NOTE: This is the final version of Chapter 11 of Yuri Biondi & Stefano Zambon (eds) *The Routledge Companion to Accounting and Business Economics* (Abingdon: Routledge, forthcoming 2013), pp. 271-303. This version may differ slightly from the printed text, which should be regarded as definitive.

**LHP: ACCOUNTING AND BUSINESS ECONOMICS IN THE UNITED KINGDOM**

**RHP: NAPIER**

**11**

**Accounting and the Absence of a Business Economics Tradition in the United Kingdom[[1]](#footnote-1)**

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# <A>Introduction

To many accounting scholars, the existence and importance of a link between accounting and economics is almost self-evident. As Hopwood (1992: 128) has put it:

The idea of a relationship between accounting, as a form of economic calculation, and economics, a form of abstract knowledge about the nature of the economic, is now a longstanding and increasingly accepted one. Conceptions of the economic nature of such accounting categories as cost and income pervade accounting treatises and even policy-orientated discussions of the craft. Economic ideas of their essential nature are used to provide a basis for gauging the adequacy of accounting calculations and to suggest possibilities for their transformation and presumed improvement. Economics, so used, is seen as a means for helping accounting to become what it should be, but what currently it is not.

Yet, as Hopwood (1992: 126) also points out, “In countries such as the United Kingdom it is as if the accountant often has more significance than accounting itself.” While British accounting may well on occasion present itself as economic calculation and may appeal to economic knowledge, most British accountants have only a superficial, and certainly an uncritical, awareness of economic theories and ideas.

The connections between accounting and economics in Britain are complex and often covert. Although academic accounting has long been heavily dependent on economics for its predominant theoretical underpinnings, accounting practitioners have absorbed economic ideas only indirectly. Often the process by which such ideas permeate into accounting practice is a slow and difficult one. The process is well exemplified by the contested way in which British accountants came to accept discounted cash flow (DCF) techniques: derided as “dangerous nonsense” and as “sheer insanity” in 1938, honoured as “the most reliable technique yet known” for assessing investment decisions by 1964 (Miller 1991: 733‒734). As Miller (1991: 744) shows, DCF was “sold” not so much on theoretical economic grounds but rather “because of its enhancing effects on the growth rate of individual companies and the economy overall.” British accountants might not be capable of understanding the theory underlying DCF; they could, however, appreciate appeals to their patriotism. On the other hand, by the 1930s, many of the then small number of British accounting academics were beginning to regard accounting as “the special means through which the theories of economic value could be put into accounting practices to guide decisions and action in the firm and the economy. . . . [A]ccounting had the particular role of making economics ‘practical’” (Robson and Young 2009: 344).

The difficulty faced by most British accountants in dealing with explicit economic ideas can be traced to two interlinked factors. The first of these is the way in which British accountants are educated. Although accounting in Britain had become a mainly graduate profession by the 1980s (Lee 2010: 35),, this is largely because of the growth in numbers entering higher education. What is important is not that British accountants have a university degree before they begin their professional training, but rather that they are unlikely to have studied “relevant” subjects. Indeed, despite the explosion in university accounting courses over the past thirty years, many accountants positively prefer “non-relevant” graduates. They see such graduates as having a “more rounded” personality, not burdened by technical knowledge. Why should this be the case? The explanation lies in the second of the interrelated factors: a suspicion of technical expertise that has permeated British society for more than a century. Accountancy has had to fight a battle against those in society who would label it “technical” and thereby dismiss it. British accountants have been remarkably successful in this, so that “the occupational structures that have emerged around [the techniques of accountancy] are ones that are no longer populated with clerks but rather with executives, managers and indeed professionals” (Hopwood 1992: 126).

On the other hand, British economists have sometimes been dismissive of accounting (Napier 1996). At best, accounting is regarded as a practical technique whose utility is that it generates the data with which economists may perform their analyses. At worst, it is seen as a source of error and confusion, best ignored by the pure economist. Some of the apparent disdain for accounting was due to the difficulties that economics faced in establishing itself as a distinct profession within the British universities, state, industry, and commerce. Although attempts were made by some economists to develop a “science of commerce” in which accounting played a central role, mainstream economists put more effort into developing a “science of economics” in which “practical” issues were only distractions.

In order to study the intellectual and professional influences of economics on accounting in the United Kingdom, therefore, it is first necessary to consider the contexts in which accounting and economics operated around the beginning of the twentieth century. Early attempts to locate the teaching of accounting within university economics and commerce departments and the lack of success of these attempts are next considered. This leads to an examination of the work of the Department of Business Administration at the London School of Economics in the 1930s, which had a disproportionate influence on the relationship between accounting and economics in Britain. After World War II, the theoretical dependency of accounting on economics has become widely accepted within the academy, but it has been slower to penetrate the minds and practices of accountants.

# <A>Economics, Accounting, and the “Science of Commerce”

## <B>The Independent Development of Accountancy

As Napier and Noke (1992) have noted, accountancy[[2]](#footnote-2) in Britain adopted many of the symbols and structures of other, longer-established professions, in particular law. Although law was recognized as an academic discipline as well as a professional activity, in the nineteenth century it was by no means necessary for lawyers to achieve a university degree in order to enter the profession. Similarly, few early accountants had been to university. Following the model of the solicitors’ profession, professional accountants adopted a pattern of professional training whereby entrants would be apprenticed as “articled clerks” to existing practitioners and would learn their accounting on the job during a five-year training period. This pattern of training provided few opportunities for acquiring theoretical perspectives on accountancy practices, and any applications of theoretical notions to accountancy arose only indirectly and implicitly.

Because of this training pattern, advanced textbooks in accounting were slow to emerge (until the 1880s, textbooks tended to restrict themselves to the techniques of bookkeeping), and no formal statement of a body of accounting rules and practices can be discerned. Indeed, such a statement would probably have been regarded by practicing accountants as too “theoretical.” Although the existence of an income tax implied the need to measure taxable profit, the method of assessing these profits contained a considerable amount of discretion. The main principles that developed related to the identification and treatment of capital expenditure (Edwards 1976), where tax law did not permit a deduction in determining profits. Hence, British accountants saw the capital/revenue distinction as crucial. Bryer (1991, 1993, 1995) has argued that the general expression of this distinction, as stated by leading accountancy practitioners of the mid- to late nineteenth century, reflected the way in which contemporary political economists, in particular Karl Marx, were elucidating a concept of capital. There is no evidence that British accountants were aware of Marx’s work, and it is probable that both the accountants and Marx were responding to an unreflective adoption by businessmen of a capital/revenue distinction articulated originally in the context of British aristocratic estates (Napier 1989), and itself possibly deriving from the Roman Law concept of *fructus* (Schneider 1991).

As theoretically oriented writings on accounting matters began to emerge in Britain, with the founding of the weekly periodical *The Accountant* in 1874, writers (who were almost invariably accountancy practitioners) tended to look mainly to the law for “rules” relating to accounting (see e.g., the papers collected in Brief 1976). Yet the British common law tradition tended to avoid the systematic formulation of bodies of rules. Thus, Lord Justice Lindley, in the case *Lee* v. *Neuchatel Asphalte Company* ((1889) 41 Ch. D. 1), stated, “It is not a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into a capital account, what into an income account, is left to men of business.”[[3]](#footnote-3) Indeed, parliament was to say little about the measurement of profit for financial reporting purposes until as late as the Companies Act 1981.

