Erasmus Journal for Philosophy and Economics,
Volume 16, Issue 2,
Winter 2023, pp. 85–106.
https://doi.org/10.23941/ejpe.v16i2.809

Repoliticizing Privatization

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Abstract: According to Joseph Heath, privatizations should be judged on a case-by-case basis with appeal to the Pareto criterion. This approach, or so I argue, amounts to a depoliticization of privatization. While Heath's approach is effective and at times illuminating, I show that a consistent application of his methodology is self-defeating in that it eventually requires a politicization of privatization. With appeal to transaction cost theory, I show there are *social* costs associated with affirming the competitive pressures of the market. Subsequently, I argue that while private actors may, according to Heath, pursue efficiency with appeal to an adversarial morality, state-owned enterprises (SOEs) are much more constrained in how they may achieve such gains. Due to the pressures of liberal neutrality, SOEs may chase efficiency only without setting actors back. Conversely, the private sector's potential for success is predicated on its ability to compete for Kaldor-Hicks efficiency, which specifically allows for win-lose interactions. While SOEs are often no more able than the private sector to achieve Pareto optima, this discrepancy makes it so that SOEs produce gains that are ex-ante lower but more equal, whereas the private sector produces gains that are ex-ante higher but more unequal. Thus, the social cost of affirming the competitive pressures of the market is ex-ante inequality. If this premise is accepted, there is no way to avoid the conclusion that a consistent case-by-case approach requires a structural, political view on how privatizations affect the state's ex-post Pareto-enhancing abilities.

Keywords: Pareto, Kaldor-Hicks, market failures, SOE, state-firm analogy, transaction costs, cooperation, competition, liberal neutrality, inequality

JEL Classification: H4, H6, L2, L3, P16

I. INTRODUCTION

While the Dutch railways were slowly being privatized between 1995 and 2002, ministers overseeing the process had to contend with a persistent wave of public discontent. The privatization project had been plagued by severe teething troubles, resulting in overfull trains, cancellations, and personnel shortages, as well as a palpable sense of patriotic loss. Something, so the public felt, was being taken from them. The preceding decades had already been characterized by widespread privatizations of many traditionally state-governed industries. Yet where an earlier governmental consensus touted the virtues of the market in all contexts, modern critics had grown steadily dourer. They pointed to the staggering failures of several privatization efforts, at least in part due to—or so the argument went and still goes—a colonization of the public by the private.

Naturally, the subject has not left political philosophers cold, either. In more recent years, calls for a reevaluation of the supposed boons of privatization have seen a marked resurgence. Many of the most popular criticisms adopt a distinctly deontological hue (Cordelli 2020; 2021).[1]

Joseph Heath's article is a nuanced, thoughtful counteroffensive to the counteroffensive. It is also simultaneously an extension to and combination of his work on the market failure approach (Heath 2023b) and his ideas about public governance (Heath 2022). On Heath's view, there is no knockdown argument against privatization as such. Rather, any given instance of (de-)privatization should be judged on a case-by-case basis against the value of Pareto efficiency. "This is a view", so says Heath, "commonly held by economists, and much less commonly held by philosophers and political theorists" (2023a, 60). Values like equality, justice, or other "basic principles of political philosophy" (30) are often irrelevant to a public manager's generally non-ideological "pragmatic managerial decision-making that merely adjusts the inevitable boundary between public and private" (31). On my view, Heath's account thus amounts to a *depoliticization* of privatization.

Yet depoliticization need not be a dirty word. In fact, Heath's depoliticized account of privatization is immensely attractive! Its considerable strength derives not only from its intricate systematization of the various forms privatization may take, but also from its common-sensical formulation. That is, *if* one accepts—like many economists do—that "state involvement in the economy should be guided primarily by the norm of

[1] A significant exception is Satz (2019).

[Pareto] efficiency" (60), *then* it would certainly be prudent to assess whether this norm has been satisfied on a case-by-case basis. Indeed, this rather modest conclusion is difficult to argue with.

Of course, many philosophers and political theorists alike reject this type of Paretian view wholesale. At least part of the reason for that is the growing body of economic data—as well as robust philosophical argumentation—suggesting that a healthy skepticism vis-à-vis whether Pareto efficiency should be considered a *primary*, and not just an instrumental, moral value is warranted (Piketty 2021; Vrousalis 2023). This is particularly poignant in the case of Paretian wealth inequality—astronomical (and rising) inequality that is, nonetheless, perfectly Pareto efficient (Jones 2015; Robeyns forthcoming). Insights like these inform the view that, although the state should by no means completely disregard efficiency-considerations, there are other, oftentimes much more important values involved in statecraft—most particularly those pertaining to the maintenance of a cooperative social ethos (Cohen 2008; Furendal and O'Neill 2022).[2] Of course, there are very strong reasons for generating the desired ethos in the most cost-effective manner, but this is far from positing that Pareto efficiency should be the state's lodestar value. Thus, I think Heath's ongoing attempt to articulate the state—even just its economic functions—as an institution chiefly geared towards efficiency gains is largely beside the point.[3]

