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The dangerous dynamics of modern capitalism (from static to IFRS' futuristic accounting)

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ABSTRACT

In this article, we utilize accounting history to demonstrate that modern capitalist accounting has evolved similarly in four prominent countries (France, Germany, Great Britain and the United States) and that this evolution has been in a dangerous direction. Using the Classic Continental European Accounting Theory lens, we show that, since the industrial revolution, capitalist financial accounting and capital calculation have progressed through the same three main stages: static, dynamic and futuristic. We also maintain that this process has permitted an unbridled acceleration of profit recognition, which contributes significantly to financial crises manifestations.

1. Introduction: main purposes and originality of the study

Our first objective in this article is to demonstrate that to date, in spite of some variations in timing, capitalist financial accounting[1] evolution in four prominent capitalist countries (France, Germany, Great Britain and the United States) has undergone the same three main broad development stages since 1800, a time when the industrial revolution was generally considered to have saturated these countries. The three stages are – to employ terminology based partially on Classic Continental European Accounting Theory – static, dynamic, and futuristic. The static stage dominates the industry throughout a large portion of the 19th century; the dynamic stage throughout a substantial part of the 20th century; and the futuristic stage is currently in full expansion.

Our second aim in this study is to confirm the existence of a clear trend in financial accounting evolution. We will demonstrate that, in theory as well as practice, an accelerative process is present with respect to profit recognition. Specifically, as a result of accounting measures being modified at certain points in history, capitalists recognize profits at an increasingly rapid pace following their initial investment, which, in turn, increases their eagerness to capture the fruits of those investments as soon as possible.

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[1] We define financial accounting as a publicly regulated accounting system that is primarily devoted to profit measurement to be distributed among capitalists. In this article, we will not treat cost (management) or tax accounting systems except if it is required for the purpose of the study.

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We attribute this evolution pattern mainly to a change in the mode of investment financing. While self-financing, broadly speaking, dominated the scene throughout the 19th century, financing through capital markets and debt prevailed in the 20th. Of course, we discuss this financing transformation in the course of this article. The fact that self-financing[2] was overwhelmingly popular with entrepreneurs in the 19th century is linked to many factors (see after) that evolved with capitalism's rapid development and provoked significant transformations within accounting. We use the main lessons of this part of the study to address two final questions: is there any relationship between the evolution of capitalist accounting and the Global Financial Crisis, and what could be the next stage of development?

A wide assortment of studies on national financial accounting systems development exist; for example those by Edwards (1989) and Bryer (2000a,b) in England, Lemarchand in France (1993), Schneider in Germany (1997), and Chatfield (1977) and Bryer (2012a,b) in the United States. However, our study is innovative for three main reasons. First, we have an international scope, attempting to compare historical financial accounting and capitalism development in four prominent countries. Second, we propose a novel analysis of capitalist accounting development stages, one that differs significantly from Bryer (2000a,b) and Macintosh, Shearer, Thornton, and Welker (2000). Third, we present a plausible direction for capitalist accounting evolution and attempt to explain it through the issue of modes of financing.

2. Definitions and theoretical underpinnings

Our study deals with the comparative history of capitalist financial accounting from 1800 to the present. *But what is capitalist accounting and why limit the study to the post-1800 period*?

It is commonly known that a myriad of definitions for capitalism exist. Authors like Schumpeter (1942) simply associated capitalism with the private property *of the production means*, while others incorporated other terms. We begin with the French *Bordas Encyclopédie* (1994, tome 2860) definition and define capitalism as an economic system in which owners or production managers reap profits as the result of employing salaried workers, who are free to sell their skills within a labor market.

Undeniably, this system originated much earlier than 1800. In fact, it can be observed as early as the 13th century, with the appearance of big markets, a strong development of big merchants governing some labor force. Merchants were motivated by a "profit-seeking mentality" (Febvre, 1952, 287), thus able to obtain profit primarily through "unequal exchanges" (Braudel, 1985, 57).

As early as the beginning of the 17th century, an affluent capitalist farmer named Loder calculated a systematic depreciation of his horses to measure his profit (Yamey, 1964). Later in that century, as shown by Lemarchand (1993) and Bryer (2000b), large merchant companies, such as the East India Company, demonstrated socialized capitalism features. Still, it was not until the industrial revolution that this economic system manifested in other branches of activity and seeing large firms with a sizeable number of employees and associated capitalists became commonplace. In this study, we observe capitalist accounting at capitalism's mature stage, specifically following the debut of the industrial revolution. In order to take account of the disparities in capitalism's maturity in the four countries studied, we establish 1800[3] as the first year of our study. For all periods studied, we focus generally on large firms in order to be able to effectively compare the leading accounting technologies at the time. For example, in the case of France, we use Schneider, one of the most significant French companies. This firm, created in 1836, has been one of the top French industrial gems from its establishment through today.

The comparison is not only across time, but also among different firms. However, this poses a particular challenge. In order to compare different firms with potentially different accounting systems, we needed to classify their accounting systems using a common description of their development stages.

One possibility was to use a classification of financial accounting development based on a Baudrillardrian perspective, as suggested by Macintosh et al. (2000). These authors distinguish four main stages throughout history. The first stage, during the feudal era, when accounting was based on cash flows and liquidation proceeds, is considered to provide a faithful representation of the real material referent (physical and social reality). The second stage, occurring from the Renaissance through the industrial revolution, involves an accounting that already contradicts reality by utilizing processes of fictitious liquidations. The third stage, referred to as "the order of production", took place from the end of the industrial revolution until the 1950s. Historical cost accounting (HCA) mainly represents this era and income was increasingly calculated based on arbitrary and artificial rules of allocation within the frame of a going concern hypothesis. Finally, the fourth stage, from the 1960s to the present, involves a system of accounting based on discounted future cash flows that provides information without any reference to the real world in the context of a "hyper-real economy".

The key takeaway from this evolution is that accounting has strayed from reality and plunged into a system of income and capital arbitrariness (Macintosh et al., 2000, 40). We chose *not* to use this particular conceptual framework for four main reasons. First, we disagree with the timing of the stages; as presented later, the second stage occurs in the 19th century and the third in the 20th. Second, the hypothesis that a "realistic" cash flow is based on feudal accounting rather than an artificial

[2] In a broad conception self-financing includes private contributions made by the founders of firms.

[3] At this time the industrial revolution has commenced in all four countries analyzed: see notably More (2000, 2) and Fleischman and Macve (2002, 2) for England, Braudel (1985) and Gervais (2000) for France and Kiesewetter (1989) for Germany.