Market Failure, Common Interests, and the Titanic Puzzle[1]

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Abstract: One important argument for the free market is that of the 'invisible hand' or 'private vices, public virtues'. That is, individual profit-seeking behaviour by suppliers will lead to better quality, lower priced goods for consumers than could be achieved by other means. Where this is so the market may be to the benefit of all, including the worst off. However, reflection on a range of cases – including what is here called the Titanic Puzzle, introduced by Thomas Schelling - shows that this is not always so. Where there are important market failures which may not be correctable within the market, the goal of helping the worst off and vulnerable can sometimes be best served by setting up structures which generate common interests between supplier and consumer. The goods considered here are termed 'high-fidelity slow-release' goods. They are those where consumption of the good is a lengthy or deferred process, 'escape costs' are high, and the quality of the good may vary over the life of the exchange, subject to the influence of the supplier even after purchase. Many long term financial products, and other goods such as education, plausibly have such character. An unregulated market for such goods is highly problematic.

1. Incentives, public benefits, and the free market

[1] I am very grateful to the participants in the Copenhagen conference on Equality 2004, for extremely useful discussion of this paper, and in the Lisbon workshop on philosophy and public policy in 2005. In particular I would like to thank Nils Holtug for his written comments which have led to a number of

Defenders of the free market often argue that in a free market it is possible to make a profit in a sustainable way only by giving people what they want. One inspiration for this argument is Adam's Smith's famous observation that 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own neccessities but of their advantages.' (Smith, 1904: Chap 1, Bk 2)

Now, it is true that over a very wide range of cases Smith's argument holds. Free competition and profit-seeking behaviour should drive out poor quality goods, and so it can be an excellent way of providing value for money for consumers. However, there is a question of how far this argument generalises. Opponents of the free market allege that consumers are likely to be tricked and cheated by ruthless capitalists in an insufficiently regulated market. The miss-selling of financial products a particular recent bugbear, but the concern is much older. For example it seems that it took the Adulteration of Food and Act of 1860 to stop publicans putting salt in beer and bakers chalk dust in bread in the U.K.

Both defenders and critics of the free market assume that capitalists on the whole pursue their self-interest to a high degree. Where they differ is in their claims concerning the likely effects of such behaviour: the invisible hand, or the slap in the face. Here I want to argue that although individual capitalists may differ in respect of their motivations, there is a more significant difference of which we should take note. The nature of some goods is such that the market for those goods will tend to drive up quality and drive down prices, but there are other goods where the market provides no such in built tendencies, and, indeed, the incentives of profit-seekers will not further the interests of consumers, especially those who are worst off. In such cases we will need to explore alternative ways

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of pursuing the interests of the poor, such as common provision or highly regulated markets, rather than the free market of classical economics.

2. A market for safety?

To illustrate the general issue I want to start by considering a remarkable passage from Thomas Schelling', which concerns the sinking of the Titanic and begins:

> There were enough lifeboats for first class; steerage was expected to go down with the ship. We do not tolerate that any more. (Schelling, 1984: 115-6)

One reading of this passage is that it appeals to what we could call 'the equality of safety' principle: that whatever else is true, inequalities in safety are not to be tolerated. Many people may find this appealing. But why? No doubt the first class passengers had access to bars and restaurants which were not open to steerage passengers. Some may object to this, or, at least, a society in which this is possible, and maybe with good reason. But a significant group of people, I conjecture, would be untroubled by inequalities in access to gourmet food, but troubled by inequality in access to lifeboats. Why?

Is there something special about safety as a good, or perhaps, anything special about markets for safety? Let us explore this through another example. In 1996 I met a man in Beijing who told me that his wife and mother-in-law jointly owned a factory in Southern China where they manufactured 'low standard car parts'. Many people in China, he said, drive old cars and when parts wear out they don't want to be forced to spend good money on something that may well outlive the car. They know low-standard parts are less safe but they take this into account when they buy them, and, perhaps, in their driving habits. Everyone knows the situation. The factory next door made 'one-week shoes': they look great on a big night out, but you throw them away when you get home. The only trouble is that, in both cases, middlemen buy in bulk, re-box them as the genuine article, and sell them abroad. At the time there had been a scandal in the UK about counterfeit car parts, and I had to wonder whether this man's wife was the not entirely innocent source of the problem.

