

Intelligence MEMOS



From: Sebastien Betermier
To: Infrastructure Watchers
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Re: BRIDGING CANADA'S INFRASTRUCTURE GAP – HOW DO WE FINANCE IT?

Pursuing economic prosperity by transitioning Canada to a clean, resilient, and digital economy is going to require a catalogue of infrastructure projects such as battery energy storage, green building retrofits, ports and data centres, and is going to be expensive. The trillion-dollar question is how to pay.

Could federal, provincial and municipal governments pick up the tab? In theory, governments are well positioned to invest in long-term infrastructure projects because they can sustain long horizons and have a higher risk tolerance than the private sector. But Canada's governments are already highly indebted: Gross government debt represented 110 percent of GDP last year.

Alternatively, private investors could step in and finance the infrastructure projects. For pension funds in particular, large infrastructure projects can be attractive investments because they generate a scalable, steady and inflation-linked stream of revenue. But they are also capital intensive and encumbered by major construction and regulatory risks. New infrastructure markets such as green steel and offshore wind are particularly risky to private investors because they are unfamiliar, complex, and often require the creation of an entire supply chain. It can take years for the first dollar return from such projects.

Public infrastructure banks are the answer, as I outline in my new C.D. Howe Institute [paper](#) which explores how governments can catalyze large amounts of private infrastructure investment in a cost-efficient way.

A well-designed infrastructure bank acts as a long-term investor with access to financing levers such as flexible loan terms and loan guarantees that help transfer risk away from the private sector and make an infrastructure project more investible. Unlike traditional public-private partnerships, infrastructure banks invest government funds with the goal of having the private sector take over and develop the market. And they expect to recoup all their investment, which is more cost-efficient than grant and subsidy programs whose financial outlay cannot be recouped.

The UK's Project Gigabit is a textbook example of how infrastructure banks can be efficiently used within an integrated policy framework. In 2022, the government launched an ambitious £5-billion program to extend broadband coverage throughout the United Kingdom by 2030. The goal was to coordinate with the private sector to build the gigabit-broadband infrastructure. But private developers were hesitant because some remote areas were difficult to reach and unprofitable and because private financing was hard to get.

To address these concerns and unlock private capital, the government categorized UK regions into three groups based on commercial viability: (1) profitable densely populated cities and towns, (2) semi-profitable areas with smaller populations, and (3) unprofitable remote areas.

Government agencies then used the public capital in a coordinated and cost-efficient way. The highly profitable, urban areas received no financial support since developers could thrive on their own. For areas in the semi-profitable category, the UK Infrastructure Bank (now the National Wealth Fund) provided loans to make these areas investible. Non-profitable areas received additional subsidies to partially cover installation costs. By using a clear framework that addressed private sector concerns and strategically using infrastructure banks and grants agencies in areas where they were most useful, the government ensured that public funding was used prudently to maximize private sector engagement and achieve the desired policy outcome.

Canada can do the same. Our pension funds are renowned for their private infrastructure investments, and we now have public investment vehicles such as the Canada Infrastructure Bank, the Building Ontario Fund and the Canada Growth Fund to bridge the financing gaps with the private sector.

Meanwhile, several major challenges need to be addressed.

The regulatory process for infrastructure projects in Canada is rife with long timelines and needless complexity. Canada's governments are highly decentralized and face chronic coordination problems. In addition to the provincial and municipal governments, there are more than 20 federal departments and agencies involved in financing infrastructure projects. Coordination between these organizations and infrastructure banks, along with regular engagement with the private sector, will be critical in order to generate maximum engagement from private investors.

Equally vital is a strong government commitment to private-sector involvement to overcome the historic Canadian ambivalence to investors. In contrast to countries like the United Kingdom and Australia, most of Canada's infrastructure assets are government owned. The lack of public enthusiasm for private sector involvement has created a barrier to monetizing large-scale infrastructure projects. There needs to be a clear communication strategy to build public support, explaining how private investment will free public capital for important social initiatives.

These challenges are manageable and the benefits are enormous. Canadian governments can leverage the large amounts of private capital available globally to accelerate policy goals, while Canadian pension funds and other investors have access to an increased supply of investible opportunities. This is a win-win situation.

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