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An analysis of economic knowledge. Centralized vs. decentralized planning Analiza wiedzy ekonomicznej. Scentralizowane vs zdecentralizowane planowanie

Abstract: *This paper analyzes the early development of centralized vs. decentralized knowledge theory which led to the free market theory and away from centralized planning of markets. It further discusses the type and relevancy of information in executive decision making whilst emphasizing the role that compatibility and objectivity of information plays in a society. Some of the key issues questioned in this paper are that the combined knowledge of the society is much more appropriate in using it as a basis of decision making in markets than any particular knowledge possessed by a few individuals and certified by a particular authority. In addition to this, it is argued that the methods chosen to collect this information such as different accounting models, can play a significant role on results control and risk reduction.*

Keywords: information, knowledge of the society, Hayek's economic theories

Streszczenie: *Artykuł analizuje wczesny rozwój scentralizowanej vs zdecentralizowanej teorii wiedzy, która doprowadziła do teorii wolnego rynku dalekiej od centralnego planowania. Następnie dyskutowane są rodzaje i adekwatność informacji w procesie podejmowania decyzji przez menedżerów, z podkreśleniem roli jaką spójność i obiektywizm odgrywają w społeczeństwie. Niektóre z kluczowych problemów podejmowanych w artykule mówią o tym, że zbiorowa wiedza społeczna jest o wiele bardziej użyteczna jako baza dla podejmowania decyzji rynkowych niż szczególna wiedza posiadana przez nieliczne jednostki i certyfikowana przez autorytety. Dodatkowo wysuwane są argumenty, że metody wybrane do zbierania informacji, na przykład różne modele w księgowości, mogą odgrywać znaczącą rolę w kontrolowaniu wyników i redukcji ryzyka.*

Słowa kluczowe: informacja, wiedza o społeczeństwie, teorie ekonomiczne Hayeka

Introduction

F.A. von Hayek was an economist who published many works about economic theory, starting in the 1930s and 1940s. The reasoning that lead von Hayek to deal with this issue stemmed from his personal experience which he acquired during his graduate studies.

Although he had an extensive background in economic theory, he also studied philosophy of science where he gained an appreciation for the philosophy behind economic theories. In 1937 he published his working paper the "Economics and Knowledge" in a journal called *Economica*. In this work he compiled some of his early thoughts about a number of issues that have to do with economic theory and in particular about the question of foresight.

Foresight

According to Hayek, foresight is based on the equilibrium theory. Hayek has many reservations about the equilibrium theory and points out several of them. The equilibrium theory can only function as an idea associated with one individual. In other words, one individual can be in equilibrium with his actions as long as he planned those actions at the same time under the same set of circumstances. Furthermore, the equilibrium can easily be set off due to unforeseeable circumstances that can affect the range of the foresight that one can plan. For the sake of argument, Hayek further analyses the possibility of societal equilibrium. In this scenario he argues that when one makes his/her plans they are based on the assumption that others will act in a specific way. This, of course, is based on the exchange based world that Hayek refers to. In this sense, all of one's plans are dependent upon the actions that others will take that are compatible with the assumption that one took during their planning.

The validity of the data gathered is another important aspect that Hayek points out. He states that one's decisions are based on factual data which should be objective and the same for all. However, this data has to be subjective in order to be compatible. In other words, the individuals that interact with each other adjust and shape the data in order to match the expectations of each other and to make the data compatible. Having said this, the equilibrium theory does not completely lose ground considering the relative nature of the term "datum", [Hayek, 1937].

According to Hayek, the term "datum" meant given or known to the person under consideration, nevertheless it has now undergone transformation and has changed its meaning.

Datum

Hayek makes an effort to elaborate further on the issue of the meaning of the term datum due to its importance in so many contexts. Datum, he points out, is understood to mean information given, but what is more relevant and frequently not stated is "to whom it is given?" This question is important because it ensures that one knows the relevance of the data as it could be different for different people. According to Hayek, there is a great difference between the factual data given to an economist and the subjective data given about things known to particular individuals whose behaviour one

tries to explain. In this aspect, Hayek attempts to answer why data in the subjective sense should correspond to the objective data.

Compatibility of intentions

Compatibility of intentions is one of the most significant aspects of societal equilibrium, [Hayek, 1937]. Hayek defends the ground that if there is no compatibility of intentions, then some of the people involved would have to change their plans inevitably. This leads to another concept elaborated by Hayek, namely the idea of what constitutes change. Hayek takes the example of weather which seems to be very appropriate for this illustration. If the weather does not change any more, this in itself constitutes a change for people [Hayek, 1937]. This shows that if one has certain expectations, then any deviation from those expectations can mean a change.

If one changes their driving route to work every single day and then suddenly decides to stay with the same path for a while, the fact that one is not changing the way anymore can constitute a change in itself. In light of this Hayek concludes that equilibrium is constant in a society as long as the data from outside corresponds with the expectations of that society. These conclusions demonstrate the importance of foresight while emphasizing that correct foresight is not a precondition to equilibrium but rather a defining characteristic of the equilibrium [Hayek, 1937].

Applicability of Hayek's ideas today

Hayek presents a great example that applies to the most recent economic developments for the 2007-2009 global economic crises. He explains the nature of equilibrium by using the example of home builders and buyers. If builders plan for a certain number of houses by gathering the necessary building materials, labour and other resources and the buyers save for purchasing these homes later, then one can conclude that there is equilibrium [Hayek, 1937]. However, if these plans are disturbed by external events such as natural disasters, changes in technology that make the plan undesirable or other factors that disturb this equilibrium, Hayek considers these to be changes in the objective data.

