

# Solidarity Borders: Communitarian vs. Cosmopolitan Public Mandates

Etienne BILLETTE DE VILLEMEUR  
Université de Lille

Justin LEROUX  
HEC Montréal

## Abstract

The design of regulation that is both "effective" and "ethical" requires understanding the objectives of the stakeholders and following clear-cut normative criteria. While the objective of private agents is often plain, that of public corporations is less so. We argue that the objective of utilities operating over several jurisdictions should be made explicit, whether it is a "communitarian" one, whereby outside operations merely serve as instruments to increase the welfare of the home community, or a "cosmopolitan" one, where the objective is to serve as many users as possible—both at home and abroad—at the lowest rate. Whatever the perspective, we claim that it would be detrimental to *a priori* forbid public utilities from seeking profits outside their home jurisdiction. Rather, regulators should focus on how these benefits are distributed among stakeholders. A special *caveat* is to be noted regarding risk-taking. Overall, we argue that neither isolationism nor "laissez-faire" are decently defensible. A lesson of the analysis is that although apparently unrelated, geographical, social and cultural factors should enter in the very definition of public mandates.

# 1 Introduction

The expansion of utilities beyond their home jurisdiction is often met with scrutiny. The fact that a utility may develop profit centers in other jurisdictions seems to be at odds with its mission to serve the public good. The concern is twofold. First, profit generation implies that some users abroad are paying more than necessary for the service. Moreover, because the expansion can go awry, it places residents of the home jurisdiction at a financial risk.

Examples of utilities expanding their operations beyond their home jurisdictions abound. This is not only true of private corporations, but also of entities with a public shareholder. Such expansion may take place within developed regions of the world (see Clifton et al., this issue, for two examples within Europe) as well as along a North-South axis often—but not only—through not-for-profit vehicles (see Rusca and Schwartz, this issue, on "Water Operator Partnerships"). Issues of expansion can also occur within a country when a municipality corporation starts to offer services in other cities or regions (Acevedo et al., this issue). Regardless of the scale, the question we address here is whether expansions are desirable given the 'public' character of the services provided by utilities.

In practice, several considerations may explain expansion, whether they are to explore new market opportunities, to promote 'local champions' or for motives internal to the corporation. However, although some operators may have questionable motives, we shall argue that operating outside its jurisdiction can still be in line with the objectives of a utility faithful to its core mission of serving the public. It may even be the case that this very mission calls for expanding its operation, as when "improving service provision in developing countries" is invoked. Our question is one of consistency between having such a public mission and operating abroad. Our analysis being normative in nature, the observed behaviors of utilities are actually irrelevant here. We aim at prescribing how utilities ought to behave in order to fulfill their mission rather than describing what they actually do.

We shall adopt the economic standpoint according to which the core mission of utilities is giving access to the largest number at the lowest price.<sup>1</sup> We are aware that other objectives may be pursued, like job preservation and the empowerment of communities. While desirable, we shall not include them as part of the core mission of the utility to serve the public. Likewise, we shall assume away issues of accountability, transparency, and participation. Finally, we shall also abstract from some other dimensions important to the problem, like technical, social, and environmental efficiency. This is not to say that they are secondary, but accounting for them would not change the nature of our answer to the question on the compatibility between the public objective and expansion beyond the jurisdiction.

Formally, our approach is one of modeling, which aims at parcimony in order to pinpoint the essential mechanisms at play. This leads us to initially set

---

<sup>1</sup>We assume that quality of service is unaffected.

aside important geographical and sociological aspects in order to conduct our economic analysis. However, this very same approach will allow us to pinpoint exactly where they ought to enter the picture. In fact, we shall conclude that they play an essential role in the definition of the breadth of the public service mandate.

To be clear, the meaning of the word 'public' as we shall use it here is unrelated to the private or public nature of the utility's capital understood in the usual sense, nor to its governance structure. In particular, we eschew the discussion of the relative merits of government-run operators versus the delegation to a private party. Instead, by 'public' we refer to the assigned mission of the utility and its intention to "serve the public". Our contribution resides in the clarification of this public mission. However, we do not address the manner in which the public objective of accessibility and affordability is achieved. Emphatically, this objective precludes profiteering from the commercialization of essential services. While we are aware that profits may be reinvested for the benefit of the community through other, unrelated projects (e.g., education, libraries, healthcare, etc.; see, e.g., Acevedo et al., this issue), we consider that having several competing objectives puts the achievement of the primary goal at risk. This is what leads us to give the highest priority to accessibility and affordability and to effectively consider it as the utility's sole core objective.

