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Brazil's Bold Industrial Turn

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SÃO PAULO – For many in the developing world, Brazil is a rare beacon of hope in an otherwise bleak global landscape. Along with his South African counterpart, Cyril Ramaphosa, President Luiz Inácio Lula da Silva is among the few world leaders who have stood up to US President Donald Trump with dignity and a measure of success.

Brazil has succeeded in reversing some of Trump's most punitive measures, despite lacking the bargaining power of countries like China. The 40% tariff he imposed on Brazilian agricultural exports, for example, was quietly rolled back without any concessions from Brazil. Likewise, the absurd US sanctions against Brazilian Supreme Court Justice Alexandre de Moraes, who presided over the conviction of former President Jair Bolsonaro, were lifted without fanfare.

At a time when many governments around the world are retreating from their climate commitments, Brazil is doubling down on decarbonization. Since returning to office, Lula has accelerated efforts to curb deforestation and announced plans to triple renewable capacity and double energy efficiency by 2030.

Even in what many regard as a less ambitious third term, and despite being constrained by strong opposition in Congress, Lula's administration has launched several important reforms. Most notably, it has simplified the Brazilian tax system and addressed some of its most regressive features, although much remains to be done to make it genuinely progressive.

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Lula's industrial policy, launched in early 2024, marks a clear departure from the market-led approach that has dominated recent economic policymaking, offering in its place a mission-oriented reindustrialization program structured around six priority areas. Beyond strengthening agro-industrial supply chains through increased mechanization, the program seeks to increase the share of domestically produced drugs, vaccines, and medical equipment in national consumption, and to improve urban well-being through investment in sustainable infrastructure, sanitation, and mobility.

The program also seeks to accelerate the digitalization of productive enterprises and boost the technological capabilities in emerging sectors, and aims to reduce carbon emissions by 30% by the end of 2026 through greater reliance on biofuels – a strategy that raises its own set of concerns. Finally, Lula's industrial policy signals a major shift in Brazil's national-security strategy. To boost self-sufficiency in defense production, the administration has set an ambitious target of producing half of the country's critical defense technologies domestically.

Lula plans to advance these priorities through a combination of public and private investment, including approximately R\$300 billion (\$54 billion) in government spending over three years. The reindustrialization program also relies on strategic public procurement to incentivize domestic

production and sourcing, along with special credit lines, regulatory reforms, and changes to intellectual-property laws.

On the surface, macroeconomic conditions look favorable, even amid global uncertainty and US tariff pressures. Unemployment has declined to 5.4%, inflation has fallen below 4.5%, and Brazil continues to run a trade surplus, even though the current-account deficit stands at around 2.5% of GDP. Moreover, the country has almost no foreign-currency debt.

Even so, many economists remain deeply pessimistic about Brazil's economic outlook. At a recent economic conference in São Paulo, few believed that the premature deindustrialization that has marked the Brazilian economy over the past few decades could be reversed.

That pessimism has far less to do with external conditions than with monetary and fiscal policy. Brazil's benchmark interest rate, the Selic, is among the highest in the world, at 15% – and that's merely the base rate from which other interest rates are derived. The country's real interest rate, at 9.4%, is second only to Turkey's. Given how difficult it is to imagine any private investment projects being viable at such levels, it is hardly surprising that Brazil's investment rate has remained stubbornly low, at around 18% of GDP.

High interest rates persist not because they are economically rational, but because of political choices. Since the early 2000s, successive progressive governments have entered into a Faustian bargain with private banks and financial investors, tolerating exceptionally high returns in exchange for the political and financial stability needed to pursue limited progressive social policies. The fact that a significant share of Brazil's public debt is held by non-residents, even though it is denominated in reais, further intensifies fears of capital flight.

With few controls on cross-border capital flows, exchange-rate policy is often used to curb inflation by limiting import-price pressures. But the combination of high interest rates and currency appreciation also erodes the competitiveness of Brazilian firms and discourages precisely the kind of productive investment that the government's new industrial policy intends to stimulate.

High interest rates also place a heavy burden on public finances. Interest payments on debt have accounted for between one-quarter and one-third of total public expenditure over the past decade – an extraordinarily high share, particularly given that Brazil's public debt, at around 85% of GDP, is modest by international standards. Brazil now allocates roughly 6% of GDP to servicing its debt, more than any other G20 country. By contrast, Japan, with a public debt of 252% of GDP, spends only 0.1% of GDP on interest, while even debt-stressed Argentina – whose debt amounts to 154% of GDP – pays just 2.4%.

Such self-imposed constraints are not merely the result of political bargains. They also reflect the restrictions on domestic policy autonomy that come with exposure to global capital markets. In this sense, Brazil offers yet another revealing example of how financial globalization has undermined the development objectives of middle-income countries.

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