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**Economic development, governance and
accounting: Lessons for LDCs from the
past Western experience.**

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1. Introduction.

The United Nations Millennium Declaration opened the new horizons in the efforts of international community to alleviate poverty and speed up the economic, social and human development in the third world (United Nations (2000)). It set out the number of certain goals which should be achieved within the predetermined time period. In 2003 the set of concrete indicators was agreed in order to monitor the progress towards Millennium Development Goals (MDG) (United Nations (2003)). Therefore the development goals were turned into *concrete numbers* which from this point onwards should *govern* the process of their achievement and *measure the progress* in the course of this progress.

The major and far more difficult job however is to be done by the developing countries themselves. The dominant neoliberal views place emphasis on building Western style civil society and market-based institutions (which are sometimes even supported by the military force of the West). These institutions include certain mechanisms of governance and calculative practices of accounting as the technology of such governance at different levels. These forms are themselves the result of socioeconomic evolution of the Western world. But what logic is behind the changes in governance and accounting in the course of development and what phenomenon is their own development?

The present paper proceeds as follows. In section 2 we will try to outline the most important generalized features which are embedded in the processes of development of governance and accounting in the Western societies and therefore try to understand in this way what development in relation to governance and accounting is. In section 3 we will briefly analyze the issues which are confronted by the less developed countries in these fields as part of their development processes. Finally, conclusion will summarize the major findings of the essay.

2. Governance and accounting in Western societies: key features of development in historical perspective.

The key role of accounting and rational bureaucracy (in the broad understanding – rational governance) for the development of the Western capitalist societies was stressed by Max Weber (1992). They were placed him together with the most important institutions of capitalism which formed the prominent distinctive features of this social order. Recent years have shown the revival of interest in the nature of accounting as the social institution and practice and its relation to governance at different levels of social organization.

The attempt to formulate the research agenda for understanding the calculative practices in the social context is made by Miller (2001). As he summarizes the content of such agenda: “This paper calls for greater attention to these practices, and argues that it is important to examine their emergence, and the ways in which new calculative practices alter the capacities of agents, organizations, and the connections among them. It also examines how they alter the power relations that they shape and are embedded within, and how particular calculative practices enable new ways of acting upon and influencing the actions of individuals. Calculative practices, in other words, should be analyzed as “technologies of government”... - as the mechanisms through which programs of government are articulated and made operable” (Miller (2001: 379).

Miller focuses on the management accounting as specific calculative practices (cost accounting, budgeting and budgetary control, calculation of rate of return and investment decisions, etc.). He provides important insights into the nature of this set of calculative practices. First, management accounting linked together responsibility and calculation and therefore created *individually responsible and calculating individual*. This gives freedom to individuals in decision making but imposes certain economic norms on them (ratios, limits, etc.). Second, this set of calculative practices has one magnificent feature – ability to transform complicated socioeconomic reality (different processes, outcomes of decisions, etc.) into a single financial figure. This immediately

makes above mentioned reality visible, calculable and comparable and therefore provides the starting point for deliberate management action in order to achieve the objectives of capitalist process in diversified industrial, technological and organizational structures.

Miller gives two examples of the transformations in the management accounting which provided the new instruments of governance at different levels. First example relates to the development of standard costing in the first three decades of the 20th century. This change developed new opportunities for clear vision of the future set of processes and procedures the whole complexity of which is reduced to the set of figures. On the one hand, this enabled to put the activities of each worker within certain economic norms and then to compare actual vs. standard cost to derive the variances and find the causes of such variances. On the other hand, managers become subject to objective quantifiable control at different levels of management and within different scope of activities in the organization. Second example refers to the emergence of discounting techniques for the investment decision-making. In this case *the set of future opportunities* which again incorporates number of diverse and rather complicated processes (different technologies, different cash flows over time, cost of capital, different risk measures) is transformed to the manageable financial figure – net present value of the particular project – which becomes visible, calculable and comparable. The investment decisions of the managers can be subject to certain transparent economic criteria and in turn becomes object of management from higher levels of the hierarchy.

In order to understand the process of development of the accounting practices as the social phenomenon which shapes social vision of the material reality we would like to review some research papers which deal with the historical evidence of the changes in Western accounting. One of the attempts to trace the transition from pre-capitalist calculative mentalities to capitalist calculative mentalities in the course of capitalist formation in England is made in Bryer (2000 a, b). This research relies on the Marxian political economy for the explanation of transition to capitalism in England and tries to distinguish certain phases of such transition which were

manifested by certain calculative mentalities and embedded in the relevant accounting practices. Bryer also defines accounting as the social practice and social reality (and not just set of technical tools for computation) which was inseparable part of the broader socioeconomic reality and was the product of the historical development. In accordance with the Marxian tradition these calculative practices were linked to the social and economic relations of the mode of production.

The transition path to capitalism could be shown by the following table:

Table 1.