In their professional training, accountants emphasized law over economics. As lawyers did, professional accountants put great weight on the notion of “public practice,” to the extent that the early professional bodies initially excluded from membership those employed within industry and commerce, and they later questioned the independence and thereby the professionalism of employees (Kirkham and Loft 1993: 550). Integrity and independence were seen as of at least equal importance to technical and conceptual skills. Such skills were acquired haphazardly, although here Scottish chartered accountants often had an advantage over their English counterparts. From the beginning, the Scottish professional accountancy bodies were actively involved in providing classes for apprentice accountants, and the examinations taken by these apprentices included, in addition to bookkeeping and accounting, a substantial amount of law, as well as actuarial science and political economy (Stacey 1954: 21). Because of the nature of the Scottish educational system, a sizeable minority of apprentice accountants were graduates, who had probably already studied some law and political economy as part of their degrees. For non-graduates, part-time attendance at university courses in law was compulsory, while attendance at university classes in economics and accountancy became required from the early twentieth century (Solomons 1974: 17). Chairs in accountancy were established at Edinburgh University in 1919 and at Glasgow University in 1925, although they were both held on a part-time basis (until the 1960s) by accountancy practitioners.

## <B>The Professionalization of Economics

At the same time as accountancy was emerging as a profession, early steps were being taken to establish economics as an academic discipline. As Kadish and Tribe (1993: 1) observe, “The study of political economy in British universities around the middle of the [nineteenth] century was not well developed, but no one seriously disputed the need to include some political economy in the curriculum, in one form or another.” In the older universities of Oxford and Cambridge, economics was generally studied as an aspect or extension of other disciplines, such as history. Frequently, the economics components of these courses involved little more than a requirement to read a standard text such as Smith’s *Wealth of Nations* (Smith 1904; first published in 1776) or Mill’s *Principles of Political Economy* (Mill 1909;first published in 1848) . The aim of the Oxford degree in particular was not to teach future experts but rather to provide a rounded preparation for life:

A minister, lawyer, banker, manager of a factory, or Justice of the Peace, or master in a secondary school, or journalist, would draw inestimable advantage from having passed through the curriculum at Oxford, in spite of all its limitations. Many of those who had to deal with the organization of the Modem History School were convinced that it was serving its purpose sufficiently well by training the average good citizen from the governing classes in the past annals and present problems of the British Empire. (Oman 1939: 247‒248)

It is important to note that the British tradition of education for the “governing classes” was not one that focused on the study of law and public administration. On the contrary, a period at Oxford or Cambridge (not necessarily capped by taking a degree) was as much a socializing as a learning experience, with the intellectual content heavily dependent on a study of classical languages. The philosophy of higher education reflected by Oxford and Cambridge was well summed up by John Stuart Mill (1867/1984: 218, emphasis added):

There is a tolerably general agreement about what a university is not. *It is not a place of professional education.* Universities are not intended to teach the knowledge required to fit men for some special mode of gaining a livelihood. Their object is not to make skilful lawyers and physicians or engineers, but capable and cultivated human beings.

However, this view of the role of university education began to be challenged toward the end of the nineteenth century. Alternatives to Oxford and Cambridge were provided by new universities in London and Durham, and later in major commercial centers such as Manchester, Birmingham, Bristol, Leeds, and Liverpool. As Sanderson (1972) points out, these new “civic” universities raised their endowments from local industry and commerce. They stressed that their purpose was to serve industry, for example by teaching the “sons of industry,” providing them with the intellectual equipment to manage their fathers’ businesses. In addition, the universities would conduct research to provide competitive advantage to local industries. With competition from the United States and Germany increasingly being perceived as a threat in the later nineteenth century, public pressure grew for better educated businessmen. Often this led to idealization of the educational system of competitor countries such as Germany (Sanderson 1972: 16).

Although both the older and new universities employed professors of economics, their teaching interests tended to emphasize political economy and to adopt a historical perspective. Moreover, beginning with John Stuart Mill, many economists “tended to take a lofty, ‘civilized’ view of the actual world of business and industry, maintaining a certain distance from its contamination, or hoping to educate its participants to a wider conception of life” (Wiener 1981: 90). This view was reflected by Alfred Marshall, the driving force behind the professionalization of economics as an academic discipline in Britain and the establishment of separate economics degrees. In fact, Marshall had a deep curiosity about the practical workings of industry. He regularly visited factories and workshops, and it was said that he “gained such a knowledge of factory processes, techniques and skills that he could guess correctly at workers’ wages by watching them at work” (Sanderson 1972: 200). However, he saw his mission as being to elevate the businessman from an overconcentration on short-term profit maximization. As he stated in his inaugural lecture following his appointment as Professor of Political Economy at Cambridge in 1884 (a post that he was to hold until 1908), “If more University men looked upon their life here as preparing them for the higher posts of business, what a change they might make in the tone of business. Just and noble sentiments might be introduced into counting-house and factory workshop” (quoted in Maloney 1985: 32).

Marshall was ambitious to establish economics as a “professional” discipline, and, according to Maloney (1985: 2), his objectives at Cambridge were:

First, he wanted economists to be trained in a body of knowledge which without excessive grief—he recognized would be inaccessible to laymen. Secondly he sought, via the development of welfare economics, to give the economist a specialist voice in the art of policy making. Thirdly, he wanted to enhance the scientific authority of his subject by keeping it clear of political partisanship.

The new civic universities in the later nineteenth century looked on Cambridge as a main source for teachers, and Marshall’s ideas, and his preferences for analysis rather than description and for a neutral, “scientific” approach to policy, permeated economics in these institutions.

Marshall’s major contribution to the economics literature was his *Principles of Economics* (1890), in which he considered issues of production and in particular costs. In Marshall’s *Principles*, and especially in his more elementary treatment of the economics of production in *Elements of Economics of Industry* (1892), he drew explicitly on the emerging theoretical literature of accounting. An example of this was his citation of Garcke and Fells’ *Factory Accounts* (1887) in the context of a discussion of “the lowest price at which it will be worthwhile [for a manufacturer] to accept an order” (Marshall 1892/1899: 207). Marshall was also aware of Ewing Matheson’s *The Depreciation of Factories* (1884).[[4]](#footnote-4) As Williams (1978: 81) notes, Marshall “wanted to use words to mean what the business world took them to mean,” and the accounting literature may well have influenced Marshall’s vocabulary of costs (Napier 1996). Although Marshall’s analysis of the economic functioning of firms, as the fundamental analytical units of the production process, was deep and innovative, he tended to conceptualize the “firm” in terms of a single entrepreneur making decisions within a market setting. The Marshallian “representative firm” bore many similarities to the workshops visited by Marshall in his youth, but was increasingly unrepresentative of the large organizations emerging in the later years of the nineteenth century.

## <B>Toward a Science of Commerce

The principal economist to advocate business education at the university level during the early years of the twentieth century was W. J. (later Sir William) Ashley, Professor of Commerce at Birmingham University from 1901. Ashley was a history graduate from Oxford, and he had been Professor of Economic History at Harvard before going to Birmingham. With this background, Ashley was relatively unsympathetic to Marshall’s more analytical approach (Kadish 1989: 90), and he preferred to stress descriptive economics. Before the Faculty of Commerce at Birmingham began operations in 1902, Ashley visited Germany to look at the recently created *Handelshochschulen*, being particularly impressed by that at Cologne (Ashley 1926).[[5]](#footnote-5)

The Faculty of Commerce offered the degree of Bachelor of Commerce (B.Com.), during which:

[Students] were to be offered some knowledge of a number of subjects considered relevant to a student expecting to reach top management in a manufacturing firm. These were economics, accounting, commercial law, public finance, sciences, and languages. They had also to take others, of their own choice, which came under the general heading “cultural.” This was so flexible in practice that a commerce degree student could, and did, include a workshop course in engineering. There was, in addition, the weekly commerce seminar, “the purpose of which is to train men in the investigation of commercial and economic questions, and to practise them in the presentation of their conclusions in a lucid way.” (Keeble 1992: 100‒101)

Ashley regarded the teaching of accountancy as an integral part of the B.Com. program and appointed as the first Professor of Accounting (not only at Birmingham but in any British university) the chartered accountant Lawrence Dicksee. As well as running a professional practice, Dicksee was the author of a number of leading textbooks aimed at articled clerks taking professional accountancy examinations, in particular his *Auditing* (first edition 1892). Dicksee had extensive teaching experience in both Cardiff and London, where he had run coaching classes for the London Chartered Accountants Students’ Society (Kitchen and Parker 1980: 60). Since 1897, Dicksee had been a course of lectures on “Accountancy and Business Methods” at the recently opened London School of Economics and Political Science (LSE), which he continued to give after taking up the appointment at Birmingham.

