

Tough Love for Industrial Policy

What Fifty Years of Indonesian Trade Policy
Teach About Making It Work

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Ask the right question

“Should we do industrial policy?” — both sides pick the cases that prove their prior. Same export ban, opposite results for nickel and bauxite.

- 1 Does the intervention bring investment?
- 2 Does that investment create capability?
- 3 Can the government withdraw the rent when performance fails?

Industrial policy will create rents. The question is whether they buy capability — and whether the state can take them back.

Three claims

1

HISTORY

Protection went to whoever had the power to ask for it.

2

CONDITION

Nickel made the buyer adjust. Bauxite made Indonesia adjust. Same instrument, different market power.

3

OPEN QUESTION

The investment came. Whether it leaves anything behind, we do not yet know.

Claim 1 — Protection was a political market

Grossman–Helpman applied to Indonesia: the crony-capture model fits better and better across three decades, while the national-policy model fails.

	1975 · Oil boom	1987 · Post-oil boom	1995 · Reform era
National policy	Best fit	Fails	Fails — signs reversed
Crony capture	Small	Strong	Persists

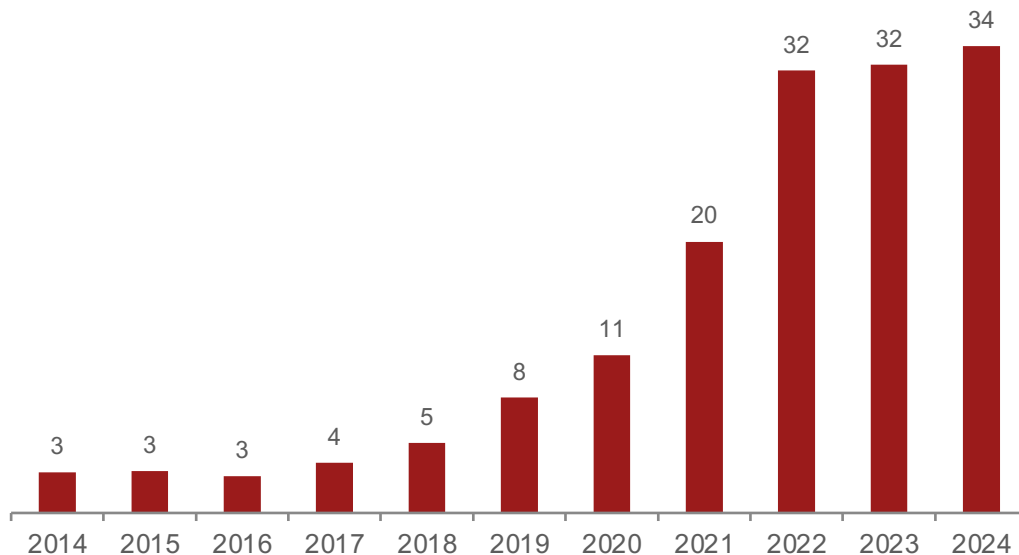
When tariffs fell, the rents moved to licences and non-tradables — they did not disappear.

The poor pay: the 2004 rice import ban raised prices by about a third and pushed 3.1 million into poverty.

Successful protection creates rents, and those rents eventually capture the policy.

Industrial policy is back — and nickel delivered

Nickel value-added exports, US\$ billion



US\$71bn

FDI into base metals since 2015

296 vs 151

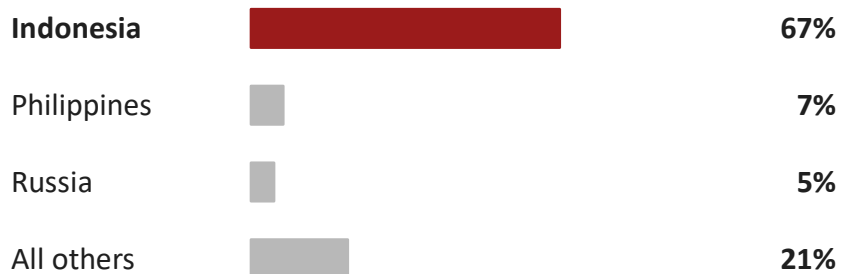
Central Sulawesi vs Indonesia GRDP, 2024 (2014 = 100)

0.37 → 0.28

Central Sulawesi Gini, 2015 → 2025

Claim 2 — Market power made the ban bite

NICKEL — SHARE OF WORLD MINE OUTPUT, 2025



China had no alternative feedstock, so China moved to Indonesia.

BAUXITE — SHARE OF WORLD MINE OUTPUT, 2025



The buyer never had to adjust. Indonesian mine output halved.

Do not copy the instrument without the market structure — and do not assume the structure survives being used.

Even with market power, a ban is not the best instrument

EXPORT BAN

- Rent goes to smelter owners
- Subsidy with no ceiling
- Fails GATT Article XI

LEGISLATED, DECLINING EXPORT TAX

- Government shares the rent
- Falls as verified smelter milestones are met
- Relief is earned, not granted

Investment $\neq$ capability. The goal is not maximum domestic processing but maximum domestic capability.

The hidden cost of forcing investment onshore

Not only who captures the rent — what industrial structure the rent creates.

OVERINVESTMENT

- Capacity expanded fast; nickel price fell from ~\$26k/t to ~\$15–16k/t
- 2026 ore quota cut, 379 → 270 Mt

The ban built capacity. Can it sustain it?

INNOVATION

- Plants moved to Indonesia; core metallurgy and R&D did not
- LFP now >55% of EV batteries — substitution risk

Investment ≠ technological capability

PRODUCTION NETWORKS

- Industrialisation is cross-border; nickel alone is not a battery
- Capability needs technology, inputs and global markets

Processing ≠ domestic capability

The objective is not maximum domestic processing — it is maximum domestic capability.

Three tests, and the through-line

Discipline is rarely self-imposed — Indonesia has twice been disciplined from outside, by depreciation in the 1980s and by Chinese smelters after 2020. These tests build the referee at home.

Market failure What externality justifies this — not just which incumbent is asking?

Discipline What measurable target, and who can withdraw support if it is missed?

Incidence Who captures the rent, and what capability comes back in return?

Creating a rent is easy. Making it temporary is hard. The test is whether the rent leaves behind a capability when the protection is gone.

An invitation: four testable claims

What I saw on the ground, stated so that better identification can prove me wrong.

1 Did rents buy capabilities?

Claim Sectors protected before 1998 kept their productivity and export presence once protection was removed.

Design 1998 IMF liberalization as the shock; Statistik Industri firm panel; event study by pre-crisis protection.

2 Crony capture or infant industry?

Claim Political connection predicts tariff-line protection better than learning potential or scale economies.

Design Connected-firm data (Mobarak & Purbasari) matched to tariff lines, 1975–1995.

3 Does rent-seeking rebrand?

Claim When tariffs fell, the same business groups reappeared behind NTMs, local content rules and licences.

Design Link tariff, NTM and ownership data; follow groups across instruments.

4 Nickel: imported discipline?

Claim Export restrictions deliver downstreaming only where Indonesia holds market power.

Design Synthetic control for nickel; bauxite and copper as comparison cases under the same regime.

What counts as capability: export survival without subsidy, product upgrading, domestic supplier linkages — not TFP alone.

THANK YOU