

The evolution of governmental accounting in China

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China has initiated the process of revising its accounting standards, including those intended to be applicable to the public sector. As a consequence, Chinese scholars have expressed an interest in knowing more about public sector accounting in the United States. This has raised a series of questions that motivate the author's comparative international governmental accounting research (CIGAR). The questions include:

- A. What are the Chinese public sector accounting standards?
- B. How have these standards evolved?
- C. To what extent are ideas from abroad applicable to China?

Thinking about these questions has raised further issues: What is the scope of the Chinese "public sector"? How does it compare with its counterpart in other countries? In particular, does there exist a "nonprofit sector" in China?

Furthermore, what is the relationship between budgetary accounting and budgeting? Do accounting standards necessarily have to be government regulations or can there be from other sources? What has been the process for promulgating these standards and what have been the sources of concepts and other ideas underlying these standards? How influential are: (a) the past practices in China itself, (b) the Marxism and Soviet practices, and (c) Western ideas and practices?

In bringing in ideas from abroad, who would also have to inquire into the goals of public sector standards in China. What are the criteria for selecting exemplary concepts and practices from other countries? What is the proper balance between uniquely Chinese characteristics and the "most advanced" practices in the world?

These questions are in effect elements of a research program that the author is embarking on. At this stage, there are more questions than answers. To some extent, the answers are shaped by the ways in which the questions are framed. If the objective of research is to describe the contemporary similarities or differences among nations in terms of their governmental accounting systems, the cross-section comparison method might suffice. However, if the purpose of research is to explain how a country's system has evolved, it is necessary to add a time dimension. The historical perspective becomes even more essential if one wants to predict changes or even help make changes. For these reasons, this paper suggests that a time dimension should be added to the comparative approach to more fully account for similarities or differences in the governmental accounting systems of the countries under study.

The primary purpose of this paper will be to describe the comparative historical method and how it has been used in social science research. It will then make a preliminary attempt to compare the evolution of public sector accounting in the U.S. and China from a historical perspective. This paper is therefore a precursor to a larger CIGAR project. In the next phase, I will learn more about the public sector accounting system of China, and will attempt to ascertain the forces which have shaped its standards.

THE COMPARATIVE HISTORICAL METHOD

The comparative historical method has been used in the social sciences to study significant events that are small in number. Because of the small number, it is impossible to perform statistical analyses which require a large number of data points. An alternative research method is case studies. The problem with case studies is their lack of generalization. The comparative historical method tries to see if there exists a pattern between the small number of historical significant events by studying their similarities and differences.

It has been used by Theda Skocpol to study the causes of social revolutions. Skocpol chose China, Russia and France as her case studies. The social revolutions in these countries happened in different times. However, by studying their underlying conditions, Skocpol was able to show that state structure, international forces and class relations combine to explain these social revolutions.

Recently Stephen Kalberg reanalyzed sociologist Max Weber's writings and characterized a substantial body of Weber's work as comparative historical sociology. He identifies three approaches to comparative historical research. The first approach, using a world systems theory, identifies the object of study in terms of its position in the world system - core, peripheral or semiperipheral. The second approach, called the interpretive historical approach, emphasizes the accurate constructions of concepts and reconstruction of cases. The third is called the causal analytic approach. This approach, exemplified by Skocpol's study of social revolutions, tries to explain the phenomena under study by examining the similarities and differences of multiple cases.

At this preliminary stage of my research on China, I have focused on understanding the environmental forces that shape the role of the public sector. After I have gained additional knowledge about the Chinese system, I will then move to the causal explanation method, and will undertake a comparison between China and the United States. I will also attempt to answer the questions posed in the introduction section.

THE EVOLUTION OF CHINESE GOVERNMENTAL ACCOUNTING IN THE TWENTIETH CENTURY

During the twentieth century, China went through several major revolutionary changes. The Qing Dynasty was overthrown and succeeded in 1911 by the Republic of China led by Dr. Sun Yat-sun. It took almost another forty years - including two world wars, and eight-year war against the Japanese and four years of civil war - before China was again united, under a communist regime (Skocpol, 1979). The People's Republic of China is now almost forty-five years old. During these years, the population double to over 1.2 billion people and the economy went from central planning to a bold experimentation with a market-oriented economy. With its "wise elder brother" Soviet Union consigned to the dustpan of history, China becomes the only major communist country. This thumb-nail sketch of recent history of China provides a context for the following description of the development of its accounting system, in particular the public sector accounting.

The Republican Period (1911 - 1949)

The Republic of China was founded under the three-people principle, under which the government of the people pledged to work for the people's welfare. Under the influence of Russian advisors, the political institutions of the young republic assumed some resemblance with that of the Soviet Union, with a representative legislature. Its financial management system was based, at least in part, on the Japanese system. It was only after the central government was able to consolidate its power after defeating the regional warlords that the system was formally instituted in 1931. The system, called chu-chi, featured an integrated system of budgeting, accounting and statistics. The system was operated by a directorate-general within the Executive Yuan (Branch), with a network of branches at the provincial and local levels of government. It was modified over the years with American advice as the Nationalist Government was struggling with its war against the Japanese and also with the communist. It won the war against the Japanese at the conclusion of World War II but was defeated in the subsequent civil war. Its effective domain was in 1949 reduced to mostly Taiwan, which has been transformed into a robust economy and with a reasonably democratic government. As the United States was an ally of the Nationalist Government during those wars and provided considerable foreign aid throughout the 1950's, American influence was discernible.