While teaching at Birmingham and LSE, Dicksee found time to write his textbook *Advanced Accounting* (1903). Dicksee saw this book as serving the needs of not only accountant students but also “others, who, while desiring a knowledge of Accounts, had yet no intention of entering the profession of accountancy” (Dicksee 1903: vii), including, presumably, university students of accounting. However, the part-time nature of Dicksee’s appointments, and similar appointments made at other universities, constituted a serious barrier to any substantial exchange of views between economists and accountants. Accountancy teaching was regarded as best provided by part-timers, who, while they could bring experience of accountancy practice to their teaching, were not necessarily well equipped to do much more than present current accountancy practice in a relatively structured way. In the three institutions where the “higher commercial education” was well established—LSE, Birmingham, and Manchester—interchanges between accountants and economists were either inhibited or unlikely to provide much of a theoretical structure to accounting.

There were various reasons for this inhibition. At LSE, with its strong commitment to education in business and administration (Dahrendorf 1995: 88‒89), economics teaching was dominated between 1895 and 1926 by Edwin Cannan, who was not regarded by contemporaries as a major contributor to economic theory and who was out of sympathy with the analytical tendency in economics represented by Marshall (Milgate 1987). Yet at the same time, Cannan (1902/1962: 187‒188) was unconvinced by the argument that economics could help the businessman:

I do not mean to argue that a knowledge of economic theory will enable a man to conduct his private business with success. Doubtless many of the particular subjects which come under the head of economics arc useful in the conduct of business, but I doubt if economic theory itself is. ... The practical usefulness of economic theory is not in private business but in politics.

Cannan seems to have done little at LSE for the development of business education. This is not to say that all economics teaching at LSE was abstract and analytical. By the early 1920s, undergraduates could select a wide range of courses under the heading “Commerce and Industry”, covering issues such as industrial organization, labor unions, wages systems, industrial structure and location, business finance and trade with most parts of the world. The courses were mainly descriptive, without a clear theoretical underpinning.

At the University of Manchester, a two-year evening Commercial Certificate had been available from 1889. This initially included a compulsory bookkeeping element in the first year, while from 1890, a second-year course in advanced bookkeeping and accounts was offered, taught by an occasional lecturer, a Mr. Trevor (Tribe 1993: 199‒200). Most of the economics lecturers were former students of Marshall. In 1899, a daytime certificate in commerce was introduced: This was described as “more academic in nature” and included no accounting. In 1901, however, the chair in political economy at Manchester was filled by Sydney Chapman, who was instrumental in creating the Faculty of Commerce and Administration in 1904. The new B.Com. degree was structured so that students could take and be certified in individual courses, including accounting, taught by a local accountant called Roger Carter. Taking single courses was much more popular than following the whole degree, with individual courses often attracting several hundred students, whereas only about twenty a year registered for the full degree. At Manchester, “the teaching of economics remained at the core of the syllabus” (Tribe 1993: 207), but again accounting was seen as essentially professional and practical, and part-time teachers such as Carter seem to have had little contact with the full-time economists.

In Birmingham, Ashley regularly propagandized for “higher commercial education.” In December 1905, for example, in a speech reported in *The Times*, Ashley (1905: 7) stated:

In my opinion, a true science of commerce is capable of being created. At present, however, it does not exist. That should have been the task of the political economists, but hitherto English economists have been too content to pursue the results, the conclusions to be reached by a process of reasoning starting with certain assumptions. . . . It seems to me that it is necessary that the problems which actually arise and which present themselves to a businessman in the course of his operations should be realized and studied.

In a later address, Ashley located accounting more specifically within the “science of commerce”:

By the side of . . . “political” economy . . . there must be created something that I may provisionally call *Business Economics*, which frankly takes for its point of view the interest of the individual business man or business concern.

. . .

The problem of Cost Accounts, which is attracting more and more attention in the business world, is hardly one that can be left entirely to the accountants. For it is fundamentally a question not of technique but of policy—not how to get certain figures, but what figures to try to get, and how to combine them. (Ashley 1908: 187, 195)

Ashley believed that the “science of commerce” should be addressing the ignorance of businessmen as to the best methods within their industries, and that the role of universities was to discover and diffuse these best methods. Thus, the “science of commerce” was empirical and comparative, not theoretical. Unfortunately, while Ashley saw the significance of accounting, he found it difficult to incorporate much teaching of accounting within the B.Com. degree. Dicksee gave up the Birmingham chair in 1906, and accounting continued to be taught on a part-time basis until 1931, when Donald Cousins was appointed to a full-time Readership in Accounting and Administration (Craner and Jones 1995). As in Manchester, however, student numbers were disappointingly low: In the first forty years of the degree, fewer than 400 students graduated (Keeble 1992: 102).

One factor behind the lack of success of Birmingham and the other civic universities in attracting students was the continuing prestige of Oxford and Cambridge. From the 1890s on, the latter university made a particular point of seeking to attract sons of businessmen. Marshall’s efforts to establish an Economics Tripos at Cambridge (thus constituting a separate economics degree) were motivated by his view that business increasingly needed broadly based non-technological graduates as managers. Marshall (1905a: 4) had a clear idea of the role of an economics degree:

What is desired is not technical instruction, but education of a high type which shall have the additional advantage of preparing the student to take, without unreasonable delay, a responsible place in business or in public life, and which shall have as high an educational value as that of any other school.

This conception seemed to leave no room for the study of “practical” topics such as accounting, and the educational correspondent of *The Times* challenged Marshall’s apparent disdain: “If there is one subject a knowledge of which is indispensable to a business man, it is surely the theory and practice of accountancy, and the omission of this subject from the Cambridge scheme is certainly significant” (Educational Notes, *The Times*, December 11, 1905: 6). Responding to this, Marshall stated his attitude to accounting frankly:

The detailed techniques of accounting fill the mind, without enlarging it and strengthening it. . . . It is faculty rather than knowledge which the business man of today needs. It is a powerful and capacious mind, rather than one already crammed with dead matter, that a University should send out to the work of the world. (Marshall 1905b: 5)

In the years before World War I, therefore, a “science of commerce” did not emerge to any significant extent. One reason for this was that economic theory made little attempt to analyze firms as they were, rather than as the simplifications of Marshallian theory postulated them to be. Another reason was the low prestige in which applied education in universities was held, which constrained both the supply of and the demand for “higher commercial education.” The few accountants with contacts inside the universities rarely reflected current economic thinking in their work, while early references to accounting in academic publications such as the *Economic Journal* emphasized the legal aspects of accountancy practice (e.g., Schuster 1900; Barlow 1901; Sanger 1903). In his textbooks, Dicksee also stressed the legal context within which accountancy practice operated. The intellectual paradox of British accounting by 1914, therefore, was that its ideas and principles were grounded much more in law than in economics, although law did not offer explicit systems of rules for the determination of profit and the valuation of assets. Hence, textbooks accentuated questions of how accounting should be practiced rather than *why*.

