

The background features a light blue color scheme with a network of thin white lines connecting various circular nodes. Some nodes contain currency symbols: the Euro (€), the British Pound (£), and the Japanese Yen (¥). On the right side, there is a faint, stylized globe. A thick, dark blue horizontal bar is positioned at the top left, with a circular end on the left side.

# Applying the RAB approach to infrastructure

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# Outline questions

- What are the special characteristics of infrastructure?
- How do these factors impact on the cost of capital?
- How can governments and regulators commit to the sunk costs?
- Where does the RAB fit in?
- How would the RAB work outside the utilities?
- What role could the Green Bank play?

# What are the special characteristics of infrastructure?

- Long asset lives
- Capital intensive
- Sunk costs
- $AC > MC$

**⇒ Long term contracts explicitly or implicitly with governments**

# How do these factors impact on the cost of capital?

- Risk allocation to those best able to manage it
- Regulatory and political risk is non-diversifiable

⇒ Cost of capital high if commitment not credible

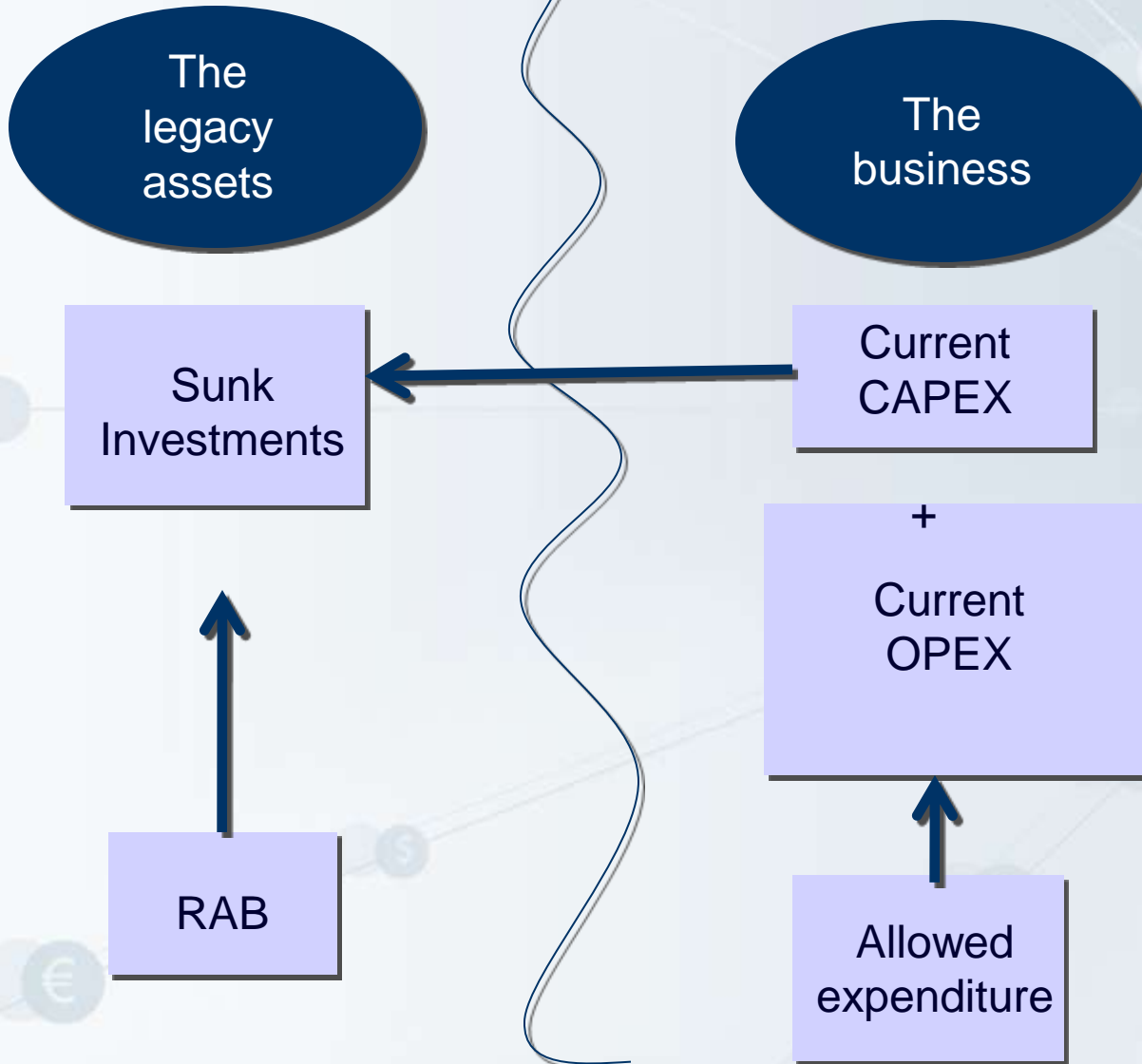
- Examples include:
  - PFI Scheme
  - PPP Underground contracts

