2016).

Schumpeter, unlike other economists, focused on business leaders rather than abstract forces and factors. The young Schumpeter’s vision of the *businessperson as hero* — the *Übermensch* — i.e. the ideal superior man of the future who could rise above conventional morality to create and impose his own values; to then dream up a new world and bring it into being through force of intellect and will.

The dark world that Schumpeter envisage in 1942 never eventuated. The socialist alternative that loomed large back in 1942 briefly held sway after the war, but has since imploded. The emerging world has capitalism to thank for its escape from endless cycles of poverty. Despite this, as Schumpeter grew older, his vision darkened. He became increasingly preoccupied not with heroism but with bureaucratisation, and not with change but with decay.

What would Schumpeter think of the world today? We have the ultimate *Übermensch* businessperson — President Donald Trump, as the leader of the “free-world”. But is he a hero or villain where capitalism is concerned? He has already walked away from deals that would have facilitated free trade in the Pacific region. He is talking about protectionism of the US manufacturing industry, by introducing tariffs on imports; and has encouraged companies to ‘onshore’ rather than ‘offshore’ their plants. The surge of populism that brought President Trump to power, is happening across the western world — Brexit has happened — France, Germany and other western countries will most likely follow. But is this populism, and everything that comes with it, the only concern that capitalism has?

Another of Schumpeter’s concerns was that of *big government*. He claimed that the state activism (i.e. big government spending) of Roosevelt’s New Deal was undermining the free-market. But in 1938 the American government was spending only a fifth of GDP. Today it is spending 38%. Italy (51% of GDP) and France (57%) are also big government spenders. In Australia, its 20%, still a large slice of the GDP. President Trump is talking about big government spending on infrastructure projects. Schumpeter’s viewed such intervention as diminishing free-market capitalism, observed the Economist magazine.

Looking at the West today (and that includes Australia and New Zealand), it would not be going too far to echo Schumpeter, and warn that capitalism cannot survive in the next decade — because the problems that led Schumpeter to worry have actually grown. His biggest worry was that capitalism was producing its own gravediggers in the form of an anti-capitalist intelligentsia. Today that very elite — snug in Hills of Los Angeles and in university departments in Cambridge, Chicago and Melbourne — has expanded. Hollywood studios denounce the wolves of Wall Street, the big short-sellers, killers in the tobacco industry and the environmental vandals at large in the oil industry. The liberal sort of academic

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(meaning the type that favours big government) far outnumbers the conservative kind, by five to one, according to one recent study (Economist, Dec 24, 2016). Despite President Trump saying that he is against big government, his actions in his first week in power reflect that he holds the exact opposite view.

Along with state activism at levels greater than that ever imagined by Schumpeter; *big regulation* has advanced more rapidly than *big government*. One of Schumpeter's great insights from his later years, was that big firms can be more innovative than startups — if given the right incentives. But today's incentives do not favour activity or innovation, from both big and smaller firms. Excessive, and often draconian regulation to peruse tax avoiders and money launderers across international borders, are stifling organisations that do legitimate business. The cost per employee of red tape—endless form-filling and dealing with health-and-safety rules — is multiples higher for companies that have a few dozen staff than for those with hundreds or thousands. Schumpeter called for owner-entrepreneurs to lend dynamism to economies; but today's over regulated industries are against owner entrepreneurs.

Also, today, many big professional firms thrive because of government and regulation. The financial accounting and auditing profession only survives because of government regulation. In Australia, where small companies are not required to undertake a statutory audit; 95% of companies do not get themselves audited. This clearly indicates that audits are only done by companies that are statutorily required to have one done; not because they see any value in the audit process. The same goes for *International Financial Reporting Standards (IFRS)*, which companies must adhere to because of regulation. Today in some countries, SMEs are also required to adhere to IFRS! However, this 'over-regulation gone mad' is the backbone of the financial accounting and auditing profession.

And there are new difficulties that Schumpeter never foresaw. Today capitalism exists without capitalists—companies are "owned" by millions of shareholders who act through institutions that employ professional managers whose chief aim is to search for safe returns, not risky opportunities. Some light flickers on the horizon. High-tech companies are overhauling an ever-wider slice of the economy, including shopping and transport, which should be good for growth (though it also means power is being concentrated in the hands of fewer big firms). The 'sharing economy' — Uber, Airbnb etc., technically can make us all capitalists — but at the expense of the more traditional industries in the transport and leisure industries. Overall, the Economist magazine observes that the rate of productivity growth across the rich world has been disappointing since the early 1970s (with only a brief respite in 1996-2004 in the case of America). There, and in other rich countries, populations are ageing fast. Meanwhile, the fruits of what growth there is get captured by an ever-narrower base.

So how does all this affect the management accounting profession? Its roots go back to the dawn of free-trade across nations — via the Silk Road — where the traders in Europe, the Middle-East, India and China wanted to ascertain the cost and profitability of the trading ventures they undertook over 500 years ago. Later, cost accounting flourished in the industrial revolution of the 1800s; which saw the birth of modern capitalism with the formation of the first joint-stock companies. Today, management accountants provide the decision information required by these companies in pursuing their capitalistic objectives and strategies. In essence, management accounting has powered capitalism by providing the information for companies to *create value*.

In the future, if Joseph Schumpeter dire predictions indeed come true — in the absence of government statutory protection — the management accounting profession will need to reinvent itself; if it needs to still be relevant in an era where capitalistic ideals are diminished, if not completely dead.