# <A>Integration and Alienation: Economics and Accounting Before and Between the Wars

## <B>Professional Accountancy and the “Higher Commercial Education”

Neither professional accountants nor industrial and commercial concerns saw much value in university-level education for their articled clerks and management recruits. The widespread view (at least in England) was that three years at university actually spoiled potential businessmen, through inculcating bad work habits. British industry was inconsistent, complaining on the one hand that graduates lacked technical expertise while preferring on the other to select (if they recruited at all from universities) arts graduates who had achieved the necessary “rounded personality” and had avoided a “mind crammed with dead matter.” There were, of course, exceptions to this view. One of the most outspoken accountants to favor closer involvement with the universities in professional education was Charles Hewetson Nelson, a member (and president 1913‒1916) of the Society of Incorporated Accountants and Auditors. In a lecture on professional education in 1911, Hewetson Nelson advocated the attendance of accounting students at relevant university courses (on the Scottish model), considering that the accountancy training of the time involved students picking up their knowledge in a “happy-go-lucky” manner depending on the attention that their principals could afford to give. He observed that “the modem Universities . . . are all, more or less, moving in the direction of higher commercial education, and the machinery which they have already started can . . . be usefully utilized to further the progress of the preliminary education of the accountant of tomorrow” (Hewetson Nelson 1911: 16). He spoke with particular approval of the German *Handelshochschulen*, especially that of Berlin. However, Hewetson Nelson was in a minority within the accountancy profession, and training under articles and study through correspondence courses continued to dominate professional accountancy education into the late 1960s.

Within industrial firms, the later years of the nineteenth and early years of the twentieth century saw what Solomons (1952b/1968: 17) described as “The Costing Renaissance.” Although recent research (e.g, Fleischman and Parker 1991; Fleischman and Tyson 1993) has tended to contradict the conclusion of Pollard (1965: 248) that “the practice of using accounts as direct aids to management was not one of the achievements of the Industrial Revolution,” what is clear is that there was no substantial *discourse* of cost and management accounting in Britain before the late nineteenth century. Costing methods developed inside individual firms on a trial-and-error basis, and businessmen were rarely explicit about the reasons for trying and adopting or rejecting the methods whose traces remain in the archive. The costing renaissance identified by Solomons was attributed by him to an increase in the complexity of British business, and to the growing difficulty of price fixing in industries such as engineering, where the naive models of price determination through competitive markets propounded by many economists failed to reflect what was rapidly becoming a highly specialized activity. Yet there is no significant evidence that costing systems in practice were being developed according to any sort of theoretical model: If the business prospered, then that validated the costing system. Moreover, as Armstrong (1987: 419) observes, “The future of cost accountancy as a body of knowledge was, at this time, open.” Much of the work of constructing and maintaining costing systems was in the hands of engineers rather than accountants—Emile Garcke, for example, was an electrical engineer— while the few accountants in industry who were capable of taking an interest in costing would probably have been regarded as “bookkeepers” rather than “qualified” accountants. Chartered accountants were called on from time to time to advise on the installation of costing systems (Jones 1988), but their main business remained insolvency and audit, where they could act as external consultants, disengaged from management.

Loft (1986) and Armstrong (1987) have explained how cost accounting came of age in Britain as a result of the pressures of World War I. Briefly, attempts to avoid war profiteering and to determine “fair market prices” in the absence of competitive markets led to the adoption of cost-based pricing and thereby to the need to ascertain costs. “The cost investigations required were carried out by cost investigation departments. Qualified (chartered or incorporated) accountants were employed to lead teams on the accounting side” (Loft 1986: 145). However, these groups probably had little practical knowledge of costing before they started their work, and thus they had to learn on the job. It was significant that “eminent City accountants were appointed to senior positions in Government service” (Loft 1986: 146), particularly at the Ministry of Munitions, which developed standardized accounting procedures for its contracts (Marriner 1980), as this began to legitimize cost accounting in the eyes of the accountancy profession. A byproduct of the development of costing in Britain during World War I was the formation in 1919 of the Institute of Cost and Works Accountants (ICWA, now the Chartered Institute of Management Accountants). As Loft (1986) demonstrates, this organization had ambivalent aims: While it was intended to encourage the expansion of knowledge about costing methods, it also attempted to raise the social status of cost accountants and works accountants. Much of the work of developing cost accounting during the 1920s was motivated by the notion of “scientific costing,” derived from North American ideas of “scientific management.” These ideas impressed some economists, most notably Marshall himself. In his last book, *Industry and Trade* (1919), Marshall discussed the work of Taylor and others, although he did not attempt to incorporate this rigorously into an economic analysis of the industrial firm. Unfortunately, Marshall’s dabbling with scientific management was of little inspiration to the next generation of economists (Williams 1986).

University courses, which before World War I had been heavily biased toward bookkeeping and financial accounting, began to reflect the interest in cost accounting. At LSE, a course in cost accounting was introduced in 1918 (Dev 1980:; 4), and costing also began to be taught at the civic universities. Indeed, the years immediately after the war constituted a significant period of development in the “higher commercial education.” The LSE raised nearly £300,000 to develop a B.Com. degree, available not only to full-time students of the University of London but also to external students. Commerce degrees were set up in many provincial universities, including those in Scotland and Ireland, and these tended to include an element of accounting in their syllabuses. However, comparatively few graduates of these degrees actually went into industry or commerce (Sanderson 1972: 210). Moreover, the heavy reliance on part-time teaching for accounting courses continued to make it difficult for a dialogue to develop between accountants and economists.

During the 1920s, a few isolated individuals attempted to encourage such a dialogue. Significant among them was Sir Josiah (later Lord) Stamp. In an address to the Society of Incorporated Accountants in 1921, titled “The Relation of Accountancy to Economies,” Stamp claimed that much of economic teaching in Britain involved abstract theorizing, divorced from “the facts.” He commended the inclusion of elementary economics and statistics in the examination syllabus of the Society, although, as the examiner for economics, he thought that the majority of students had only a “bare textbook knowledge” of the subject. He subtly criticized those who “may have thought more of the cultural broadening effects on [the accountant’s] mind than any pointed improvements in technique” by saying:

Now you could get such general breadth of view doubtless by other subjects, such as history, political ideas, the principles of criticism, architecture, the methods of science, or particular sciences from anthropology to Egyptology, for there is no royal road to breadth of view and to the capacity to enjoy a full and rounded life rich in varied interests. But in the choice of economics you arc doing something to get this effect with a direct economy and natural fitness. (Stamp 1921: 44)

Stamp claimed that an economic perspective could only enhance accountancy—the professional accountant “must be the better for a large grasp of the problems in hand in their wide economic significance, and for being more than a legally trained ‘figure merchant’ skilled in the presentation of numerical records”. He also suggested that accountancy might inform economics, through providing the raw data as to the results of industry for economists to analyze. However, to date, accountancy had failed to make a single substantial contribution to economic science. Stamp set out a number of areas where economists were theorizing in the dark: “How the differentials of profit for profitable concerns, as compared with marginal concerns, are made up and classified, and to which elements of advantage most profits are due”; “the relation between profits and capital . . . what share of the total reward belongs to the different economic elements of risk, direction, management and so on”; “the problem of the relation between changes in trade volumes and changes in prices, with corresponding changes in profits”; and “the amount of the national capital.”