Yet because his position is commonly held by many a chief economic advisor and policy maker, it is worth meeting Heath head on, on his home turf. This entails adopting not only the Paretian 'Market Failures Approach' (Heath 2014), but also the relatively inoffensive conclusion that follows from it with regards to privatization. By depoliticizing the practice, Heath seems to sidestep several important considerations that make the question of privatization much more amenable to 'basic principles' of political philosophy. However, or so I argue, taking seriously his own approach eventually obliges him to also take seriously the question of structural power between private and public actors regardless. Crucially, my account shows that this does not require importing deontological considerations, nor adopting a socialist political morality: *a simple appeal to*

[2] Incidentally, this is often where the core of modern egalitarian resistance to privatization seems to stem from: not from an appeal to an ideological "distaste for the commodity form" (Heath 2023a, 35) nor "promoting greater equality" (60) in the myopically distributive sense. Although Heath may be forgiven for thinking so, because a majority of egalitarians seem curiously unaware of this themselves.
[3] See Heath's nonetheless brilliant *The Machinery of Government* (2020).

efficiency suffices. In brief, even depoliticizing privatization cannot shield Heath from its immanently political nature.

The argument will unfold as follows. Section II will expand on and adopt Heath's usage of the 'transaction-cost approach', arguing that while Heath incisively presupposes there are social costs associated with not privatizing, there must also be similarly social costs associated with, in fact, privatizing. Section III will go on to establish that there is a marked distinction between how privately-operated enterprises and state-operated enterprises are morally authorized to approach the question of efficiency maximization. Section IV consolidates the previous two sections by demonstrating that this distinction points towards the idea that social costs associated with privatization are best expressed as ex-ante inequality. Section V shows how this conclusion forces Heath's methodology to include political sentiments so as to further a view on the state's ability to turn ex-ante Kaldor-Hicks gains into ex-post Pareto gains. Section VI concludes.

II. THE TRANSACTION-COST APPROACH TO THE STATE

To set the stage, Heath invokes a particular economic parlance in his argument. In meeting him on his own territory, this parlance will prove to be extremely productive. To illustrate that setting the boundary between public and private is chiefly an efficiency consideration, Heath appeals to the 'make or buy' decision which "has figured centrally in the transaction-cost theory of the firm" (2023a, 30). The idea is as follows. Before the early 20th century, economic theory tended to treat firms as essentially black boxes; this changed with Ronald Coase's landmark 1937 paper "The Nature of the Firm". Coase asked a brilliantly simple question: If the market is so efficient, why are there firms? Indeed, why do these black boxes, strangely authoritative in nature, even exist when the market is able to allocate resources perfectly well through competitive means?

The answer Coase landed on was equal parts brilliant and simple: if there are firms, that must mean there are certain hitherto undiscovered costs associated with using the competitive price mechanism. Firms, after all, are characterized by "the supersession of the price mechanism" (389), after which the "entrepreneur-co-ordinator, who directs production" (388) takes over. This regime, Coase notes provocatively, is not at all unlike "what is normally called economic planning" (388).[4]

[4] This insight is taken to entail very productive, albeit contested, conclusions in Phillips and Rozworski (2019).

Of these costs associated with using the price mechanism—*transaction* costs—Coase brought to light three. And although modern transaction cost economists, building on Coase's insight, have meticulously specified and added to the concept,[5] just one will serve to illustrate Heath's point. Bargaining costs, or the "costs of negotiating and concluding a separate contract for each exchange transaction which takes place on a market" (390–391) were, according to Coase, able to severely hamper the price mechanism's efficacy. Indeed, metaphorically bargaining with every fisherman for every single fish caught can obviously be nigh-eliminated by drawing up long-term, incomplete contracts.

By dint of the above, it is not difficult to see that in many cases, it is simply cheaper to 'make' a product in-house by hiring long-term employees than it is to suffer the costs associated with having to 'buy' a market contract for that same product. And, in "strikingly similar" (2023a, 30) fashion, or so Heath argues, the decision whether a service should be privatized or kept 'in-house' falls mainly to a comparing "the state's 'agency costs' […] to its 'contracting costs'" (31).

Perhaps a knee-jerk reaction to this argument would be to accuse Heath of surreptitiously invoking the state/firm analogy—a device nowadays often considered a non-starter for various reasons (Frega 2020). This would be a mistake; Heath is doing no such thing. He is merely arguing that the state's economic functions appeal to the same considerations as the firm's economic functions. This is a far cry from appealing to an analogy that takes state and firm to be similar in structural, philosophically salient ways. Indeed, Heath takes special care to separate the state's core functions from its economic activities (2023a, 26).