While the idea of producing and selling low standard car parts may seem scandalous in these safety conscious times, it is as well to pause and ask why. What is wrong with allowing the sale of low-standard car parts? There is, after all, some room for variation in standards even in highly regulated societies. There would seem to be no bar to a manufacturer offering 'deluxe standard' parts, and so, by implication, suggest that others are relatively low standard. So it is possible to offer different levels of safety performance. In fact we see this with tyres, where expensive tyres are sold on the basis of the safety improvements they offer. And indeed it is possible - or at least used to be - to buy retreads or recuts. Variation in safety standards is accepted and understood, and we do allow people to purchase different levels of safety. Hence any grand claim along the lines that 'safety has no price', or 'safety should never be for sale' flies in the face of accepted commercial practice.[2] Nevertheless we do insist on minimum safety standards in this, as in so many areas.

One obvious reason for not allowing the sale of low standard parts is that, as we saw, they may be passed off as high standard. Another is that cars are a danger not only to the driver but to third parties who need protection. But to concentrate on the central issues let us assume away such market failures. Let us assume, first, that everyone has the same knowledge and no one can be deceived. This is not the assumption of perfect knowledge of classical economics, but rather an assumption of common knowledge, which I will put in terms of 'no asymmetries of knowledge', which allows symmetries of ignorance. Second, imagine there are no third party effects. Risks are taken only for oneself. Would there remain any reason for regulating safety if people knew that their choices affected only themselves, and they knew exactly the risks they were taking?[3]

[2] This should be sufficient to rule out any simple version of an argument, inspired by Walzer 1983, that safety constitutes a 'separate sphere', and so safety should never be exchangeable for money.
[3] For discussion of the question of whether people should bear the costs of their own choices see the papers in this volume by Ingmar Persson, Richard Arneson, and Andrew Williams.

A practical problem is that often we do not have a choice. Think about rail safety. If there were 10 completely independent operators running routes between London and Manchester, offering differing levels of safety at different prices then each of us could choose our own price/safety trade-off. But there is only one system and so no chance of setting a price/safety trade-off for yourself. Where there is a monopoly there is a monopoly safety level too. It seems that regulation is our only sensible option under such circumstances.

We have identified three ways in which real markets may fail to live up to the text book fiction of the perfect market: asymmetries of knowledge, externalities and monopoly. If we didn't regulate safety there could be disastrous outcomes in which traders exploited asymmetries of knowledge and monopoly positions, and everyone ignored third party effects. I understand China is experiencing a major breakdown in road safety. Perhaps a little more regulation of the standard of car parts wouldn't be a bad thing.

Do any of these arguments apply to safety aboard the Titanic? First, there is no obvious sense in which there are third party effects. Second, the suppliers of the good do not know more about the safety of the Titanic than the passengers: all were equally deluded. This delusion, is, of course, a concern, but it is not clear that it is salient here. After all, even if everyone believed the Titanic to be unsinkable, this does not rule out the possibility of the vessel becoming ravaged by fire, and so safe exit should always have been a consideration. Finally, as different safety standards could in principle be offered there are no monopoly effects to concern us. The source of our concern does not appear to stem from one of three standard forms of market failure.

In response, it could be said that there is something which could be called a third party effect which may be highly disturbing. In this particular case we are offering not purely a different level of safety, but, in the case of the ship sinking, a different form of treatment by other human beings. Differential entitlement to access to lifeboats would be horrible to implement and to police in an emergency. The ship's officers will effectively be sending people to their deaths. Perhaps it is the horror of that situation, and not differential safety per se, which determines our thoughts about the case. So let us change the case. No doubt there is empirical evidence about which cabins would be safer than others, given risks of explosion, fire and other hazards, as well as sinking. Would it be wrong for the owners of the titanic to place the first class cabins in the safest spots, and advertise that, say, they are 50% safer than the steerage cabins, as well as much larger, better appointed, and so on? Does this strike us as 'off-colour'? Or suppose a train operating company advertised that they were putting the first class carriages in statistically the safest part of the train (at the moment they are often at the front, the most dangerous part). I predict that the press would attempt to manufacture an 'outcry' about this, and may have some success, whereas other differences are accepted without comment. I am not suggesting that the outcry is obviously correct, but there seems more resistance to market pricing of safety than to other issues of consumer choice.

The source of this resistance may be clarified by considering a modification of the Titanic example, in which each comfort class came with two possible levels of safety. People could pay a supplement for a higher level of safety within any class of travel. Perhaps the inequality in safety between first class passengers would not trouble us. Those who decide to save what for them is a little money, we might think, should be entitled to make their own decisions. If this is right, then the problem is not inequality in safety per se, but rather the inevitability that the poor will suffer reduced safety if safety is left to market pricing. The concern, then, is that the inequality that will inevitably follow market pricing will, most likely, adversely affect the poor.[4]

3. Further arguments for regulation

We have seen a number of arguments for regulating safety based on the idea of market

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[4] I'm grateful to Nils Holtug for clarification on this point.

failure. Yet we have also noted that there is some intuition that the market for safety should be regulated to protect the poor, who inevitably will find themselves subject to higher risks, at least on average, if safety is market-priced. What lies behind this intuition?