Accounting signatures of the transition

Calculative mentality	Feudal	Capitalistic	Capitalist
Accounting signature	Consumable surplus (CS)	CS/Opening capital	Profit/Capital employed

Source: Bryer (2000a: 137)

At the initial point the objective of the feudal owner is to derive the consumable surplus from the peasants. In order to compute the consumable surplus the feudal owner needs to maintain the records of revenues and expenditures but he doesn't bother too much about the quantitative representation of the stock of his wealth via balance sheets. The capitalistic calculative mentality marks the start of the transition period to capitalism but by itself is not yet the capitalist one. It emerges in agriculture and trade as soon as farmers and merchants start to socialize capital and have to make different choices for their investments. Therefore they change the calculative practice from just absolute figure of the consumable surplus to the ratio of the consumable surplus to the value of opening capital. They need not only the records of revenues and expenditures but they also need some form of representation of the capital stock to derive the above mentioned ratio. The end point – the capitalist calculative mentality which emerges at the end of the 18th century with the figure of industrial capitalist and is marked also by widespread use of double-entry book-keeping and developed profit and loss accounts – deals with the increasing socialization of capital which moves between different spheres of social production

and is measured by the profit on capital employed which should be equalized between different spheres of production under the pressures of competition. The developed capitalist accounting practices should necessarily include developed balance sheets to trace the capital employed in its various functional forms and the profit and loss accounts and all relevant components to trace the value of profit earned. The double-entry book-keeping came into wide use also with the development of capitalist calculative mentality by the end of 18th century although it was described three centuries earlier as the emerging practice.

The above described scheme of transition from pre-capitalist accounting practices to capitalist accounting techniques also relates to the change of the mechanisms of governance from those used by the feudal lord in relation to his peasants to those used at the end of the story by the industrial capitalist in relation to the factory workers. These mechanisms of governance are determined by the economic objectives of these socioeconomic agents and therefore the accounting vision is transformed with the relevant governance structures and serves as the information basis of the relevant governance mechanism.

Bryer used the method of historical testing for empirical verification of the model constructed on the basis of the Marxian political economy. He used available archival books and accounts of feudal estates, farmers, trading companies and industrial enterprises and found that for the period from the beginning of the 16th century to the end of 18th century the available evidence supports his scheme of development of calculative mentalities in the course of capitalist transformation in England.

Richard (2005) provides important insights into the driving social forces of the development of capitalist accounting on the basis of historical research of such important area of financial accounting as valuation methods in France and Germany. He comes to the conclusion that development of accounting practices (and their legal regulations) was linked to the dominance of different groups of stakeholders of business organizations at different stages of capitalist development. The author distinguishes four stages of development in valuation methods in

France and Germany. The first stage (1673 – 1800) was marked by the emergence of two approaches – cost valuation and market value but the limited influence of creditors on the accounting and legislative practices predetermined the cost valuation approach during that period. The second stage (1800 – 1890) led to the reverse change of the accounting and legislative practices to the market valuation methods. However this period was also characterized by the change in the dominant form of business organization which also affected the specific features of the dominant valuation method. The earlier period with the prevailing unlimited liability companies and the focus on the creditors' interests, was dominated by the pure market valuation approach. The later period saw the transition to the joint-stock companies with limited liability which in the combination with the same focus on creditors' interests produced the somewhat different result – the valuation based on actual cost or market value whatever is lower. The third stage (1890 – 2000) represents in broad sense the era of global prudent approach, i.e. the lower valuation between cost and market value. At the same time the period was marked by additional interferences, namely the influence of cost based approach for some individual accounts such as fixed assets and the emergence of the accounting of consolidation purposes within multinational corporations. The latter apparently increases the relative power of internal stakeholders vs. creditors in shaping the accounting practices. And finally the fourth stage which starts from around 2000 is heavily influenced by the concept of “fair value” which is either pure market value or value in use and which is favored by national and international shareholders who manage their investments via developed and diversified capital markets.

The overview of the long-run development of the accounting practices and the major determinants of changes in these practices over time is presented in Toms (2005). This research is particular interesting because it relies on the historical evidence from the British cotton industry which was the core sector of the industrial revolution and hence this case study includes the development of accounting practices in the capitalist industry through the whole life of modern industrial capitalism.

The author constructed the analytical framework for the analysis of the change in accounting practices which was based on the Marxian political economy. The two major processes which take place in the course of capitalist development – centralization of production and socialization of capital – were put in the centre of the analysis. The analytical framework was supplemented by the modern notions of asymmetry of information and financial risk. As Toms (2005: 630) points out: “Asymmetries between productive forces and ownership interests provide the context for management accounting and asymmetries between market participants provide the context for financial accounting. ... Scholars often argue that financial and management accountings have distinct conceptual foundations, but in Marx’s framework, they are two interrelated branches of accounting sharing the same conceptual foundation – accountability for the rate of return on capital. Financial accounting is reporting to investors on the realized return on capital to control senior management. Management accounting is reporting to senior management on the production and the realization of the required return on capital to control workers. If this common conceptual framework is accepted, then it follows that financial and management accounting techniques are likely to be used interchangeably, either as substitutes or in complementary fashion”.