Yet Heath takes his transaction cost approach to the state even further. Heath argues that there are, like transaction costs that are associated with using the price mechanism, also "some hidden costs associated with state involvement" (60) that do not arise in the private sector. That is, in furnishing a counterargument to the egalitarian rationale holding that inefficiency is "a cost worth bearing for achieving the more egalitarian outcomes" (60), Heath supposes that bad state performance in optionally public environments—environments in which *public* provision is not a requirement—often causes citizens to develop structurally negative attitudes to state involvement in general. In turn, so says Heath, this can easily evolve into "easy fodder for right-wing politicians with an ideological hostility to government activity in all domains" (61). In brief, what Heath

[5] See, famously, Oliver E. Williamson (1975).

is demonstrating, in astute fashion, is that there are also costs (or risks of costs) associated with *not* using the price mechanism. These costs, however, are of a social caste.

It must at this point be noted that this observation may appear more profound than it really is. Indeed, a very similar phenomenon had been hypothesized some decades ago by Henry Hansmann (1996). Hansmann deduced certain "costs of ownership" on the level of corporate governance which feature most prominently in democratic firms, pertaining to the costs of collective decision making (45); call these *cooperative costs*. The general idea is that decision-making does not take much time, nor deliberation, for firms that appeal to shareholder primacy. Shareholders simply tend to want the same thing: to maximize shareholder value. In turn, this drastically lowers collective decision-making costs in comparison to, for instance, worker cooperatives where different workers may have wildly differing interests and preferences depending on their position in the collective, which department they work for, which colleagues they personally admire, and their idiosyncratic ambitions.[6] Insofar as, on Heath's diction, the state's economic functions resemble the firm's economic functions, one can see how his process may be construed as a 'cooperative cost'.

Yet it takes some analytical finesse to see Hansmann's discovery as a particularly *social* cost. Indeed, an ostensibly more unambiguous example is the converse instance that socialists of various stripes have long perceived. According to these scholars, it is using the price mechanism that in fact comes paired not just with transaction costs, but with social costs, as well (Arnold 2020; Maguire 2022; Vrousalis 2012). Call these *competitive social costs*. This extremely large literature on how the market may inspire greed, forces us to instrumentalize each other, or excludes certain individuals (cf. Frye 2023) is, of course, highly contested. More recently, however, less controversial literature has in a similar vein and relevant to our purposes argued that continual governmental outsourcing results in

[6] Abraham Singer, in contrast, argues that "the time and energy, or even the money, spent on democratic decision-making might not be deal-breakers", and that "workers might be willing to bear these costs for the ability to democratically control the workplace" (2019, 151). The real problem, so he posits, are the costs incurred by poor decisions—qua efficiency-considerations—that may follow from democratic control. Yet this view is certainly not uncontested, either. Felix Gerlsbeck and Lisa Herzog (2020), for instance, have argued that epistemic arguments surrounding democratic costs traditionally used *against* worker ownership, should in fact count *in favor* of it. On their view, workplace democracy can "effectively harness latent information distributed throughout a company, allow for multi-perspectival decision-making, and facilitate adaptation and reflexivity" (329).

a decimated, infantilized public sector (Mazzucato and Collington 2023). Somewhat surprisingly, various libertarian writers have also run with this originally socialist premise, yet argue that the social externalities of the market are, in fact, broadly positive (Tomasi 2012; Brennan and Jaworski 2015). Of course, there are also positive social externalities associated with public provision; where failing public institutions may erode it, they may also facilitate trust in a way the private sector cannot when they *do* work (Faulkner 2018). Heath is, of course, duly aware of this (2023a, 61). The upshot, however, is that various theorists agree that, in addition to efficiency costs associated with using the price mechanism, there are social costs (or benefits) associated with affirming the competitive pressures of the market.

All this goes to say that Heath's appeal to transaction cost theory points to a social phenomenon looming over the question of privatization in general—a phenomenon that is, unfortunately, not easily perceived when utilizing a strictly case-by-case methodology. And while it may seem somewhat uneven that Heath temporarily departs from evaluating each separate case of privatization "on its merits" (41) to further a structural (and compounding) argument against public provision, his insight does provide us with a method. In brief, like Heath argues that there are cooperative social costs involved in matters of public provision, it is clear that privatization may incur similar competitive social costs, which make singular instances of privatization even trickier to assess. In the next section, I will argue that a conception of competitive social costs does, in fact, not need to depart from Heath's approach by appealing to controversial socialist assumptions. Indeed, these social costs can be cogently expressed in terms of efficiency.