As recalled in Tsanga Tabi (2014), the *raison d'être* of public services are social justice and solidarity. In turn, we argue that the question of 'how far' this solidarity extends is of crucial import for the definition of clear normative objectives. Of particular interest here is whether solidarity extends beyond administrative borders. There are essentially two philosophical stances with respect to this question. The communitarian view of solidarity emphasizes the connections among individuals in a community of people within a geographical location, or who have a shared history or interest. By contrast, cosmopolitanism deems all humans, and not merely compatriots or fellow-citizens, as members of a single community. The boundaries between districts, states, cultures or societies are therefore morally irrelevant.

It follows that the distinction between the communitarian and the cosmopolitan views will qualify the public character of the utility's core mission. In turn, this will have concrete implications as to what the mandate of the utility should be. We shall see that a public mandate imbued with communitarianism calls for seeking profits abroad in order to further increase accessibility and affordability at home. Absent profitable opportunities, the utility should not venture beyond its jurisdiction. By contrast, a cosmopolitan mandate recommends expanding abroad to increase accessibility to the largest number even when such endeavors come at the cost of decreased affordability at home.

Whether a utility's expansion is consistent with its mandate depends on the underlying views on solidarity. Indeed, a communitarian mandate will never prescribe a non-profitable expansion whereas a cosmopolitan one may deem the same expansion desirable. Moreover, the behaviors outside the jurisdiction prescribed by both mandates differ markedly: communitarianism calls for profit maximization abroad—i.e., high prices—whereas cosmopolitanism demands em-

phasizing affordability abroad. Thus, the very definition of the public mandate calls for the identification of 'solidarity borders'; i.e., of a sense of belonging to a community, which arises from the historical, cultural and sociological background of the population considered. This background, which we chose to set aside initially along with geographical factors to conduct our economic analysis, matters to a great extent, insofar as it determines the nature and size of a community's solidarity borders.

When risk enters the picture, the outside operation may end up being less profitable than anticipated, or even operate at a loss. The question then arises as to whether financial losses abroad should be allowed to spill over to the home jurisdiction in the form of higher rates to home users or whether home users should bear a portion of the risk so that users abroad are also guaranteed access to the service. Communitarianism demands that home users be protected as much as possible from adverse events. While this does not completely prevent risk taking, outside endeavors should be considered very cautiously except when profitability is overwhelmingly likely. By contrast, cosmopolitanism calls for more risk taking. This follows from the fact that, even absent risk, increased accessibility may more than compensate the downside of financial loss abroad. Moreover, the possibly negative outcomes of risky endeavors are spread among the wider population consisting of both home and outside users. In other words, the presence of risk discourages the expansion of utilities with a communitarian mandate more than those with a cosmopolitan mandate.

Our contribution thus underlines the fact that the appropriateness of expansion depends crucially on the definition of the public mandate. As already mentioned, the latter is shaped by the community's views on solidarity and, obviously, of itself. Ultimately, to judge the morality of a utility's expansion, we first need to define the limits, if any, of a community's solidarity and reason in accordance with its 'solidarity borders'—again, if any.

## **2 Communitarian versus cosmopolitan public utilities**

### **2.1 Defining the public objective**

The activity of any utility always generates both public and private benefits. By private benefits, we mean the financial results of the utility once all costs have been accounted for. Simply put, private benefits are the profits of the utility. Public benefits, by contrast, refer to the value to the users of the utility services. In turn, by value to the users, we intend an estimation in monetary terms of the value derived from the—nonmonetary or in-kind—services, net of the bill consumers must pay to be served. In economics, this is usually referred to as 'consumer surplus', a technical term that aims at capturing what is commonly dubbed the 'social value' of an activity. This goes back to Dupuit (1844) who first observed, in the context of public works, that the value to society of a public service exceeds the price that users pay for it.

