

The Coordination Problems, the Market and the Firm

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Abstract

In this paper I am concerned with the coordination problems and their solutions. The starting point is the distinction between two kinds of coordination as proposed by Klein (1997) and Sautet (2001). Although there is a slight difference in their views, basically they take the same position, which can be summarized as follows.

There are two kinds of coordination.¹ Type I coordination is a process through which mutual awareness of individuals' plans becomes gradually greater. Here coordination happens without individuals being aware of it and without ever knowing each other. Type II coordination refers to situations where one coordinates one's actions with those of others in a purposeful way. This kind of coordination problem can be assessed by the human mind. In this case the coordination is explicit and requires the use of certain common means to achieve a particular end.

The two authors argue that these two kinds of coordination are solved in two different ways. Type I coordination is the result of the entrepreneurial competitive process as described by Hayek (1946) and Kirzner (1973). An entrepreneur, by discovering profit opportunities, turns information into knowledge and tends to improve the degree of coordination of individuals' plans. Since past entrepreneurial acts create new profit opportunities (Holcombe 2003), this process never comes to a state of rest. Out of this process emerges a spontaneous social order that exists without being planned, which is based on abstract rules and has no particular purpose. Type II coordination is solved by rules or conventions such as "we all drive on the same side of the road". To put it differently, while the resolution of type I coordination brings about "a pleasing arrangement" (Klein 1997), that of type II means an agreeable interaction for the actors.

However, this simple schema poses additional problems. An important issue, which is discussed by neither author, concerns the role of firms in solving coordination problems. It is not clear whether firms serve exclusively to solve type II coordination or not. Similarly, neither is it evident that type I coordination can be solved exclusively by the spontaneous market process. A third issue to investigate is related to the question of whether the solutions of type I coordination could have an exclusively non-designed character.

The aim of this paper, through providing answers to these questions, is to contribute to a better understanding of the market and the firm. For this I will proceed in the following way. First, I differentiate, on the one hand, between the nature of coordination problems and their solutions, and, on the second hand, between the coordinating devices and the solutions of coordination. Second, I will argue that the term market has two meanings. The first is what is understood in Austrian economics: market process. The other one refers to a particular set of coordinating devices as an alternative to the firm.

This framework allows me to draw some new conclusions. (1) As far as type I coordination is concerned, the coordination is needed not because of decentralization itself,

¹ I use Sautet's labels, i.e. type I and type II coordination, while Klein calls these metacoordination and coordination, respectively.

but rather because of change. This being said, the appropriateness of the institutions that helps a spontaneous market order to emerge and allows market prices to coordinate (O'Driscoll 1977) must be discussed. A conclusion is that consciousness, to a certain degree, matters in markets too, just as it does inside firms. (2) On the other hand firms handle not only type II coordination problems, but type I as well. The CEO cannot coordinate the activities of others in detail, instead, the institutions of the firm like the institutions of the market, make coordination possible; this is type I coordination. (3) Regarding type II coordination, my argument is that there are market relationships (e.g., long-term contracts, supplier programs, joint ventures, etc.) in which individuals (firms) coordinate their activities in a purposeful way, which is similar to the way activities are coordinated inside firms.

To sum up, both the market and the firm could be seen as particular solutions for both kinds of coordination problems.

Key words: coordination, coordinating devices, knowledge problem, firm, market
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