III. WHAT KIND OF EFFICIENCY?

To express competitive social costs in terms of efficiency, however, it is imperative we specify what kind of efficiency we are talking about, as well as determine how the economic functions of both public and private sector relate to those conceptions. While I agree with Heath that the firm and the state's economic functions are comparable in a relevant philosophical sense vis-à-vis privatization, without falling prey to the firm/state analogy, it bears keeping in mind that many modern theorists reject this analogy for an extremely pertinent reason. That is, firms, unlike states, draw their legitimacy from their "functional role" (Frega 2020, 19). According to Abraham Singer, what characterizes the firm in normative terms is "the

competitive market environment in which the corporation operates, which presents itself as crucial given the *efficiency rationale* we have ascribed to firms" (2019, 140, emphasis mine). In essence, Singer's insight is the philosophical operationalization of Coase's economic insight: if firms are not more efficient than the market, why would there be firms at all? And given that there would be no firm if it were not more efficient than the market, it follows that efficiency must always remain the firm's *raison d'etre*—lest it ceases to exist. Crucially for our purposes, it is important to note that the state lacks such a demanding efficiency rationale. Indeed, the egalitarian view that Heath resists suggests that the state is sometimes *required* to be inefficient in order to achieve more equality. As I will show, it is this crucial difference between firm and state that results in both institutions differing severely in their 'efficiency mandates'—that is, the manner in which they are morally permitted to pursue efficiency. This fact, in turn, will eventually make it difficult for Heath's methodology to entirely circumvent more nakedly politicized (and egalitarian) considerations. More specifically, in this section I show that where privately-owned enterprises may (indeed, must) pursue Pareto efficiency indirectly, state-owned enterprises are permitted to do so only directly.

III.I. Competition, Markets, and Pareto Efficiency

The genius of the market—indeed, why it works like it does—is that it repurposes the otherwise deleterious free rider incentive. The incentive unfortunately tends to eat away at gains from cooperative endeavors; more specifically, it tends to generate compliance problems. Readers of this article should be intimately familiar with the phenomenon, since most student group assignments suffer from it. Teachers rarely do not suspect this one particular student (you know the one) of being a free rider that has probably contributed to the project much, much less than their peers. 'Probably' is the operative word, here, since the fact that we can never know for sure makes it so that "patterned arrangements are often feasible only where there is close to perfect observability of contribution as well as a mechanism in place to punish free-riders" (Heath 2023b, 55). It follows that the more actors enter a cooperative scheme, the more deleterious the free rider incentive becomes, and the less feasible the cooperative scheme.

Sometimes, however, *competitive* schemes[7] are able to put the free rider incentive to work instead. By offering 'the best' participant some type of substantial reward, compliance problems can be circumvented. Competitors no longer have to care about the team, or a collective purpose, of the cooperative scheme; they only have to want to win. Importantly, however, winners now have to win *at the expense* of other participants. In essence, competitors have to "defect rather than cooperate" (Heath 2014, 96). The gains that can be made through the competitive scheme often far outweigh the gains that could have been made cooperatively, however.

The market is precisely such a competitive scheme, and one Heath has analyzed extensively. According to Heath,

> there is nothing magical about the ability of markets to transform private vices into public virtues. This sort of laundering is a general feature of all competitively structured social interactions. And like all other forms of competition, market competition must be governed by a set of rules, *restricting the range of strategies* that individuals may employ, in order to ensure that it remains healthy. (2014, 101, emphasis mine)

If properly restricted and regulated, market competition through profit maximization tends to generate Pareto efficiency; per the fundamental theorems of welfare economics, so says the familiar formula, results making "at least one person better off without making anyone worse off" (2023b, 31) are entailed by the disciplining nature of perfect competition (Arrow 1973).

It is at this point crucial to note that a new set of *competitive* compliance problems may arise in any given competitive scheme, including the market. More specifically, this particularly competitive form of a cooperative structure entails it is liable to devolve into a 'race to the bottom'. The global financial crisis of '08/'09 should now immediately come to mind. But, of course, we must note that this liability is the very reason that the market works so well when it does work. Indeed, competitive attitudes can bring about a "much higher level of performance than anyone would have thought possible […] it may produce outcomes far superior to what mere compliance could have achieved" (Heath 2023b, 58). In summary, because competitors do no longer have to be concerned with

[7] I follow Hussain (2020) in considering competition to be just another cooperative scheme, yet one that appeals to a set of rules that structure competitive interactions.

the team or a collective purpose, they are "merely obliged to respect certain *outside boundaries* in the pursuit of their private interests" (Heath 2023b, 66, emphasis mine). What these 'outside boundaries' consist in is expertly defined by Heath's Market Failures Approach (2014); but, unfortunately, the very structure of a competitive scheme "precludes this sort of high-mindedness" (98), and so often the outside boundaries will have to be forcefully maintained. As we have seen time and time again, a failure to maintain healthy market competition—to restrict the range of strategies allowed—sees the inherent liability of competitive schemes result in market failures that are utterly ruinous to society at large. But if everything works, it works *really well*.

All this goes to say that Pareto efficiency is essentially an accident. It is, as Heath has it, "necessarily a byproduct of the competitive activity" (98). This means that firms do not, in fact, strive for Pareto efficient outcomes. Indeed, they *should* not, because the very idea of Pareto efficiency entails a focus on winning, which in the market context amounts to maximizing profits. Call this this phenomenon the 'market efficiency mandate'.