In accordance with its public objective, the utility must set rates that are as low as possible—to ensure affordability—yet high enough to be able to continue its activity—and guarantee access to the service. In other words, the joint objective of accessibility and affordability becomes tantamount to seeking the largest possible consumer surplus subject to the utility not incurring losses (Figure 1). This implies that, even for a utility faithful to its public objective, it is important to consider not only consumer surplus but also financial profitability.<sup>2</sup>

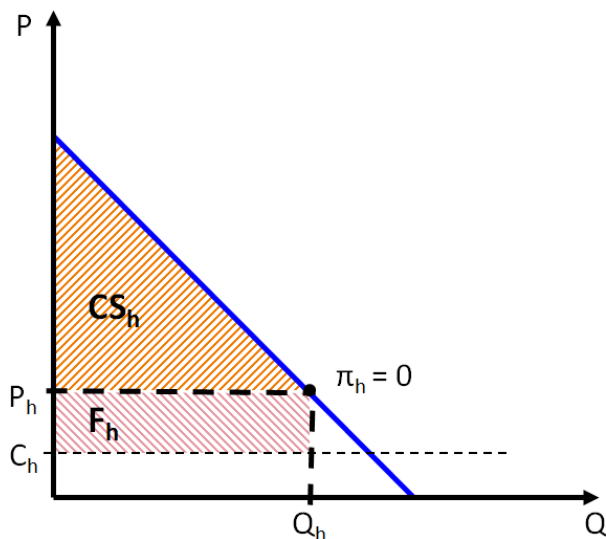


Figure 1: When operating only on the home market, the utility must set its price,  $P_h$ , above its marginal cost,  $C_h$ , so as to cover its fixed costs,  $F_h$ . When doing so, the consumer surplus,  $CS_h$ , is maximized subject to the utility not losing money (its profit is exactly zero:  $\pi_h = 0$ ).

This also has implications with regard to the issue of expansion. Indeed, additional profits generated elsewhere can potentially allow the utility to better serve its home users by charging lower rates, thus increasing their surplus. As an example, suppose the home rate is initially at 10 \$/unit for a total production of 100 units at home. If the utility makes a profit of \$300 outside its jurisdiction, it can lower its home rate by at least 3 \$/unit. In general, this rebate will lead to higher demand. If producing additional units of service costs less than 7 \$/unit, the utility will actually make strictly positive profits at home at this price. Thus, it will be able to offer an even larger rebate to its users.

<sup>2</sup>By contrast, revenues should be of interest only insofar as they enter in the calculation of profits. The fact that some existing utilities focus on revenues as a dimension of interest is simply a symptom that they are not entirely faithful to their public objective.

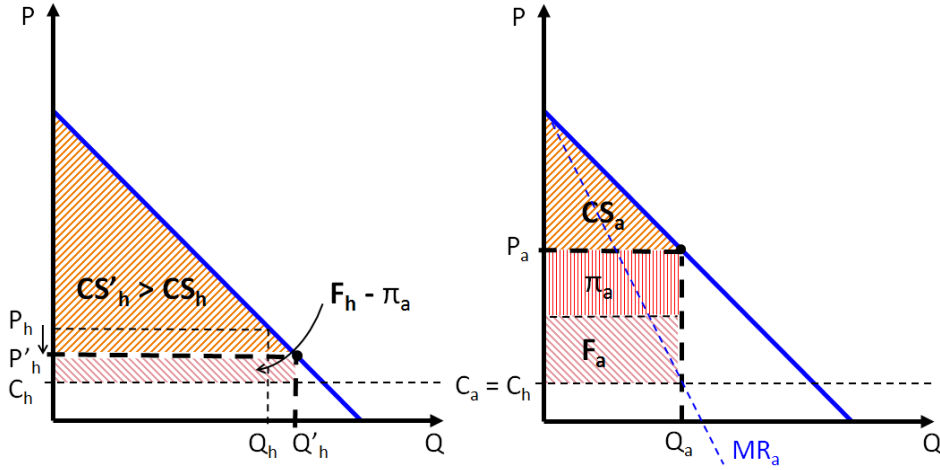


Figure 2: A utility can use profits made abroad to lower the rates on its home territory. It may still make zero profit overall. The right panel shows the utility charging a high price  $P_a$  abroad and making a profit  $\pi_a$  on top of recouping its fixed costs abroad,  $F_a$ . The left panel shows an increase in consumer surplus on the home territory,  $CS'_h > CS_h$ , resulting from the decrease in price due to the cross-subsidy.

## 2.2 Two attitudes: communitarianism and cosmopolitanism

When utilities grow beyond their home jurisdiction, one of the first aspects to consider is whether their mandate is communitarian—i.e., to pursue the benefit of the sole users of the home jurisdiction—or cosmopolitan—i.e., pursuing the benefit of all users, including those beyond the home jurisdiction. In other words, the question is whether operations outside their initial boundaries are only *instrumental* to serving home users or whether the (public) mandate of the utility *extends* beyond its initial territory, thus aiming at a 'global common good'. Formally, a utility imbued with a communitarian mandate should aim at maximizing the consumer surplus at home whereas a utility following a cosmopolitan mandate should seek to maximize the total surplus, at home and abroad.