Perhaps this is best explored by considering its denial: the argument that ‘if the poor wanted better safety then they can purchase it’. This counter rings hollow. Safety is rarely perceived as urgent as buying food or paying a utility bill. Importance and perceived urgency can easily come apart.[5] People can be tempted to skimp on safety, when this was against their interests, values or true preferences. Mandating equal safety, so it could be argued, is required in order to protect people from themselves. There are many ways in which such an argument could be developed, and there is little to be gained by going through the possible variations. The important question is whether such arguments prove too much. If an argument along these lines can be constructed to support equal safety standards, can it be stopped from spreading to equal food standards, or levels of cabin comfort? After all, better food and a better bed may also lead to a healthier, longer life. Yet many who argue for equal safety standards would not object to market provision of food of varying nutritional value, and cabins of different comfort levels.

Perhaps the answer is that while any inequality will in some degree, undermine the idea that we are all equals, some inequalities appear to do this in a more devastating way than others. Accordingly some inequalities will be thought to be relatively trivial, and permissible as a way of allowing greater individual choice, and a richer texture of opportunities and variations within society, others bite too deep and do too much violence to the idea of a society of equals. Arguably inequalities in health and safety are, in some cases at least, on the intolerable side, while inequalities in comfort are, on the whole, tolerable in this respect.

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[5] Anyone who has rushed to meet an urgent deadline on a trivial matter should be familiar with this distinction.

But why? One argument is that certain inequalities can take on a particular symbolic value. Inequalities in access to particular goods can have an enormous social importance, even if the goods themselves are not very important. For example, racial or religious exclusion from a golf-club has been used deliberately as an instrument for sending the message that the races or religions are not equal. Here, though, context is all and the main issue is whether a group which has previously suffered from discrimination is also excluded from access to the good in question. Indeed I have argued elsewhere that in such cases levelling down can be justified (Wolff, 2001, drawing on arguments from Phillips, 1999).

I accept, then, the argument that differential access to goods symbolises and encourages inequality among citizens when it correlates with a salient social distinction involving previous discrimination. Does this help in this case? I doubt it. Most thinkers within the broad egalitarian tradition accept that even in a just society some people will have more money than others. But if those who are richer than others are not permitted to purchase things that the poor cannot also buy then this is a way of saying that inequalities in holdings of wealth or income are not permitted after all. Excluding access to goods on grounds of relative poverty is a natural consequence of differential wealth and income and not a form of arbitrary discrimination.

The only other 'symbolic' argument I can think of is that certain goods are considered so important that differential access to them is considered unacceptable, even if the consequences would be reasonably favourable. This may well explain why John Stuart Mill's proposal for plural votes for the wealthy or educated, to save the poor from their own lack of understanding of economics, has attracted no support. Having the same say as others in the electoral process is considered of extreme symbolic significance. Yet to say that safety has such a precious status seems to me in need of justification both conceptually (what is the argument?) and empirically (what is the evidence?). I do not wish to assert that there is nothing to the case, for it may have some plausibility. Yet to rest with such an assertion would be an unsatisfying end point.

4. Difficulties with regulation

We have been considering the proposition that equality of safety is required to protect the poor. Yet some will argue that this gets things backwards. In general, refusing to allow people to make their own consumption decisions about safety is irrational, and against everyone's interests. Insisting that everyone purchases the same level can be argued to be especially unfair to those who put a lower price on safety – again most likely the poor - who may generally prefer to take greater risks in order to have more to spend on other things. And, equally, it may be unfair to those who would want to pay more. Like all averaging strategies it will exactly satisfy only a very few. Consequently from an egalitarian point of view it seems possible to argue that while regulation is a strategy designed to help the poor, in the sense of protecting their safety, it may, in one important sense, actually make them worse off. Hence unless regulation is backed by subsidy it looks far less attractive from an egalitarian point of view.

5. The plot thickens

It seems hard, then, to find arguments to support the 'equality of safety' principle which appeared to underlie Schelling's argument. However, appearances can be deceptive, as we see when we read how Schelling continues the passage:

> Those who want to risk their lives at sea and cannot afford a safe ship should perhaps not be denied the opportunity to entrust themselves to a cheaper ship without lifeboats; but if some people cannot afford the price of passage with lifeboats, and some people can, they should not travel on the same ship. (Schelling 1984: 115-6)

Amazingly, then, the concern Schelling is reporting seems not to be with minimum safety standards, or equal safety standards within society, but simply equal safety standards within a tightly defined group. And remember that in the particular case Schelling describes we are talking about equality within one of the most status conscious sub-populations there has ever been; the passengers on the Titanic on its maiden journey.