Stamp’s address met with a mixed reception, with leading chartered accountants such as Sir William Plender (senior partner of Deloitte & Co.) welcoming the idea of cooperation between economists and accountants in principle, but pointing out “the view of economists of what is profit may differ from that of the lawyer, and of the business man who is responsible for a company’s management and finance, and this fact should not be ignored” (in Fells 1922: 125). Plender clearly felt more comfortable with the view of the lawyer than that of the economist. Nonetheless, Stamp’s message did inspire several professional accountants and led to some collaborative work, including Stamp and Hewetson Nelson’s book *Business Statistics and Financial Statements* (1924), a remarkably detailed treatise on the compilation and analysis of accounts, covering topics such as budgets, consolidated statements, and auditing. Significantly, however, this book, written for students studying outside formal courses, was, as the authors pointed out, based on an American model.

On the economists’ side, Birmingham continued to be an important center for the “higher commercial education”. One of Ashley’s successors as Professor of Commerce, Philip Sargant Florence,[[6]](#footnote-6) maintained Ashley’s philosophy of regarding the education of businessmen as a central role of the modern university. Florence specialized in industrial organization, the subject matter of his leading book (Florence, 1933). In addition to a study of more traditional aspects of industrial economics, such as production functions and costs, sales and marketing, labour policy, industrial location and the optimal size of industrial concerns, Florence was innovative among economists in Britain in considering managerial structures. He was well aware that, by the 1930s, the most important industrial and commercial concerns in Britain were large firms giving rise to significant problems of management and integration. Florence was not an original thinker in this area, tending to follow US ideas, such as the ‘line-and-staff’ model for organizational management. Florence was, however, aware of the ‘scientific management’ movement, and in particular the publications in the late 1920s and early 1930s of pioneer management consultant Lyndall Urwick (Brech, Thomson and Wilson, 2010; Parker and Ritson, 2010). He regarded accounting as a statistical aid to the provision of economic information within organisations, and placed some value on well-operating budgetary control systems, but he was typical of economists in Britain during this period of both seeing accounting as having only a technical role and not developing a well-articulated theory of business organization and management.

## <B>Bringing Economics to Accounting: The LSE in the 1930s

In her analysis of management education in Britain, Keeble (1992: 93) gave great weight to the establishment of the Department of Business Administration at LSE. In the 1920s, accounting at LSE had continued to be taught by part-timers, first Lawrence Dicksee, who had been appointed Cassel Professor of Accounting and Business Methods in 1919, and then F. R. M. de Paula, who succeeded Dicksee as Cassel Professor in 1926. In 1930, de Paula resigned to take up an appointment as Chief Accountant to the Dunlop Rubber Company (a significant example of a chartered accountant entering industry; Kitchen and Parker 1980: 81‒120). His chair was filled not by another accountant but by an economist, Arnold Plant, who had previously been Professor of Commerce at Cape Town. On leaving school, Plant had joined an engineering firm and had risen rapidly to a managerial role. Unusually for the time, he decided to study for a degree, taking the University of London B.Com. degree in 1922 and LSE’s B.Sc. (Econ.) in 1923. He returned to LSE in 1930 as Cassel Professor of Commerce at the age of thirty-two (Coase 1987) in order to develop postgraduate education in business administration.

Plant, who was a charismatic teacher (Baxter 1991), gathered a group of young scholars around him, most notably the “three Ronalds”: Coase, Edwards, and Fowler.[[7]](#footnote-7) Edwards, who had left school at age sixteen and trained as an accountant, had been a student on the University of London’s external B.Com. degree. He attracted the attention of Plant, who secured Edwards an appointment as a lecturer in the Department of Business Administration in 1935. Coase had also studied for the B.Com. degree, taking no courses in economics but rather specializing in accounting in his final year (Medema 1994: 3). Fowler had been a fellow student of Coase, had written a monograph on depreciation (Fowler 1934), and collaborated with Plant on various projects involving accounting. Plant in both formal teaching and private conversation encouraged his students and colleagues to study real-world problems, but to do so from an economic perspective:

His analytical system was unsophisticated but powerful. He thought of the economic system as essentially competitive, with monopoly transitory and relatively unimportant. The State had a role in providing law and order, but State intervention commonly promoted monopoly and . . . was designed to promote the interests of groups with political power. He was especially interested in attempting to understand the reasons which led to the adoption of business practices. (Coase 1987: 891)

The main theoretical and methodological contributions to economics of academics at LSE in the 1930s came from Lionel Robbins, Friedrich von Hayek, and, to a lesser extent, John Hicks (Coats 1983). Robbins, particularly through his *Nature and Significance of Economic Science* (1932), emphasized the “fact” of economic scarcity, so that economics became “the science that studies the relationship between ends and means that have alternative uses.” The emphasis that Robbins put on scarcity (a concept that, although it can be traced back to the classical economists, was not central to Marshallian analysis: see Montani 1987) reflected the fact that, in his teaching, he relied less on Marshall than on P. H. Wicksteed’s *The Common Sense of Political Economy* (1910). A main theme of Wicksteed was that all choice and allocation could be understood in terms of the selection between alternatives, and he developed this concept into one of opportunity cost: “By cost of production, or cost price, I mean the estimated value . . . of all the alternatives that have been sacrificed in order to place a unit of the commodity in question upon the market” (Wicksteed 1910: 385).

Hayek considered the role of information in providing signals for planning and decision making, and during the 1930s, he was particularly active in defending the “market” against “socialism” (Hayek 1935). Plant in particular shared Hayek’s regard for the price system as the best available mechanism for achieving optimal allocations of resources. Hicks was beginning to work with the ideas of Frank Knight on risk and uncertainty,[[8]](#footnote-8) and he was starting to analyze how business organization (e.g, the joint-stock company) might function as a means of risk sharing but would give rise to problems of control (Hicks 1931/1982)—an analysis that in some ways is a precursor of the much later agency theory. From these economic analyses, Plant and his colleagues distilled a notion of accounting’s role in economic decision making and a normative principle that accounting should be “decision-useful.”

The critique of contemporary accounting practice developed by the LSE School, and its recommendations for improving both financial reporting and managerial uses of accounting were discussed through the Accounting Research Association (ARA). This organization was launched in 1936 by Edwards in conjunction with Cosmo Gordon, the librarian of the Institute of Chartered Accountants in England and Wales (ICAEW) and a keen historian, and reflected the diverse interests of its supporters. These included the editor of *The Accountant*, which provided a platform for some of the most influential publications in accounting theory to emanate from the LSE School.[[9]](#footnote-9)

Between July and September 1938, the pages of *The Accountant* welcomed a series of articles by Edwards on the nature and measurement of income. These show from the start the influence of Robbins (echoing Wicksteed): “The financing of a business involves deflection of resources from the alternative uses to which they might have been put; and the amount of resources employed in any given use will be determined by the competing demand for them for *other* purposes” (Edwards 1938/1977: 97). After a lengthy review of the current state of financial reporting practice, Edwards (1938/1977: 126) concludes “that they are, from the standpoint of income measurement, inadequate and confused” and proposes in their place what he calls “the increased-net-worth theory of income,” which involves an essentially forward-looking rather than historical basis of valuation. His conclusion is that:

Published accounts should have as their object the provision of information for a judgement of net worth. The clearer and more relevant this information, the easier it is for the shareholder to calculate his income. The accountant should try to provide the information on which the net worth judgement is based, but cannot normally be expected to make this judgement himself. As we find out more about the ways in which investors reach decisions—and this is very much a job for the research worker in accounting—we shall learn how to develop the methods and forms of reporting that are most likely to help. (Edwards 1938/1977: 139)

Following the Edwards articles, *The Accountant* published a series by Coase (1938/1973), “Business Organization and the Accountant.” This drew heavily on Edwards’ article (1937), “The Rationale of Cost Accounting,” which emphasized the importance of marginal costs and marginal revenues to business decisions, showing that the accountant’s practice of allocating fixed costs lacked theoretical economic support and that additional (generally replacement) costs rather than historical costs were relevant for decision making. Coase (1938/1973: 108) cast decisions in terms of opportunity costs:

The cost of doing anything consists of the receipts which could have been obtained if that particular decision had not been taken. When someone says that a particular course of action is “not worth the cost”, this merely means that he prefers some other course of action. . . . This particular concept of costs would seem to be the only one which is of use in the solution of business problems.