### 2.2.1 The communitarian public mandate

In the absence of risk, profitable outside operations should always be undertaken by a utility imbued with a communitarian public mandate. In fact, profit-seeking behavior is actually a sign of faithfulness to its mandate. This is due to the fact that a communitarian utility will lower its rates at home thanks to profitable endeavors abroad. As an illustration of such behavior, the reader can refer to the example of the previous section (see Figure 2).

### 2.2.2 The cosmopolitan public mandate

By contrast, a cosmopolitan utility first aims at increasing accessibility—rather than profitability—abroad. Accordingly, even non profitable endeavors—in the sense of private benefits—may be justified on account of the fact that more users will be given access to the utility’s services. More generally, even when operations abroad do not result in a financial loss, the utility will be less able to lower rates at home because of its concern for affordability to all.

As an example of increasing total surplus while incurring financial losses abroad, recall the previous example and suppose that before any outside project is undertaken the value of the utility services to the home users is \$3,000. Suppose also that outside operations benefit outside users to the tune of \$1,500 but result in a financial loss of \$400 to the utility. To absorb this loss, the utility must increase the home rate by more than \$4/unit<sup>3</sup>, resulting in the decrease in the value of the utility services to home users by, say, \$500. In other words, home users see their benefit decrease from \$3,000 to \$2,500 in order to grant outside users a benefit of \$1,500. The total net benefit has increased by  $\$1,500 - \$500 = \$1,000$ .

That is not to say that expansion by cosmopolitan utilities always comes at a cost to home users. Suppose that the utility’s cost consists of infrastructure costs (or fixed costs) of \$800, and production costs amounting to \$2 per unit. The utility breaks even by selling 100 units at home at a price of \$10 per unit, fulfilling its public mandate of serving home users at the lowest price. Suppose that expanding services abroad requires an additional fixed cost of \$400, and that selling at \$10 per unit would yield demand for 70 units, generating a profit abroad of \$160. The utility can then lower its rate both at home and abroad to, say, \$8 per unit so as to serve a total of 200 users (e.g., 120 at home and 80 abroad) and break even.

### 2.2.3 Judging the appropriateness of expansion

From a normative standpoint, a utility with a communitarian mandate must expand if it can make positive profits abroad. By contrast, a utility with a cosmopolitan mandate must expand if its operations can increase total surplus (i.e., if the increase of the surplus abroad is larger than the decrease in surplus at home, if any). In both cases, it is not desirable to always expand, nor is it desirable to prevent the expansion of these utilities, because expansion may be in line with the utility’s public objective. In other words, judging the utility’s faithfulness to its public objective cannot be done solely on the basis of whether or not it chooses to operate abroad. Likewise, it is worth pointing out that the desirability of an expansion is not tantamount to home users benefitting from it, except in the case of communitarian mandate.

---

<sup>3</sup>This is because fewer units will be sold after the price increase.

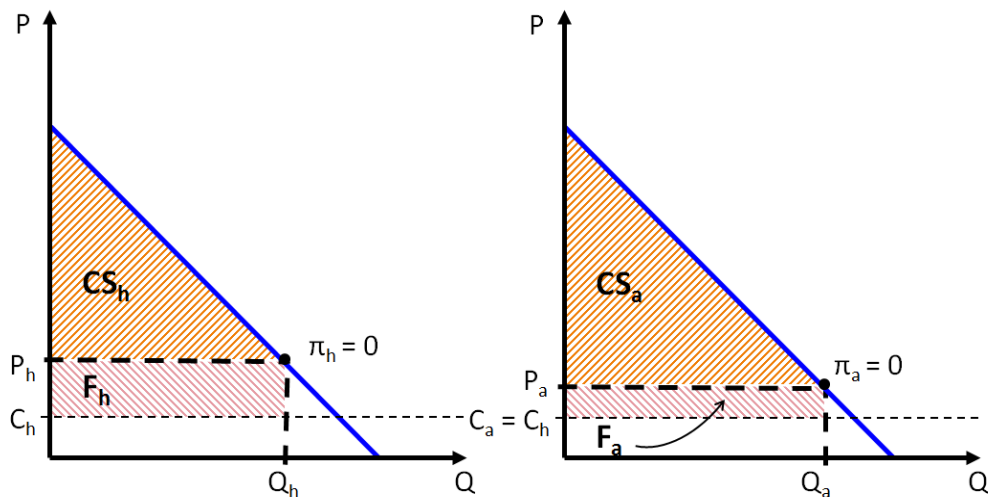


Figure 3: To protect home users from the risk of outside losses, the utility can compartmentalize its operations ('accounting separability'). In doing so, the utility effectively behaves like a communitarian utility on each territory.