Orthodox Marxist Period (1949 to 1980)

1949: Public Ownership and Central Planning. The victory over the Nationalists in 1949 put the Communists in control of a nation with over 500 million people. The new government moved quickly to consolidate its power by starting the Land Reform Movement throughout China. Land ownership was transferred to poor peasants, who were organized into work brigades. The property of former enemies and foreigners was seized by the state. A system of public ownership was beginning to be firmly established. At the same time, a series of political movements were launched to convert the populace to communism. On the economic front, the government moved rapidly to create a new currency and proceeded to stabilize prices and increase production. Not surprisingly, the Marxist doctrine of central planning was the guiding principle in the economic transformation. Under a friendship treaty with Stalin's Soviet Union, Russian experts came to China in large numbers and advise the China in all areas, including the finance functions. (On the political front, in the post-WW II Cold War era, the United States became China's enemy for its support of the Nationalists and involvement in the Korean War.)

1952-1957: Soviet-Style Economic System. In 1952, China launched its first Five Year Economic Plan to boost its economy. The blueprint for the plan was supplied by Russian experts in person and through the translation of numerous textbooks for use through China's colleges and universities. A Soviet-style enterprise accounting system was gradually developed. The system emphasized cost planning and management. Monitoring through such an accounting became pervasive in every aspect of economic life. Accounting analysis was widely used as a tool for increasing economic efficiency. The popular slogan for the period was "Be responsive to those at the foundation. Be responsive to production increase. Be responsive to the people." The call for attention to those at the foundation reflected the central planner's awareness that the system would not work without the efforts on the front-line of the production process. During this

period, the main goal was increased production and savings. Privately owned businesses were nationalized. All public enterprises were instructed to practice “team business accounting.” That is, each production team was exhorted to assume responsibility for achieving specific quotas for cost savings, and increase in efficiency. This forerunner of “activity costing” was given credit for the successful completion of the First Five Year Economic Plan. The accounting technique was, however, only one aspect of an concerted effort to articulate a theoretical framework for managing a socialist system of production by integrating concepts of public ownership, centralized planning and financial management, and detailed economic activity analysis. This framework continued to be guide the development of accounting during the next thirty-years or so, even as the ideological split with the Soviets led to the withdrawal of Russian experts in 1957.

1958-63: Back to Economic Rationality. The officially proclaimed success of the First Five Year Plan also led to excesses. Inspired by slogans such as “Man is more powerful than nature” and convinced of the superiority of the socialist system, it was politically rational for local leaders to report almost miraculous accomplishments in production. When such excessive claims were challenged, the skeptics’ ideological loyalty was questioned and political fates were sealed. It was politically incorrect to doubt the Great Leap Forward Movement. The entire population was mobilized in socialist production. Neighborhood miniature steel mills were set up on sidewalks. Intellectuals and students went up to the mountains or down to the villages to be closer to the people. The people themselves were organized into communes, where they not only worked together but also lived together. The socialist doctrine of “from each according to his ability” was undermined by the practice of feeding all from the same rice bowl - both actually and symbolically. As the prevailing ideology was to be boundlessly optimistic, local leaders reported fantastic production accomplishments. Such exaggerated claims were not challenged by auditors, but by mother nature. Natural disasters and man-made policies combined to create widespread famine. In the face of such dire consequences, remedial measures labeled as “Adjust, Consolidate, Substantiate, and Increase” were instituted to revive the Chinese economy. This also resulted in the restoration of the accounting function in the economic system. Government regulations were issued to insulate the accountant from unscrupulous officials. The importance of an effective accounting system became more apparent as management by cost targets and control through funds allotment was practiced. Great emphasis was placed on economy and savings, as evidenced by the slogan of “Save even one-tenth of one percent.” Renewed respectability gave rise to an outpouring of expressions of diverse viewpoints on theoretical issues in accounting, and the celebration of the crucial role of accounting in national economic realignments and construction.

1963-77: Years of Chaos and Destruction. For ten years, the Great Cultural Revolution led by the Gang of Four inflicted enormous cost in terms of lost and tortured human lives. The Red Guards rampaged the entire country, overthrowing existing institutions and claiming countless victims. Economic activities grounded to a halt, and factories and school laid idle. During this period of rampant disorder and chaos, accounting ceased. There was nothing to account for, except for the cost of chaos and destruction. Ironically, it was during this period that China opened its doors by receiving U.S. President Richard Nixon. The visit ended twenty years of political, economic and cultural isolation from the West.