It should be no surprise, then, that actual Pareto optima are few and far between. The idealized circumstances required for perfect competition are rarely, if ever, met. But this is not the point of Heath's Market Failures Approach. Heath's argument is simply that Pareto efficiency should be the market's normative standard. In reality, markets much more often produce Kaldor-Hicks efficient outcomes. The Kaldor-Hicks norm denotes an interaction that is simply "aggregate-welfare-enhancing" (Moriarty 2020, 118). That means that while the Pareto standard is restricted to generating win-win situations, Kaldor-Hicks may produce win-lose situations *as long as the winner's gains are large enough to compensate the loser's losses*. It is, so to speak, unconcerned with *if* gains made are distributed ex-post, as long as they *could be*. The Pareto standard, in contrast, can be expressed as a pre-distributive, relational principle: gains may be made only such that there are no losers, and so that winners cannot win at the expense of others. This is, of course, why only Pareto efficiency is relatively uncontroversially considered to be not just an economic, but also a moral principle. Kaldor-Hicks efficiency specified as such is much, much more difficult to defend on moral grounds.[8]

[8] According to Singer, "to be relatively indifferent to efficiency is to be relatively indifferent to human welfare" (2019, 27). It is extremely difficult to imagine that he intends to refer to Kaldor-Hicks efficiency here.

III.II. Competition, Schmarkets, and Pareto

Governments have, of course, long realized the market's ameliorative qualities. Indeed, the past century is perhaps best characterized as the period in which the state had "discovered that an institution possessing a monopoly of force could also be an important economic actor" (Heath 2023a, 27). While its economic endeavors have not always been successful, there is something significant about the behavior of state-owned enterprises (SOE), or so I will show, that recontextualize the question of privatization when analyzed over lines of efficiency.

Since the state lacks the firm's efficiency rationale, it is able to adopt multiple—sometimes even conflicting—values. Indeed, this is why SOEs are often derided for "the possibility that in conducting business, government-owned or -controlled entities may [...] substitute political ambitions instead of or in addition to profit-making" (Malkawi 2019, 23). Yet it is precisely this ability that allows government to "accomplish certain tasks that no private actor seemed prepared to take on" (Heath 2023a, 27). As is well known, the state's economic endeavors are not necessarily motivated by the promise of profit, but often include a range of noncommercial objectives motivated by "the presence of significant positive externalities" (36), as in the case of education, or because the state is in various circumstances "not vulnerable to adverse selection" (36) or moral hazard (see also Horne and Heath 2022). Heath is—and so am I, in staying with his logic—inclined to explain this away as the state correcting market failures. And while this may be the case, it is important to in addition note that it is able to correct those market failures in large part *because* it lacks the firm's efficiency rationale.

As a result, the state is able to erect 'schmarkets'—competitive environments that *simulate* market competition where it would, in actuality, be impossible to sustain a real market due to a crippling presence of, for instance, information asymmetries or negative externalities. Schmarkets may even see the state have several SOEs compete with each other, such as is often the case in banking and finance, and—in many West-European countries—in transportation; or the state may allow private actors to compete with each other in a heavily subsidized schmarket, such as in several countries' telecommunications sector. The point is that prior to erecting a schmarket, the state has already proceeded to make several normative and structural decisions concerning what exactly this artificial market should look like.

Now, the distinction between the state *correcting* a market failure and *erecting* a schmarket might seem academic in the pejorative sense. But it is significant. One can see the distinction's relevance when one considers the market's historical emergence as a state-induced structure (Graeber 2011). More specifically, markets are not natural phenomena; they are designed by states (Murphy and Nagel 2004; Roth 2015). To construe the state as only ever being able to correct market failures, even to the extent that meticulously subsidized, otherwise non-existent markets are seen as market failures mended, implies that markets are a form of pre-state institution. This is both historically and analytically incorrect. In fact, the very fact that a schmarket is erected where a relatively self-sustaining market would never survive, implies the very opposite. That is, when a state has a stake in a first-order objective it may, in order to achieve it, select the market mechanism as a second-order tool. Per Heath's logic, then, this may very well happen for efficiency-related reasons; but it is important to note that the first-order objective need not itself be based on efficiency considerations.[9]

It follows that there are also reasons for SOEs to co-exist with private market actors in a 'real' market. The state might want to, for example, make some good freely available at a loss, yet allow private actors to produce their own version of the good for profit to support public duties it deems essential regardless of market provision,[10] or it might want to stimulate private R&D while simultaneously developing "certain capabilities, technologies, and knowledges [...] without being limited by commercial considerations" (Willemyns 2016).[11] The point is that SOEs are, because of the absence of the efficiency rationale guiding private actors with its invisible hand,[12] not so affected by the alluring pressures of the market efficiency mandate. They can forgo 'winning' specifically so that other objectives are met.