While the concepts of marginal and opportunity cost had a long ancestry both within and outside Britain, what was significant about the contribution of the LSE School was that they sought to reform accounting practice in the name of economic theory.

The immediate impact of the LSE School was small. Edwards in particular faced vituperative rejection of his thesis from his LSE colleague Stanley Rowland, who as not only a chartered accountant but also a qualified solicitor reflected the more traditional “legal” basis of British accounting thought. Rowland suggested that “Mr Edwards has ‘gone berserk,’ ” that he was “enjoying the sport of bludgeoning the heads of accountants with intent that they shall be both bloody and bowed,” and finished with what Miller (1991: 741) has described as “a statement almost moving for its evocative appeal to the ledger as a domain of objectivity and security in contrast to what [Rowland] saw as the speculative and showy world of the accountant”:

Let us leave these nightmare thoughts and get back to a world in which cool sanity reigns. Let the accountant sit before his ledger and regard it with confidence as the bed rock on which his whole scheme rests. Let him record the present as it flows into the past and let him leave to others the risky business of tearing aside the veil which conceals the future. (Rowland 1938: 522)[[10]](#footnote-10)

Neither was Coase immune from Rowland’s shafts, being accused by him of “lay[ing] greater emphasis on the speculative element than on experience” (Coase 1990: 8). However, Coase by no means restricted his work to accounting matters. During the 1930s, he was developing what later came to be regarded as his seminal article, “The Nature of the Firm” (Coase 1937). In this article, he attempted to provide an explanation for a phenomenon that Plant and others tended to play down: Why, if markets and the price mechanism were so desirable as a means of achieving optimal resource allocation, did large organizations not only emerge but grow and flourish? The “theory of the firm” of Marshall and other mainstream economists effectively considered the firm as a production function, a “black box,” where an entrepreneur coordinated factors of production and decided on outputs, all within a known system of market prices. But this analytical tool provided no explanation for the emergence of “real” firms, in which “the distinguishing mark of the firm is the supersession of the price mechanism” (Coase 1937: 389). Coase’s analysis stressed that transacting through markets. Coase importantly defined the firm as consisting of “the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur” (Coase 1937: 393).

Coase’s concept of the firm was significant in that it attempted to preserve the analysis of economic phenomena in terms of marginal costs and benefits: “A firm will tend to expand until the costs of organizing an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organizing in another firm” (Coase 1937: 395). This marginal analysis also permeated Coase’s articles in *The Accountant*, particularly when he reflected on information costs:

It would be Utopian to imagine that a businessman, except by luck, could manage to attain this position of maximum profit. Indeed it may cost more to discover this point than the additional profits that would be earned. (Coase 1938/1973: 102)

Despite the innovative thinking of Edwards, Coase, and others, however, they had little direct impact on accountancy practice at the time. Nor were they teaching large numbers of students who could import their ideas into practice. The onset of World War II led to the temporary break up of Plant’s group. After the war, the work of Coase and Edwards moved away from accounting, although they had a continuing personal influence on the new generation of accounting academics, the LSE Triumvirate of William Baxter, Harold Edey, and David Solomons (Whittington 1994; see also Baxter 1991: 147).

## <B>National Income Accounting

The work of Plant and his followers at LSE in the 1930s was, in comparison with other developments in British economic theory, a relative byway. The most vital contributions to economics appeared to be those made by macroeconomists, most notably Keynes. In Britain, the macroeconomic theorizing of the 1930s is associated mainly with Cambridge, where Keynes was based. Among those working at Cambridge was Richard Stone, who is particularly associated with the development of the system of national income accounts that is still widely used throughout the world (Stone 1947, 1981; see also Suzuki 2003a, 2003b). In developing an operational measure of national income, Stone, and his collaborator, James Meade, drew on the “central concept of income” developed by Hicks in *Value and Capital* (1938). The Hicks income concept has permeated the accounting literature concerning income measurement, despite Hicks’s own dismissive attitude to the income concept (Clarke 1984: 94‒98). It was applied by Meade and Stone (1941) in their attempts to construct the raw materials of national income accounts.

The movement toward national income accounting during World War II was one of many manifestations of greater state involvement in economic planning and control. The economic planners, though, needed adequate economic data, and they found the accounts of companies to be grossly inadequate. Suggestions were made that standardized forms of accounts should be introduced, and economist H. W. Singer brought out an appreciative study of the German system of accounts (1943). Bircher has documented a submission from *The Economist* to the Cohen Committee on Company Law Amendment (1945), calling for standardized information to be supplied to economic policy makers:

The doctrine that the state was responsible for the economic health of the country was a new one but it was nevertheless widely accepted. Yet that doctrine had implications for accounting very different from that which prevailed before it became accepted. The regulation of accounting data must accordingly be approached with the needs of economic policy makers in mind. [*The Economist*] therefore called for standardized, very detailed sets of accounts with legal definition of such terms as depreciation, reserves, reinvestment of profits and other important terms. (Bircher 1991: 256‒257)

Standardization of accounts was, however, strongly opposed by the ICAEW and did not become part of the law relating to company accounts.

Not all accountants were opposed to the national income (social) accounting approach, however. Significant bridges between economics and accounting were constructed by Frank Sewell Bray, an incorporated and chartered accountant who played a key role in the emerging accounting research of 1940s and 1950s Britain. Bray was responsible for the foundation of the journal *Accounting Research*, supported by the Society of Incorporated Accountants (until it was closed down following the absorption of that body into the chartered institutes in 1957). While continuing as a partner in the accountancy firm Tansley, Witt & Co., he held an appointment as a Senior Research Fellow in Richard Stone’s department at Cambridge. Bray published extensively on the design of accounts (1947, 1949) and opened the pages of *Accounting Research* to articles on social accounting (Forrester 1982). He also held the Stamp-Martin chair of accounting at Incorporated Accountants’ Hall.

Although the development of national income accounting might have provided a focus around which practicing accountants and economists could have come together, attempts to do so tended to be of little lasting benefit. One such initiative may be mentioned. This was the Joint Exploratory Committee set up by the ICAEW and the National Institute of Economic and Social Research just after World War II. Although this contained several sympathetic accountants such as Bray, its report, *Some Accounting Terms and Concepts* (Joint Exploratory Committee 1951), has been described by Parker (in Forrester 1982: 10) as “rather disappointing and now forgotten.”

# <A>Developments After World War II: A Dialogue of the Deaf?

By the end of the war, there was at least a promise that accounting and economics in Britain could march together. Application of economic theory to analyze and improve the use of accounting in business decision making had been initiated by the LSE School and was to be developed further by Baxter, Edey, and Solomons (Napier, 2011). The possibility that accounting could provide useful data for national economic planning was accepted, and moves to make financial statements more useful to the state were at least under consideration. The accountancy profession was securely established and rapidly expanding, and (in certain places at least) it had a clear commitment to research. Moreover, the profession was beginning to acknowledge, in the universities scheme recommended by the Joint Committee Representing the Universities and the Accountancy Profession (McNair Report 1945), the benefits that might accrue from a relevant higher education. The scheme offered certain exemptions from professional training and examinations for students who had taken relevant degrees. The McNair Committee recommended that these degrees would contain roughly equal amounts of accounting, economics, and law. The encouragement of the universities’ scheme led several universities to appoint full- and part-time accounting teachers, including in 1947 the first full-time professors at LSE (Will Baxter) and Birmingham (Donald Cousins). However, a worrying signal of the continuing professional disdain for the newer universities was given by the ICAEW’s preference for offering funding for accounting education to Oxford (which turned down the offer) and then to Cambridge (which accepted the money and used it to endow a chair for Richard Stone).