### 3 Accounting for risk

#### 3.1 Who bears the risks?

As discussed above, whether the utility aims at the local or global public good shapes how profits abroad are to be redistributed: A communitarian utility will transfer all profits to local users in the form of lower rates whereas a cosmopolitan utility will lower rates across the board. If risk enters the picture, outside operations may result in losses. How these losses ultimately impact users will depend again on how they are distributed. With a communitarian mandate, outside users bear the brunt of the risk so as to protect home users as much as possible. However, home users may not be fully sheltered and are exposed to some residual risk. By contrast, under the objective of maximizing global public benefits, risk is spread evenly across all users. However, it is possible to aim at the global common good while fully protecting home users from the risk of outside losses. This can be done through accounting separability, and making the outside operation its own publicly-minded entity. Note, however, that accounting separability would also compartmentalize gains so that home users could not benefit from outside operations.

Extending the above example, suppose the fixed cost abroad,  $F_a$ , is subject to risk and may take on three different values with equal probability: \$400, \$600 and \$800. Recall that if  $F_a = \$400$ , we assume that the utility could make a profit of up to \$300 abroad so that, if imbued with a communitarian mandate, it could lower its home rate to less than \$7 per unit. In the same case, but when



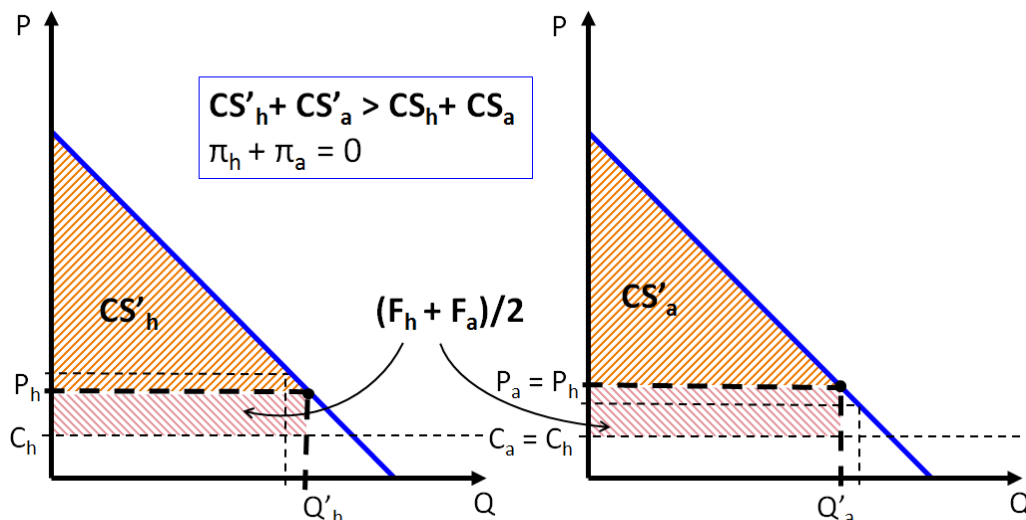


Figure 4: A cosmopolitan utility does not aim at offering the lowest possible rate to its home users. Instead, charging equal rates at home and abroad allows it to maximize the total consumer surplus,  $CS_h + CS_a$ , but also spreads the financial risk between home and abroad. In particular, home users are not protected from financial losses abroad.

the utility is imbued with a cosmopolitan mandate, it can lower the rates in both regions to \$8 per unit. Similarly, if  $F_a = \$600$  a communitarian utility can lower its home rate to less than \$9 per unit. By contrast, maintaining a rate of \$10 per unit across the board would result in a financial loss of \$40 ( $= \$160 - \$200$ ) abroad. The utility could either increase its rate to all users by, say, \$0.25 per unit or maintain the home rate unchanged while increasing the rate abroad by roughly \$0.70 (what we referred to as accounting separability). Finally, if  $F_a = \$800$ , even if the utility aims at maximizing profits abroad, outside operations will result in financial losses. More precisely, a communitarian utility will take a \$100 loss abroad and will be forced to increase its home rate to more than \$11 per unit. If the utility is imbued with a cosmopolitan public mandate, it may choose to increase its common rate to, say, \$11.50 per unit. Furthermore, if the utility practices accounting separability, the outside branch would simply go bankrupt so as to preserve a low home rate.