If anything, SOEs are influenced most by being under a constant pressure to project liberal neutrality, which must entail some care duties as

[9] Of course, it *can* be. That is, if a citizenry *prefers* something, the state may have efficiency-related reasons to pursue the fulfilment of that public preference. It should be noted, however, that this line of argumentation just passes the buck to a question economists are generally unwilling to answer, namely: 'Where do preferences come from?'
[10] Although this is in danger of leaving, as Heath rightly notes, "relatively powerless citizens consuming the public version of the good, people whose complaints can more easily be ignored" (2023a, 52).
[11] Cf. Mazzucato (2015).
[12] See for a modern, sophisticated view on this point: Hussain (2023).

well as a minimal commitment to citizens' equality.[13] According to Ronald Dworkin (1978), a state failing to project equal concern and respect cannot be a liberal one. Indeed, some minimal conception of equality is implied by the very concept of neutrality. Of course, most liberal philosophers have taken this conception to imply the state has at least some measure of distributive responsibility, most prominently among them John Rawls. Famously, his principles of distributive justice are based on the idea that "while justice draws the limits, and the good the point, justice cannot draw the limit too narrowly" (1993, 174).[14] As shown earlier, Heath tends to think this limit is attenuated by the adversarial morality of the market; and, indeed, this is reflected in the market efficiency mandate. However, even if one does not buy this type of high-minded argument, it is abundantly clear that a specifically liberal state requires its populace's trust to function properly, and that this in turn demands at least a veneer of neutrality in distributive matters (Warren 1999; Lenard 2015).

By dint of the above, it is my contention that even if one agrees with Heath that "state involvement in the economy should be guided primarily by the norm of efficiency" (2023a, 60), it is clear that the state's constitutional commitment to liberal neutrality profoundly affects the manner in which it is able to go about meeting this norm. Indeed, states are not firms. More specifically, SOEs that operate within a market environment experience 'outside boundaries'—or moral limits—beyond just the task of maximizing profits in ways that allow Pareto efficiency to theoretically obtain under conditions of perfect competition. Indeed, the "extremely onerous constraints that are imposed on [state] procurement" (46) to which Heath appeals, far beyond what can be expected of any private firm, are clear proof of this phenomenon. It should be obvious that SOEs are often prohibited from "developing strong relationships with suppliers" (46) not because of efficiency-considerations, but because of *neutrality-considerations*. Indeed, SOEs must operate not as if they were operating in a market under conditions of perfect competition, but *as if they were operating in a schmarket*. And as Heath rightly ascertains, this constraint often puts the state at a significant disadvantage compared to the private sector vis-à-vis profitability. On efficiency grounds, this disadvantage can

[13] This pressure is much attenuated in SOEs that are only partially owned by the state. I do not go into such cases in this paper.
[14] The particulars of liberal neutrality vis-à-vis distributive considerations are significantly more complicated; see, for instance, Schaller (2004). I do not take a position regarding any of this in this paper, however.

certainly be said to furnish a *cooperative cost*; yet we can now start to consider the possible *competitive social costs* that may follow suit.

To see this, consider again that firms may justifiably pursue profit due to the competitive social norms that the market appeals to; indeed, on Heath's account, "markets privilege efficiency over equality in a way that is far more radical than what one can find in any other social institution" (Heath 2023b, 37). However, as we have seen, under conditions of imperfect competition—which is indeed almost always—market competition will only bring about efficiency of the Kaldor-Hicks variant. Importantly, SOEs' schmarket-constraints *do not allow for such shortcuts*; indeed, whatever the objective being pursued, the pressures of liberal neutrality demand SOEs do not disadvantage actors in the way that Kaldor-Hicks efficient outcomes imply. They are principally not allowed to privilege efficiency over equality to the same extent that 'pure' market institutions do. In general terms, we may posit that SOEs cannot as a rule set back one party and privilege another, whilst remaining agnostic on whether the losing party will ever be reimbursed. This would, in a very direct sense, come into conflict with the minor (distributive) equality considerations associated with liberal neutrality.

All this is a rather technical way to spell out that where market competition between private actors experience competitive pressures to produce Pareto efficiency only *indirectly*, state-led economic endeavors experience cooperative pressures to pursue it *directly*. Call this the *schmarket efficiency mandate*.[15]

IV. THE COSTS OF USING THE PRICE MECHANISM

So what does the difference between the market efficiency mandate and the schmarket efficiency mandate entail for the concept of competitive social costs? In this section, I show that the difference between these mandates can be expressed as a competitive social cost, and that this cost is, subsequently, best expressed in terms of *inequality*.

Due to the market efficiency mandate, efficiency gains are, again in general terms, *ex-ante* more *unequal* when the private sector is involved. This is actually a rather uncontroversial point. Indeed, Heath himself notes that "courts often use a KH [Kaldor-Hicks] conception of efficiency in considering competition law cases. Similarly, regulation is often

[15] Of course, I certainly do not intend to deny particular problems that may occur in, or are associated with, specifically state provision, such as those that are flagged in Heath (2023a).

justified through cost-benefit analysis (CBA), and CBA uses the KH standard" (Heath 2019, 23). Thus, very often, only *potential* Pareto gains are achieved by the market.[16]

My additional, more novel contention is that SOEs, conversely and due to the pressures of the schmarket efficiency mandate, tend to more often achieve efficiency gains that are ex-ante more equal. Far from trying to deify SOEs, I must immediately add that these gains are frequently not even *potential* Pareto gains. That is, they are, owing to several difficulties Heath spells out with acuity in his paper, generally much lower than the Kaldor-Hicks gains made by the private sector. Yet due to the schmarket efficiency mandate, they are more often made with an internalized distributive factor that bars SOEs from facilitating the win-lose interactions that characterize the Kaldor-Hicks standard.