As accounting spread as an academic discipline in British universities, it was often initially located in economics departments, and some exchange of ideas could be achieved. However, given the continued prestige of analytical economics and macroeconomics, a specific business economics found it difficult to emerge. This may have been due to a certain degree of modesty on the part of the early academic accountants, who appear to have made no attempts to expand their discipline into an autonomous business economics. Most of the early academic accountants came from a professional background and were heavily committed to the legal basis of financial reporting. Thus, economics was a tool for analysis to be furnished by economists rather than a goal for the academic institutionalization of accounting. Accountants who wanted to develop a more theoretical understanding of industrial organization, for example, often moved away from teaching and researching in accounting and saw themselves as economists rather than as accountants: The postwar career of Ronald Edwards is a good example of this. Edwards became Professor of Business Organization at LSE, and he tried to promote the application of economic ideas to business problems, particularly through his seminars for businessmen, civil servants, and academics (Dahrendorf 1995: 418). However, he contributed less and less to accounting, and eventually he left LSE to follow a senior career in industry. Coase moved to the United States in 1951, leaving behind a small number of economist colleagues interested in understanding the firm and its accounting through economic theory (mention may be made in particular of George Thirlby and Basil Yamey). However, the main use of economic analysis to understand the workings of the firm continued to emphasize markets rather than internal organization.

The central influence of LSE on the development of academic accounting in the United Kingdom was reinforced by the extent to which the members of the generation of professors appointed to British chairs of accounting in the 1950s, 1960s, and 1970s were likely to have taught, studied, or both at LSE (Dev 1980). As students of the LSE triumvirate, they absorbed the notion that accounting needed to be understood, and could be improved, through an application of economic theory, but on balance the theory they acquired and promulgated owed more to traditional economic analysis in terms of prices and markets than to a Coasean approach to the organization. This is not to say that British academic accountants ignored the emerging economics of the organization and management associated with North American writers such as Baumol (1959), Simon (1947, 1957), and Cyert and March (1963), augmented by the British economist Robin Marris (1964): Their contributions influenced several researchers, as well as underpinning textbooks such as Amey and Egginton’s *Management Accounting: A Conceptual Approach* (1973).

With regard to financial accounting and reporting, however, the conservatism of the professional institutes tended to inhibit opportunities for a greater integration of theory and practice. Textbooks for professional accountancy students generally presented accounting as a collection of untheorized practices constrained within a body of legal rules. These rules, augmented by the ICAEW’s Recommendations on Accounting Principles (Zeff 2009), hardly ever had a discernible theoretical basis, and the latter often did little more than express existing practice (with all its inconsistencies) in an orderly way (Leach 1981: 4). Unfortunately, with the closure of *Accounting Research* in 1958, there were no specialist research journals in accounting in Britain at a crucial point in the expansion of accounting teaching in universities.[[11]](#footnote-11) The Association of University Teachers of Accounting (AUTA), formed in 1947, sponsored the publication of three collections of readings: *Studies in Accounting*, edited by Baxter (1950); *Studies in Costing*, edited by Solomons (1952a); and *Studies in the History of Accounting*, edited by Littleton and Yamey (1956). But there was an unfortunate absence of an authoritative textbook applying economic theory to financial accounting. Moreover, the academic accountants suffered a psychological blow from the rejection by the ICAEW’s Committee on Education and Training of a greater role for theoretical education in the training of accountants (Parker Report 1961). This Report was excoriated by Solomons (1961a: 412):

Whenever it can find specious reasons for opposing change it does so. . . . For some reason, the Institute has always preferred to take advice on its educational policy from amateurs. . . . Many thousands of articled clerks will be subjected to the profession’s archaic training methods before the system is again the subject of review. This is a sobering thought; for a great opportunity has been lost, and the price will be paid not by those who are already members of the Institute but by those whose professional education might have been but now will not be worthy of a great profession.

Thus, despite the continuing growth of university courses in accounting, the early 1960s were a relatively dark period for the development of accounting theory in Britain, evidenced in particular on the institutional front by the fact that the AUTA was moribund during the decade and on the personal front by Solomons’ departure for the United States in 1959 (Zeff 1997). Nonetheless, Baxter and Edey, and their growing number of ex-students, continued to argue for a greater application of economic thinking to accounting, and for more economics training for professional accountants (Bourn 1965a, 1965b, 1966a, 1966b). Baxter in particular encouraged the development of the “deprival value” (or “value to the owner”) concept, which he had derived from the work of the American writer Bonbright (1937), while Edey (1982), through his membership of key committees of the ICAEW, tried to encourage more research and increased theoretical content in the professional accountancy examinations. Both Baxter and Edey attempted to persuade the Jenkins Committee (1962) to permit companies to use replacement cost accounting. Although this was the first occasion on which full-time accounting academics gave evidence to a Company Law Committee, the recommendations of the Jenkins Report were anodyne and led to little change in the form and content of company accounts.

As the 1960s continued, the rate of price inflation, which had since 1950 been small but positive, started to accelerate. The appropriate way of reflecting price change in company financial statements, which had been a longstanding topic in the writings of the LSE triumvirate and others, started to become a matter of wider debate within not only the accountancy profession but also academic economics. The influential *Readings in the Concept and Measurement of Income* (Parker and Harcourt 1969), edited by an accounting professor and an economics professor, brought together many of the seminal contributions to accounting income theory in the English language. The collection included a article by Solomons (1961b: 383), in which he suggested that “the next twenty-five years may subsequently be seen to have been the twilight of income measurement”. In an influential book chapter, Solomons (1966) developed a formalization of the “value to the owner” concept in terms of replacement cost, net realizable value, and present value of future cash flows, and this was taken up by Parker and Harcourt (1969: 17). With the rapid increase in the rate of inflation in the early 1970s, not only the accountancy profession but also the British government became involved in attempts to reform company financial reporting to reflect the impact of price change. These attempts have been documented at length by Tweedie and Whittington (1984), but the contributions of Robson (1994a, 1994b) are particularly important in explaining the extent to which many of the proposals for inflation accounting appealed to relatively unarticulated notions of economics. Speaking of the connection between technical methods for inflation accounting (such as current purchasing power) and state counterinflation discourses, Robson’s main conclusion is that, “to examine the inflation accounting discourse within the terms of economic value theory, when it is not clear that participants in the debates necessarily structure their ‘choices’ or view their interventions in terms of ‘economic value,’ can assist in ignoring, overlooking or obfuscating these connections” (Robson 1994b: 210). It is probable that the unwelcoming reaction to inflation accounting on the part of considerable elements of the accountancy profession was due to ignorance of the theoretical underpinnings of the recommended systems, if not downright hostility to the “academic.”