### 3.2 When are risky investments worth pursuing?

Risky investments should be undertaken when—and only when—they are deemed more beneficial than they are harmful. Uncertainty calls for assigning probabilities to the possible outcomes. Although stakeholders may evaluate each of these outcomes, the presence of risk generally requires the situation to be as-

sessed as a whole. In particular, the mere possibility of an adverse outcome, however unlikely, may lead some to consider the entire endeavour as undesirable. The overall desirability of a project requires one to identify how each stakeholder perceives the risky situation. What decision must be taken on the basis of individual evaluations pertains to the realm of collective choice theory. In particular, overall desirability does not necessarily follow from individual (expected) net benefits simply summing up to some positive number.

To be able to judge the appropriateness of pursuing outside operations, one must distinguish *ex ante* evaluations from *ex post* results. Specifically, realized losses are not a sign that the investment decision was a bad one, no more than positive realized gains are proof that the risky undertaking was justified. Realized gains or losses are but a one-dimensional summary of a single scenario among the many that could have occurred. In particular, such accounting information does not reflect the fact that the actual situation is the result of a risky enterprise. The appropriateness of the investment decision should only be judged on the basis of information available at the time it was taken.

In general, risk aversion—i.e., the reluctance to place oneself in a risky environment—leads individuals to attribute a lower value to a risky situation than the monetary amount that probabilities dictate they will receive on average. Thus, by looking at expected profits, outside investments can be deemed worth undertaking; however, because profits are ultimately passed on to users in the form of lower rates, those same users may not be willing to be exposed to such risks. In other words, the same project can be associated with both *positive* expected private benefits and *negative* expected public benefits.

To sum up, profitability alone is insufficient to judge the social desirability of outside risky investments; however, when risk levels are acceptable for the users it is the utility's duty to undertake these investments in order to best serve the public interest.

## 4 Conclusion

We have argued that expansion is generally justified when the risks are tolerable, albeit for different reasons. When a utility is communitarian, expansion is justified on the grounds that profits abroad allow home rates to be reduced, provided the risks of possible financial losses abroad (and, in turn, of rate increases at home) are tolerable to home users. For a cosmopolitan utility, expansion is justified on the grounds that it will give more people access to the service. In fact, expansion is justified *more often* for a cosmopolitan utility. Should home users be unwilling to take on the risks of financial losses abroad, the utility can resort to accounting separability, thus protecting them entirely from the risks—but also from the rewards—attached to the expansion.

Solidarity has been expressed here only through the price of services, specifically through sharing costs so as to achieve affordability. Clearly, the impact of the utility on a community goes beyond mere monetary considerations. For instance, it may contribute to other important socio-economic aspects like job

creation, dignity, a sense of belonging, and social harmony. Accounting for these aspects requires defining clear objectives to accompany the ones of accessibility and affordability studied thus far. Otherwise, this may result in drifting away from the core mission, possibly to the point of going against the primary objective. Of course, the notion of solidarity does not apply solely to the provision of utility services. Yet, it seems quite clear that 'solidarity borders' are likely to differ when applied to other public services like, say, social security, rather than water distribution.

To conclude, our contribution provides a concrete example of the complementarity between the economic approach and the social and cultural dimensions of policy making. On the one hand, economic analysis provides a clear-cut pricing policy to ensure the viability of public services. As such, it materializes the aspirations that are conveyed by the public mandate. On the other hand, our contribution underlines the fact that the very definition of the public mandate cannot be understood independently of geographical, sociological, and cultural factors.

## References

- [1] Tatiana Acevedo, Jeimy Arias and Kathryn Furlong, "Regulating Public Water Corporations in Colombia: 1909-2012", this issue.
- [2] Judith Clifton, Daniel Díaz-Fuentes and Mildred E. Warner, "The Loss of Public Values when Public Shareholders Go Abroad", this issue.
- [3] Jules Dupuit, "De la mesure de l'utilité des travaux publics (1844)", *Revue française d'économie*, Année 1995, Volume 10, Numéro 2, p. 55 - 94
- [4] Vincent Merme, Maria Pascual, Maria Rusca, Klaas Schwartz and Mireia Tutusaus, "Public-Public Solidarity or a Trojan Horse? The Interweaving of Commercial and Non-commercial Activities in Water Operator", this issue.
- [5] Marie Tsanga Tabi, "Public values as essential criteria for public entrepreneurship: water management in France", mimeo, 2014.