The argument, here, is that this comparison reveals a competitive social cost involved in decisions of privatization. Moreover, since both the public and private sector are realistically unable to achieve perfect Pareto optima, but only the private sector is allowed to generate win-lose interactions, this cost is best expressed as one of *ex-ante* inequality. In somewhat more morally laden terms, the Pareto standard clearly internalizes some notion of basic equality; that is, winners may only win if it is not at the expense of other participants. Conversely, Kaldor-Hicks gains constitute only potential Pareto gains; that is, winners may win at the expense of others as long as they are able pay them back with their winnings. Yet it is this very potentiality that constitutes the notion of basic equality furnishing the *normative* facet of the Pareto principle. Indeed, without this facet—if the losers are not reimbursed—we are left with an economic interaction that just generates inequality.

Note that this comparison does not, in fact, incur the levelling-down objection. The oft-used objection attacks the monistic egalitarian notion that only equality is intrinsically valuable. It follows, so the objection suggests, that to egalitarians a more widget-equal distribution is preferable to a less widget-equal distribution in which all actors nonetheless possess more widgets.

[16] Note, again, that this fact does not furnish a problem for Heath's Market Failures Approach. See Heath (2019).

	Widgets
Original allocation	95, 95
Unequal distribution (A)	150, 100
Equal distribution (B)	85, 85

Table 1.

Egalitarians, then, should prefer B over A. Hence, egalitarians are committed to *levelling down* gains whenever this would create a more equal distribution. This is, of course, a very hard bullet to bite for egalitarians.

Whatever the merits of this device,[17] it is not applicable to my comparison. That is, I am comparing instances that follow the schmarket efficiency mandate in which gains are low, but no actor is ex-ante set back, against instances that follow the market efficiency mandate in which gains are high but, crucially, at least one party is set back.

	Widgets
Original allocation	250, 250
Market efficiency mandate (A)	150, 850
Schmarket efficiency mandate (B)	260, 260

Table 1.

Thus, we might appropriately express the competitive social cost of privatization as *ex-ante* inequality. Yet the operative word here is, of course, 'ex-ante'. Heath might even agree with the above analysis wholeheartedly, but go on to argue that the *ex-post* gains—that is, actual gains after welfare state Pareto-enhancement—are such that even a non-ideal perspective on the market justifies the Kaldor-Hicks efficiency resulting from the market efficiency mandate. In fact, Heath might say, the ex-ante competitive social cost, while present, is entirely ameliorated by the Pareto-enhancing effect of a strong welfare state.[18] This is the point, however, where his Market Failures Approach to the state is forced to repoliticize.

[17] For a most substantive analysis, see section III of O'Neill (2008).

[18] Note that the ex-ante prefix is analytically accurate, but may be deceptive. More specifically: on Heath's account, the Pareto-enhancing effect of the welfare state does not comprise redistributive efforts, but entails pre-distributive and procedural efforts comprising regulation, monitoring, and an encompassing mandate to weed out market failures, generally guaranteeing as close to perfect competition as possible. While there is certainly no t=1 in which such a pre-enhanced outcome is extant, it can nonetheless be

V. REPOLITICIZING REDISTRIBUTION

Let us briefly take stock. I have argued that there exist not only transaction costs associated with using the price mechanism, but also social costs associated with affirming the competitive pressures of the market. Moreover, these social costs can be made explicit without reference to deontological considerations and without committing to a socialist political morality; in staying with Heath's approach, they may simply be expressed in terms of efficiency. More specifically, state-owned enterprises are heavily constrained in the manner in which they may justifiably pursue efficiency gains. They may do so only without setting actors back. The private sector experiences no such constraints, however. Indeed, its very success is predicated on its ability to compete with a lack of such 'high-mindedness'. The effect of this discrepancy makes it so that SOEs are more likely to produce gains that are ex-ante lower but more equal, whereas the private sector is more likely to produce gains that are ex-ante higher but more unequal.

Now, Heath might think this fine and fair enough, but counter that these ex-ante inequalities are generally mitigated ex-post, via the state's Pareto-enhancing abilities. This perspective would be consistent with his earlier work on the subject (Heath 2011; 2020). The problem is, of course, that the state's Pareto-enhancing abilities are directly affected by privatization. Indeed, the main problem with Heath's account is that it surreptitiously assumes economics and politics are two entirely separable domains, connected only in a somewhat detached, indirect manner. This view invokes the classic, yet now antiquated view of a welfare state ran by stern, incorruptible public servants, wholly unaffected by a market that should simply be left alone to work its magic (Marshall 1981; Goodin 1988). Antiquated as it may be (and resist it as he does in Heath 2020), Heath seems now to subscribe to this entirely procedural view, nonetheless.