Inflation accounting was only one of the issues on the professional accountancy agenda when the 1970s began. The previously lax approach to the formulation of accounting principles began to change with the setting up of the Accounting Standards Steering Committee in 1970. The early Statements of Standard Accounting Practice (SSAPs) issued by this body are significant for their *lack* of theoretical reasoning, exemplified in particular by SSAP 2 on disclosure of accounting policies (Accounting Standards Steering Committee 1971). This document proposed four fundamental accounting concepts (going concern, prudence, accruals, and consistency), but it opted out of developing a “basic theory of accounting”:

An exhaustive theoretical approach would take an entirely different form and would include, for instance, many more propositions than the four fundamental concepts referred to here. It is, however, expedient to recognize them as working assumptions having general acceptance at the present time. (Accounting Standards Steering Committee 1971: note to para. 2)

In recent years, financial reporting has become more explicitly regulated not only through accounting standards but also by more detailed company law. The latter development is largely a response to European harmonization initiatives, and there is rarely a specific appeal to economic arguments when accounting regulations are developed (a partial exception to this is the reduction in auditing and disclosure requirements for small and medium sized companies, justified by reference to a cost-benefit analysis). Moreover, academic accountants as a body rarely contribute to the standard setting process, although individual academics have played, and continue to play, a central role (the Accounting Standards Board, for example, established as the U.K. standard setting body in 1990, had two members with academic backgrounds—Sir David Tweedie and Geoffrey Whittington).[[12]](#footnote-12)

Within universities, the years from about 1965 have seen an explosion in research, much of which appeals to economic paradigms. However, British researchers increasingly draw their theoretical perspectives from innovations in the United States. For example, Whittington (1987) points to the influence of U.S. writers on the development of such applications of economics to accounting as capital budgeting, agency theory, and information economics. In all of these areas, British writers have made important contributions to the exposition of the central ideas (for capital budgeting, see Merrett and Sykes 1963, 1966; for agency theory, see Walker 1989; for information economics, see Strong and Walker 1987; Bromwich 1992), but the ideas themselves emerged in the United States. The attempts to develop an economic explanation for the supply of and demand for accounting—positive accounting theory—have also had an impact on British academic accounting research, although often through stimulating hostility rather than endorsement. Indeed, the major theoretical innovations in British academic accounting in recent years have come from the application of more broadly social and critical theories to accounting, much of which has appeared in the journal *Accounting, Organizations and Society* under the editorship of Anthony Hopwood. Some of this research, but by no means all, has been an attempt to recover a notion of a “political economy of accounting” (Cooper and Sherer 1984), but most applications of economics to accounting theory are held in suspicion by the critical accounting movement.

The position today can be summed up as a “dialogue of the deaf.” Accounting theory relies heavily on economic ideas, in both financial reporting (Whittington 1986) and managerial accounting, but the application of economics to accounting continues to be contested by the “critical” accountants. Despite the emergence in the mid-1960s of separate business schools in London (Barnes 1989) and Manchester (Wilson 1992) and the rapid expansion of postgraduate business education from the late 1980s, no specific business economics tradition has emerged. Indeed, the United Kingdom exhibits in the area of business finance what Whitley concludes with respect to the United States:

The domination of economists seeking to extend equilibrium models of perfect markets to the operation of capital markets led to the business finance area concentrating on theoretical models of asset valuation and more traditional concerns and practical topics being seen as derivative. (Whitley 1984: 188)

In finance, as in other areas of economics, theoretical analysis is still more prestigious than applied work. Even given the expansion of the business schools, much formal management education in Britain takes place in the context of professional accountancy training, and the suspicion of theory continues. In financial accounting and auditing, there is still an emphasis on law as the structuring body of knowledge, while management accounting and financial management are often taught as scarcely theorized bodies of techniques. Much professional education is in the hands of private sector “crammers” dedicated to getting as many students as possible through the professional examinations (Power 1991). Students who have not passed through a “relevant” accounting degree (or not otherwise studied the subject in their undergraduate degree) receive about three weeks’ worth of economics teaching, so they acquire only a superficial awareness. “Relevant” graduates continue to be regarded by many accountants as inferior to the “non-relevant.” The reaction of many practicing accountants to arguments couched in terms of economics is to spurn them as “academic.”

Yet the irony of the matter is that, in the United Kingdom at any rate, accounting in recent years has been heavily involved in putting into effect interventions in the name of the “economic.” Indeed, Hopwood goes so far as to suggest that regarding accounting as simply an application of an economic body of theoretical knowledge is simplistic: “If the economic is as likely to result from accounting as it is to induce it, then there are limits to the extent to which it is meaningful to explore the underlying and enduring economic truths of accounting” (Hopwood 1992: 142). But, while we can observe, with Miller (1991) and Robson (1994a, 1994b), attempts to change Britain’s accounting practice in the name of “the economic,” we rarely see attempts to change Britain’s economic theory (as opposed to economic practice) in the name of accounting. The reasons for this are partly cultural and partly educational, and they have their roots in the nineteenth century. The outcome within the academy is deference to economics on the part of many accounting academics and disdain for accounting on the part of economists, while accountancy practice continues to follow a largely atheoretical road.

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1. Reprinted with minor changes from *The European Accounting Review* 1996, 5(3): 449‒481. [↑](#footnote-ref-1)
2. “Accountancy” connotes what accountants (especially in professional practice) *do*, while “accounting” embraces the intellectual content of the discipline: what accountants *think*. [↑](#footnote-ref-2)
3. In the *Lee* case, which determined that there was no legal rule requiring companies with “wasting assets” such as mines and concessions to provide deprivation, the plaintiffs, who wanted the company to depreciate its assets before arriving at the profit available for dividend, quoted a definition of profit offered by the economist J. R. McCulloch, in *The* *Principles of Political Economy* (1825). McCulloch, who was the first Professor of Political Economy at London University (1828‒1837), defined profits as arising after “capital wasted and used in the undertaking has been replaced.” [↑](#footnote-ref-3)
4. Ironically, books such as these were considered by the professional accountancy press to be too “theoretical” to have much practical value for accountants (Kitchen and Parker 1980: 39). [↑](#footnote-ref-4)
5. It is unlikely, however, that he met Eugen Schmalenbach, who did not join the faculty at Cologne until 1904 (Potthoff and Sieben 1994: 79). [↑](#footnote-ref-5)
6. Florence was born in the USA, but educated in the UK—he studied economics as an undergraduate at Cambridge but returned to the USA to take his PhD at Columbia University. He was a lecturer in economics at Cambridge (1921-29) before his appointment at Birmingham, where he remained until he retired in 1955. [↑](#footnote-ref-6)
7. Much of the history of their activities in the second half of the 1930s has recently been narrated by Coase (1990) and Baxter (1991), with earlier discussions by Buchanan (1969), Gould (1974), Dev (1980), and Arnold and Scapens (1981). [↑](#footnote-ref-7)
8. Knight’s *Risk,* *Uncertainty and Profit* (1921) and Wicksteed’s *The Common Sense of Political Economy* (1910) were the textbooks on Robbins’s undergraduate economic course (Baxter 1991: 139). [↑](#footnote-ref-8)
9. The ARA has been discussed by Zeff (1972) and in more detail by Bircher (1991: 156‒182). [↑](#footnote-ref-9)
10. It was Rowland who used the expressions “sheer insanity” and “dangerous nonsense” about DCF quoted by Miller (1991). However, he should not be regarded as a consistent enemy of economics. Indeed, Edwards had begun his series of articles by quoting an earlier article of Rowland’s: “It is possible to preserve respect for the operation of law while not confounding matters which are legal with those which are economic. The relationship of dividend to annual profit is a matter of law; the relationship of profit to industrial and commercial operations is the subject of economic inquiry” (Rowland 1936: 250). [↑](#footnote-ref-10)
11. The *Journal of Accounting Research* was established in 1963 as a joint venture between LSE and the University of Chicago. In 1970, the ICAEW set up *Accounting and Business Research*, while the *Journal of Business Finance* (later *Journal of Business Finance and Accounting*) was founded in 1969. [↑](#footnote-ref-11)
12. Tweedie was to become the first chairman of the International Accounting Standards Board in 2001, with Whittington as a board member. [↑](#footnote-ref-12)