What arguments can be made to support the idea that equality should obtain within a group but that equality between groups is less important? One argument appeals to the instrumental benefits of a uniform safety standard. One version of this points to the negative effects of differential standards: the bitterness and resentment it may cause. This is rather like the policy that children on a school trip should all have the same amount of spending money. Furthermore it doesn't seem to matter if children on a different trip all have more: equality within the group is the thing. The idea, presumably, is that if some children within the group have more to spend than others, this could cause jealousy, arguments, bitterness, division and resentment, all of which are undesirable in a school trip, part of the point of which is to encourage solidarity and a sense of a group ethos. Perhaps for adults we become used to the idea of differential spending power, but differential provision for our safety may well stir up a host of undesirable side-effects.

Now although there may be truth in these psychological claims, arguments from envy, and social division, need to be handled carefully. Although I would not agree with those who say that issues of envy should always be irrelevant to questions of justice, I would suggest that unless the envy is justified on the grounds of independent injustice, the proper response may well be therapy rather than levelling down. Psychological arguments against inequality seem not to take us very far. Rather, a positive argument for equality is what we seek.

6. Risk and common interests

A second instrumental argument for equality, however, seems to me far stronger. Here it is argued that uniform safety standards are required for the sake of the worst off in a much more direct way. The argument is that the poor will be safer in a vessel in which no one has access to a lifeboat than in a vessel in which only some have access. The general point can be made by means of John Adams' theory of risk compensation, which says that as an individual's environment becomes known to be safer, that individual will tend to change their behaviour maintaining a relatively constant rate of risk, consuming safety improvements as performance benefits (Adams, 1995). Hence if the environment becomes safer for those in control, and their decisions impose risks on others for whom the environment has not changed, then these others will find themselves facing bigger risks. Consider Adams' example of seatbelts in cars. Adams claims that the initial effect of making seatbelts compulsory for car drivers was to increase the number of passenger deaths (Adams, 1995: 121ff). Hence, with respect to cars, there is good reason to insist that all should wear seatbelts or none, or all but the driver, but certainly not the driver and no-one else. In the case of the Titanic, if the Captain was assured of a place in the lifeboat, or even that the people he most cared about were assured of their place, then he may well have steered a riskier course than otherwise. This is an analogue to the familiar problem of 'moral hazard' in insurance, reducing people's incentives to take care. This may well be why the Captain is supposed to go down with the ship, or, at least, be the last one off.

There are, thus, cases, where one person's fate is intrinsically connected with another person's decisions. Could it be that the only way to ensure that everyone's interests are properly taken into account is to give everyone the same interests? Sometimes we need to make it the case that, either literally or metaphorically, we are all in the same boat: and we so will all be affected in the same way by the decisions of some. Accordingly, the underlying idea that some inequalities do more than others to undermine the idea of society as an association of equals receives a straightforward interpretation. It is that in some cases inequality will lead to the interests of some being undervalued or even ignored. In general these will include cases where a single, central decision needs to be made which will impact on all the members of a group

It has often been noted that societies, like the UK, which allow private health and private schooling in the name of freedom of choice, have not paid proper attention to the importance of creating common interests: setting up structures which force decision makers to take account of everyone's interests if they take account of anyone's. If decision makers and the rich are not using public services then those who do must rely on the goodwill and beneficence of the wealthy and powerful. As many commentators have noticed, these are fragile motivations. It would be much better for the poor if the pursuit of the self-interest of the rich benefited the poor too. Hence there is a Rawlsian argument for what might look like levelling down but what, in certain cases, actually improves the situation of the worst off: the abolition of private schooling and healthcare.

If, however, this 'common interests' argument is to do the work we need, explaining why our attitude to lifeboats on the Titanic is different to our attitude to its restaurants, then it must also be the case that variation in food standards will not lead to a significant falling off in nutrition for the poor. Here, I think, it could be argued that variation in food standards is better for the poor, as it allows them to tailor their provision to their preferences, rather than being forced to purchase better, and so probably more expensive, food when they would rather spend the money on something else. However we have already encountered this argument before, as a defence of allowing a diversity of safety standards. What is the difference?