The state's Pareto-enhancing abilities are, however, not procedural concepts. Nor are they ephemeral. They are entirely constituted by the state's ability to pre-distributively monitor, adjudicate and intervene in the economic realm. Here it becomes imperative that we add to Heath's observation that "state spending as a fraction of GDP typically rose from less than 2% at the beginning of the 20th century to roughly 40% at the

cogently expressed as a theoretical object in which the market efficiency mandate has not yet been tempered by the state's Pareto-ameliorative efforts.

end" (2023a, 27), that an unknown, yet presumably significant portion of that has gone to the private sector via outsourcing and public-private partnerships since the 80s (Lazonick and Shin 2020). This shift has empowered the private sector *in a structural sense*. More specifically, the shift has made the public sector more and more reliant on the private sector for its very functioning (Farrell 2018). Pressingly, this reliance includes the state's ability to regulate, monitor and adjudicate the private sector—all that constitutes the state's Pareto-enhancing qualities.

Concurrently, there is a growing body of both empirical and theoretical work that suggests corporate interests have gotten progressively more leeway in polluting the very political process that is supposed to decide on matters of privatization (Crouch 2011; Acemoglu and Robinson 2019). Synergetic research, moreover, suggests that corporate influence has grown in tandem and requires an approach to market power beyond what the standard economic fare can offer (Claassen and Bennett 2022). This all amounts to the conclusion that "many critical areas of regulation have become characterized […] by the outsourcing of the development of these rules to the market actors who will be affected by them" (Mazzucato and Collington 2023, 165). And where Heath may counter by saying that his approach would consider these paradigmatically 'core' state functions and that they are, therefore, not to be privatized, the real problem only reveals itself when seen through a structural lens. That is, there is every reason to believe that privatizing a previously public institution can realistically severely hamper the state's Pareto-enhancing abilities *in general*, even while "the state retains the ability to exercise considerable control" (Heath 2023a, 39) *over particular cases.* This is so even if a single instance of privatization is deemed to be theoretically ex-post more Pareto efficient, especially when these instances are progressively more often enacted with appeal to corporate—and not public—interests. Indeed, a

> skilled government workforce needs to be able to analyse changes both to ensure corporate laws are abided by and to amend or improve those laws where necessary […] But the more that responsibility for delivering core functions is privatized, the harder it is for the government to ensure in-house regulatory skills are up to date and improving. (Mazzucato and Collington 2023, 165)

The knowledge required for these 'core functions', however, is dispersed over various state institutions, many of which are not directly in the business of regulating markets. Indeed, "a loss of knowledge can […] undermine the state's capacity to govern relationships with the private sector,

whether through regulation, procurement or other forms of partnership" (164).

None of this is meant to say that these concerns are not relevant without my rigid adherence to Heath's methodology; indeed, the aforementioned phenomena are explored in much greater detail than I have space for here. Rather, my cursory observations are meant to show that an honest embrace of Heath's view on privatization taken far enough *requires* politicization by engaging with these matters. If we, using Heath's methodology, agree that the difference between market and schmarket efficiency mandates results in ex-ante inequality, we must naturally also analyze what are the processes that affect the state's Pareto-enhancing abilities on the ex-post outcomes. And, indeed, the analysis of these abilities can only be addressed through structural, political means, beyond a case-by-case approach that appeals to efficiency alone.

Nor is any of this meant to disparage Heath's meticulous paper. Rather, it is to show that a monist efficiency-based approach to the state is simply unable to be sufficiently exhaustive to cover the phenomenon of privatization. To approach the question of privatization in a depoliticized manner, with reference to policymakers that are "neither stupid nor particularly ideological" (Heath 2023a, 31) is to miss a crucial political effect of privatization that has significant consequences for how that analysis should be conducted in the first place. Indeed, the main theoretical upshot of this paper should be that even a nigh-manic focus on the Pareto principle will eventually be unable to sidestep questions of inequality, because it is a moral principle that internalizes egalitarian considerations. Thus, either Heath's approach bites the bullet and collapses into a form of aggregate utilitarianism (Moriarty 2020), or it embraces these egalitarian considerations, thereby repoliticizing privatization.

VI. CONCLUSION

I have argued that Heath's Market Failures Approach to privatization is made significantly more problematic by the presence of ex-ante inequality. Heath's analysis, while extremely informative, tends to compare idealized markets with non-ideal state institutions; readjusting this imbalance subsequently suggests that his approach is somewhat morally emaciated. That is, it tends to gloss over exactly why political and egalitarian considerations—pertaining to relations between economic actors—are interesting to questions of privatization in the first place. There is every reason to believe that this view is "commonly held by economists, and

much less commonly held by philosophers and political theorists" (Heath 2023a, 60) because economists are generally taught (wrongly and ruinously) that economics and politics are supposed to be separated analytically. Subsequently, the underlying politics are, unfortunately, left to philosophers and political theorists.

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