Toms constructed the theoretical model of implications of capitalist development which is seen through centralization of production and socialization of capital supplemented by informational asymmetries and financial risk for the changes in the accounting techniques and relative importance of financial vs. management accounting. This theoretical model can be summarized in the table.

Table 2

A political economy model of accounting change

Quadrant	Features of industrial organization and ownership	Control objective	Associated accounting techniques
1	Centralized production through:	Controlling labor process	Time based monitoring systems, piece rates, inter-

	<ul style="list-style-type: none"> - economies of scale - economies of scope Social capital	Accountability to social capital	process transfer pricing Overhead allocation techniques, responsibility accounting Extensive accountability and financial disclosure, strategic use of creative financial reporting
2	Centralized production through: <ul style="list-style-type: none"> - economies of scale - economies of scope Private capital	Controlling labor process Internal accountability	Time based monitoring systems, piece rates, inter-process transfer pricing Overhead allocation techniques, responsibility accounting No external financial reporting
3	Decentralized production Social capital	Policing network arrangements Accountability to social capital	Intra-network financial controls, e.g. joint venture and consignment accounting, credit management techniques Extensive accountability and financial disclosure, strategic use of creative financial reporting
4	Decentralized production Private capital	Policing network arrangements Internal accountability	Intra-network financial controls, e.g. joint venture and consignment accounting, credit management techniques No external financial reporting

Source: Toms (2005: 637)

This theoretical model was tested against historical evidence of the British cotton industry in the period 1700-2000 which went through different stages of decentralized and centralized production and private and social capital. In general the historical evidence supports the outlined theoretical model since the history of the British cotton industry shows that there were in fact the

relationships between industrial and business organization and particular accounting practices which were predicted by this theoretical model.

Accounting practices and governance mechanisms are interrelated not only at the micro level of the economy, but also at the macro level. The whole macroeconomic reality, relevant tools of macroeconomic management and accountability of governmental macroeconomic policy emerged as the result of transformation of diversified economic processes in the national economy into the accounting framework and subsequent development of the system of national accounts with set of interrelated figures (GDP, national income, national savings, etc.) (Suzuki (2003)).

We would like to summarize on the basis of reviewed research papers some important features of the development of calculative practices of accounting and their interrelationships with governance mechanisms. First, development of calculative practices relates to the development of governance mechanisms (and corresponding forms of industrial, business and other market or hierarchical forms of social organization!) and in fact these practices really service as the technology of governance. Second, these calculative practices are inseparable from the economic objectives of the major stakeholders which are determined by dominant socioeconomic relations and relevant institutions and therefore development of accounting practices goes in line with the evolution of the economic objectives of the socioeconomic agents. Third, the socioeconomic development is associated with emergence of new diversified and complex processes within more complicated social and business structures. Therefore the governance mechanisms and the relevant accounting practices should change (or be developed!) in a way that they are able to transform this diversity into manageable set of numbers which then can be the object of governing action.

3. Lessons for less developed countries (LDCs): local development and Western influence

Recent years saw growing attention to the institutional structures of the less developed countries and the ways of their transformation for the sake of economic development and beneficial integration into the globalizing world economy (World Bank (1994; 2002; 2005)). The attention is drawn to development of good governance which includes corporate governance, regulatory framework for the economic activities and responsible macroeconomic management.

Such agenda inevitably draws attention to the interrelationships between governance structures as part of the institutional environment and the accounting practices as the technology of such governance in the less developed countries. The research in this field with special focus on management accounting was reviewed in Hopper, Tsamenyi, Uddin and Wickramasinghe (2003). The authors draw several important insights into the perspectives of development of management accounting in LDCs. First, for LDCs it's beneficial to import accounting practices from the developed countries since they hardly have any resources to develop something totally different and in fact they hardly need totally different tools. Second, the successful transfer of management accounting is not and cannot be isolated technical action but it's a social process which relates to the development of regulatory and legal framework and other market-based institutions. There is clear evidence that accounting practices are dependent on different groups of socioeconomic factors and cannot be used fruitfully if there is no proper institutional environment.

Therefore the development of accounting practices in less developed countries should be seen as multi-step process which goes in line with the development of social and economic processes but it would be influenced by experience of developed countries which had already gone a long way in acquiring such experience.

4. Conclusion

Accounting is the social calculative practice which is interrelated with the governance mechanisms at the micro and macro levels of the economy and services as the technology of

such governance. The development of accounting practices and governance mechanisms are interrelated social processes. These processes are inseparable from the economic objectives of the social actors which are determined by the dominant socioeconomic relations and relevant institutions. In the course of development these practices should be able to transform new diversified social and economic processes into manageable set of numbers which then can be the object of governing action for this evolving social reality.

The development of accounting practices in the less developed countries should be seen as multi-step process which is parallel to development of governance mechanisms. But it's influenced the available experience of the developed countries and hence might take shorter period of time.

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