7. The problem of 'slow-release' goods

To understand the different it is important to contrast two difference decision making contexts. In one there is a single decision to be made, which may be of huge consequence, with only limited possibility of correction, or recovery, if any. In the other there are many small decisions, none of them disastrous if they go wrong, and a bad strategy – within limits – is fairly easily reversed by changing one's policy for the future. In this latter case freedom of choice may well help the worse off. Recall a remark made earlier: that the poor do better when the rich have an incentive to make decisions that also help the poor. This, we noted, is the classic defence of the free market: one can only enrich oneself by providing things that others want to buy. Hence a market, at least one with proper information flows (which in this context means the possibility of learning by experience and acting on that knowledge), no third party effects and no entry barriers, will help the poor, as many libertarians have argued, trying to snatch the Rawlsian ground from the interventionists. But, if so then, once again, why not a market in safety?

Here we must notice that the market for safety – and for health and schools – fails to meet the conditions just set out for where the market works best: numerous small decisions, little potential for disaster, and the possibility of learning by experience and changing strategy without cost. These are the conditions of the ideal markets of the 'private vices public virtues' textbook; what we can call fluid markets. By contrast, where one is purchasing schooling, or health or safety, or, indeed, many financial products such as pension schemes, markets are quite different. In fluid markets even relatively impoverished consumers have the power to harness the rich's self-interest, for they can defect if they don't like what is on offer, and the possibility of learning by experience and defection is a good remedy for asymmetries in knowledge. By contrast, where you are purchasing what we could call a 'slow release' good this is much less the case. A standard slow release good is here understood as a good where consumption is deferred over time, where payment is either upfront or legally binding over time, and where to change one's decision is costly. A 'high fidelity slow release good' has one additional feature: that the quality of the good remains under the influence of the supplier between the time it is purchased and the time it is consumed.[6] A savings plan, your safety on a

[6] The term 'high fidelity' is inspired by the slogan of the Lloyds's of London insurance market: 'utmost good faith'; something, as it turned out, many insiders exploited ruthlessly.

voyage, and an education for your children, are all of this nature. In this case, once your decision is made you are stuck with it for some time, unless you are prepared to pay various types of penalties, and if it goes badly you might not have a second chance. And it might go badly because of the action or inaction of the supplier. You can end up with something you did not think you are buying. Regulation then becomes very much a live issue.

To see the importance of context, consider two possibilities aboard the Titanic for providing food. First, a complete ‘meal plan’ is purchased with one’s ticket, with no possibility for change, and you are simply provided with whatever is chosen as the dish of the day. Here food is treated as a high fidelity slow release good. Second, numerous restaurants operate, all run as competing, profit-maximizing, private concerns, in a fluid market. In the first case there may be reasons for wanting there to be only one meal plan, and therefore find oneself eating the same food as those who are deciding what food is to be made available, or at least eating the same food as those they wish to impress. Otherwise, leaving aside long-term reputational effects, which may or may not be effective, what incentive is there for the food suppliers to keep up the standards? Yet it would be odd to want to move to such a situation if one was in the genuine free market, with competition for one’s business and a wide range of food choices. Here those who supply the food have an incentive to make sure it is of good standard if they want to be able to sell you anything tomorrow. It seems clear, then, that market pricing suits some contexts of delivery, while generating common interests suits others. Generally safety falls on the latter side, as it is hard to see how to arrange fluid markets in safety, and food, at least above a threshold, the former (keeping in mind the importance of information flows).

Suppose we are convinced that there are times when consumers need producers and suppliers to be consumers of their own products, as the only way of ensuring that quality standards are maintained. Is it not the case that the market can supply this itself? Why shouldn’t a firm advertise that all its executives use its products. Indeed this is a familiar tactic. However, first, we don't know for sure that they are, even if they say they are. Second we don't know whether they rely on the product in the way others might. A Director of a pension company may well spread risk in a way no other customer could afford, for example. Hence, at a minimum, high regulation seems appropriate. In essence my argument is that those who want the best for the worse off should, in some cases at least, be libertarians if it is appropriate to create fluid markets and old fashioned socialists when high fidelity slow release goods are in question.

8. Conclusion

The Titanic puzzle allows us to bring out a distinctive type of market failure: where the supplier's pursuit of self-interest may, contrary to orthodoxy, harm the interests of consumers. This will particularly be the case with regard to what have here been called 'high fidelity slow-release goods' which are reasonably common and familiar, if rarely isolated as a special category. The solution suggested here is, in effect, to create common interests by forcing suppliers to consume their own products. Of course, this is not going to suit all cases. But where it does apply then we can have greater assurance that private vices will bring about public virtues over a wider range of goods.

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