BUT... Utilities' real WACC is  $< 5\%$

# How can governments and regulators commit to the sunk costs?

- Long term contracts
- Independent contracting bodies
- Licences
- Legal protections in respect of “financing functions”
- And at the core... THE RAB

# Where does the RAB fit in?



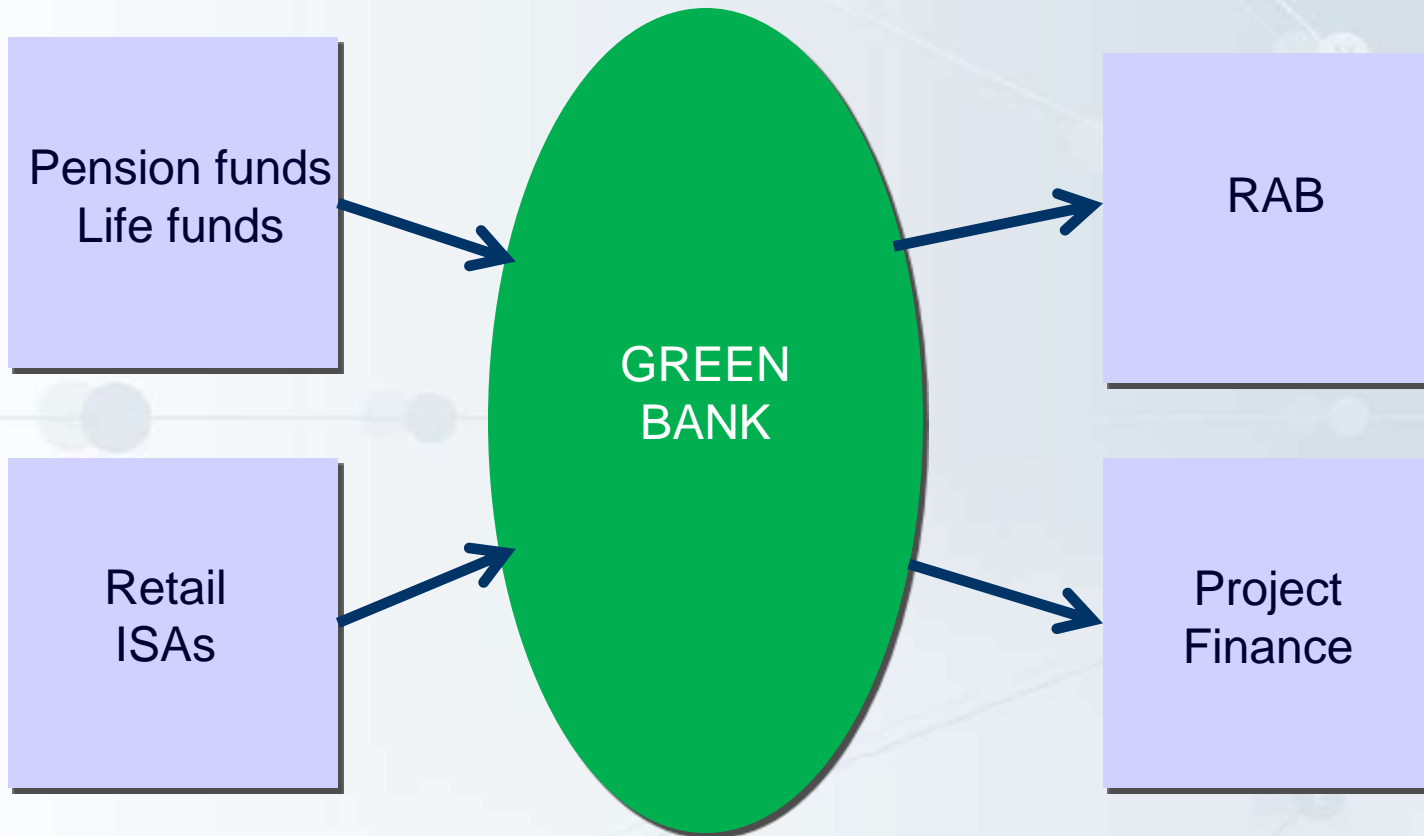
# How would the RAB work outside the utilities?

Option 1 – Long term contract protected by law

Option 2 – Guarantees in respect of RAB debt

Option 3 – Purchase and package sunk costs

# What role could an Infrastructure/green bank play?





## Further information:

***Infrastructure investment, the cost of capital, and regulation: an assessment***, Oxford Review of Economic Policy, Volume 25, Number 3, 2009, pp.307–326

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*Environmental challenges in a warming world: consumption, costs and responsibilities*, 2009, Tanner Lecture, February 21st.

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Helm, D R, Smale, R and Phillips, J, (2007) “Too Good To Be True? The UK’s Climate Change Record”, December. <http://www.dieterhelm.co.uk/publications/>

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