1979 - the Present: Maintaining Political Stability Amidst Economic Changes. Following the death of Chairman Mao and the arrests of the Gang of Four, the reformers under the leadership of Deng Xiaoping established their foothold at the Eleventh Congress, Third Session, of the party in 1979. Economic prosperity became the central policy goal, and market-oriented economy was adopted as the means. Reformers Hu Yaobang and Zhao Ziyang assumed positions of leadership and accelerated the pace of economic changes. Creative terminology, such as socialist market economy, was invented to reconcile the economic changes with the political conceptual framework. Unlike the Soviet Union like Mikhail Gorbachev, the Chinese leadership was reluctant to undertake political and institutional reforms. This eventually led to the Tiananmen Square tragedy and the downfall of Zhao. Even so, the conversion to the market economy continued after 1989, especially along the coastal regions.

The fifteen years of sustained economic reform has a number of profound implications for accounting in China. Previously, budget accounting dominated government accounting, and by extension the entire field of Chinese accounting in general. This domination was substantially curtailed by new forms of economic entities and activities. The separation of governmental functions and enterprise activities has enormous financial consequences for the public sector, and has created complex accounting issues. State enterprise are reluctant to sever their umbilical cord linking them to the public treasury that has nourished them. These cost centers are increasingly treated as, and consequently behavior like, profit centers and investment centers. Furthermore, the loosening of the central planner's firm grip and the recognition of patent rights have allowed for the formation of joint operations with domestic and foreign partners. Joint venture accounting became a rapidly developing field of study and practice. More basically, the recognition of private property rights and the flurry of commercial transactions gave rise to the need to reexamine the existing accounting concepts, principles and procedures. In response, the government undertook a four-year effort of research and deliberation among scholars and officials that led to the "Accounting Law" in 1985.

The 1985 Accounting Law was a significant milestone and it ushered in a new era in Chinese accounting. For the first time, foreign accounting firms were permitted to established representative offices in China. In 1987, minor modifications to accounting systems were made, and in the same year the government allowed the establishment of private-sector accounting firms. Two years later, more extensive changes were made, and research was begun on commercial accounting standards. To update, two sets of recommendations have been made to the Ministry of Finance for possible adoption. The accounting reform was a part of the overall effort to reform the financial and economic system. This involved changes to the banking system and the taxation system. Reforming the banking system was essential as China weathered double-digit inflation in 1991-92. And devising an effective taxation system became urgent serious disparity emerged between the high-growth regions and the poorer inner provinces. In a sense, changes the accounting system was easier than tackling the other two major issues. The effort to reform accounting standards continued, as evidenced by a major international conference in 1992. The need for financial reporting became even more urgent when stock exchanges appeared for the first in Shanghai and Shenzhen. In July 1993, the Chinese government approved a new accounting system, intended to be consistent with

international accounting standards. The Ministry of Finance also agreed to let joint venture CPA firms operate in China.

Naturally, these changes have had a tremendous impact on accounting education and research in China. Many textbooks have been written on business accounting topics. Conferences have been organized. Overseas visits, which began in 1981, have been more frequent and substantive. These aspects have been extensively covered in several papers.

The activities associated with creating the accounting adjuncts to a market-oriented has overshadowed those attempting to deal with the budgeting and accounting of the public sector. Given the developments described above, one realizes that the Chinese public sector in the 1990s was very different from the one in 1979 when economic reform in China started. The public sector is getting smaller by virtue of gradual disassociation of state enterprises. A serious public policy question facing all nations in general, and China in particular, is: What functions should government perform? Without addressing this vital question in this paper, it suffices to point out that even in the capitalist countries, government still perform myriads of activities. It is therefore important for China to reexamine its public sector, and public financial problems.

In this regard, the Chinese government has made a series of attempts to improve its budgeting and accounting system. In October 1983, the Ministry of Finance promulgated a series of regulations on the comprehensive budget accounting systems of finance agencies. In 1993, a system of dual budgets was proposed. The dual budgets referred to the operating budget and the capital budget, o date, there has not visible progress in its implementation.

CONCLUDING REMARKS

Based on the history of governmental accounting in China in most of the twentieth century, it appears that accounting is an amazingly versatile tool. Managerial accounting, with its emphasis on planning and control, based in part on accurate cost determination, was used during the period when the Chinese economy was centrally planned. Indeed, budgeting and budgetary accounting is still alive and well in serving the governmental functions, even as the government is playing an decreasing role in direct production in the market-oriented economy. Correspondingly, financial accounting, with its emphasis on profit and loss determination, is increasingly used as a way to gauge the performance of state enterprises and certainly for private enterprises, including formed in joint ventures with foreign firms. Thus accounting has shown remarkable adaptability. Its use to businessmen led Max Weber to credit it with the success of capitalism. Karl Marx predicted its even greater role in the socialist economy. Even as Marxism has eclipsed as an dominating economic doctrine, Max Weber is again correct in his assertion. Accounting is truly a tool for all seasons.

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Abbreviations: PRC = People's Republic of China, USA = United States of America, SUFE = Shanghai University of Finance and Economics

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