This is different if from the beginning the intentions were not compatible then it is inevitable that some of the people involved have to change their plans. This relates to the most recent global economic crisis which could be said that was caused by a lack of equilibrium between the parties involved in the real estate business. The builders, buyers and lenders did not have compatible intentions and therefore at the end it upset many people's and businesses' plans. Of course that this is an oversimplification of the global economic crisis for illustration purposes as there were many other factors responsible for the latest crisis [Sunwoong, 2010].

The use of knowledge in society

In 1945, after having published many writings about economic knowledge and related works, Hayek wrote, what could be considered, his most impressive work, namely "The Use of Knowledge in Society". In this paper, Hayek fostered the issue of centrally planned market or centralized decision making. This work was, to some extent, revolutionary at the time as most government had boards that made all of their economic plans centrally. It was not warmly welcomed by other economists either. There were several reasons for this, which will be discussed later. Hayek had the idea that knowledge or information is key to making decisions.

Therefore, he explored the methods by which one could gather the most accurate information in order to make the best decision possible. In light of this, Hayek developed some economic yet philosophic concepts about centralized market planning. According to Hayek, the board appointed by the government does not have the right information with regards to quantity as well as quality. Hayek further explained this essential information lies within the society. As he stated, each person in the society has a certain unique amount of knowledge or information that only they can possess. This means that the aggregate sum of knowledge of all individuals in the society is the most extensive knowledge available in terms of quantity. This aspect is fairly easily explained however the dimension of quality takes a bit more clarification.

According to Hayek, there are two types of information, scientific and time & place knowledge. The first kind, is gained through scientific research and learning from books and professional training. The second type of knowledge is gained through the unique life experience of each individual. Hayek insists that the second type, namely time & place knowledge is more important than the first type when it comes to decision making. He defends this by arguing that no two situations are exactly the same and therefore you cannot rely too much on scientific knowledge as this type of knowledge tends to assume exactly the same scenarios in order to provide the right decisions.

However, reality is that situations are never the same and the time and place of the situation is extremely important to be evaluated in order to make the right decision. These scenarios are interpreted differently by different individuals according to their relevant experience and knowledge. In addition, decisions are made as a result of building on previous knowledge which is a process that can only come as a result of experience (Lihui, et al., 2009).

The idea that the best knowledge in terms of quantity and quality lies within the society, lead Hayek to conclude that a central planning board cannot reach a better decision, than the conglomerate of the individuals within a society. This means that if each decision maker in business in a market makes a decision based on their own interpretations than the final outcome will be the best possible outcome because it has been derived from this pool of conglomerate knowledge which Hayek considers to be the best source of

decision-making knowledge. This led to the consideration of the disadvantages of the centrally planned market which was prevalent at the time that Hayek wrote this paper in 1945. This of course was criticized by many as it had many shortcomings; however, in the 60s it became a well accepted theory as the benefits of a decentralized market were evident by some of the countries, like the USA, that adopted such a model. As a result of this thinking the Free Market Economic Theory developed and spread further throughout the world. Another issue, which Hayek takes up in his paper, is that society gives too much credit to the so called scientific knowledge. Society expects that some credible authority should give his or her information which they can use to make decisions. In addition, society looks down upon those who use time and place knowledge to make decisions as if they are somehow dishonest or not credible. This does not stand, according to Hayek, because if it is true that scientific knowledge is the best type of knowledge then why is it that even the most "certified" economic knowledge that economists use can sometimes lead to disastrous results in some cases and to miraculous results in others. This inconsistency can be due to the issue of changing circumstances to which only time and place knowledge can be applied.

The importance of information

In a more recent publication, (1995), Drucker writes about the importance of information to executive decision making. In this aspect he focuses on the accounting information and its role in the decision making and the outcome of those decisions. He explains that many decisions are made based on accounting information. Traditionally, cost accounting developed by General Motors in the 70s, was used to organize information. However, in more recent times, activity based costing, is the preferred method.

The cost accounting method assumes that the cost of the total process is the sum of all the individual processes performed to achieve a task such as manufacturing goods. In activity based costing, processes not performed are also taken into account as they are seen to be costly as well. In other words, there is a cost to action as well as non-action. For instance, waiting for the shipment of parts has a cost which will be accounted for in the activity based costing.

This method, according to Drucker [1995], also gives results control. According to the same source, activity based accounting can also lead to cost cutting, as it evaluates processes in an integrated manner. It doesn't only ask the questions how many time should a process be performed, but also does it have to be performed at all and what is the best way to do so? Services tend to benefit more from activity based costing as they traditionally have a lack of information according to the cost accounting method [Drucker, 1995].

Conclusion

It can be concluded that knowledge is the key factor in making decisions in any market. This knowledge can be of different types, sources, interpretations and methods of organization. Some of the key issues pointed out in this paper are that using the aggregate knowledge of society is much more appropriate as a basis of decision making in markets than any particular knowledge possessed by a few individuals and certified by a particular authority. This in turn supports the free market concept of decentralized decision making. In addition to this, the methods chosen to collect this data such as different accounting models, can play a significant role on results control and risk reduction.

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