

CHAPTER 1

INTRODUCTION

1.1. Background

In the current global trend, energy transition from replacing high carbon energy such as oil, coal, natural gas, and other fossil fuels to low-carbon energy has become indispensable to mitigate global climate change. About 73% of the greenhouse emissions today are caused by the energy sector, particularly dominated by the use of fossil fuels. The impact of the chronic global CO₂e (Carbon dioxide Equivalent) emissions can be seen from the increasing frequency and dangerous unprecedented extreme weathers. Such as the devastating heat wave that happened in Australia in 2019-2020, the worst case of floods in Europe and South Korea in 2021 and 2022, respectively, and many more. The long-term implication can even affect the risks of food and water security, population displacement, and the increase in mortality rate (UN, 2021).

Energy transition issue is a high political issue as it has been a topic concerned in many high-level conferences, international institution goals, and international agreements alike. With the holistic change in global climate and energy policy, technological advancement, financial sector and shifts in the supply and demand of energy, it eventually would affect every aspect of the national energy system as well. Fortunately, with the rapid falling costs of renewable technologies, it has opened up

more options and possibilities to amend this issue. Up to this point, the development of energy transition in many countries have shown promising outlook to transform their energy sector, moreover, stakeholders needs to speed up and accelerate a transformational effort to do a system overhaul (UN, 2021). Such actions are needed to ensure all the targeted goals are fulfilled within the timeline and able to achieve net zero emission by 2050, in addition, to at least keeping the global temperature rises within 2 degrees and/or preferably 1.5 of pre-industrial levels (Deloitte, 2022).

The current market trend reflects that the transition of fossil fuels to clean energy is necessary and widely supported by shareholders, investors and customers who are incorporating the impacts of climate change into their decision making considerations. In fact, according to IRENA, half of the existing renewable capacity added in 2019 has achieved lower electricity costs than new coal. Many stakeholders are already moving towards the realities of energy transition. Economic calculations, along with a sense of social and moral obligation is often expressed as maintaining a “social licence to operate” and part of the biggest motivator for these stakeholders (UN, 2021).

One of the conspicuous examples and promising projects to reduce emissions is in the automotive industry. Many major automakers like Honda, Subaru, Toyota, Hyundai, Tesla, and others alike are sharing their planned target to abandon the production of internal combustion engines vehicles (ICEVs) which are powered by fossil fuels, gasoline, and solar that contributes to the emissions into battery powered electric vehicles (EV) (UN, 2021). At the present, automakers have shown sound effort

in energy transition through the production of hybrid electric vehicle (HEV), which means half of the car that still possesses internal combustion engine and half of it relies on electricity from battery to run (UN, 2021). Currently, there are automakers that have produced a complete electric vehicle available in the market and implemented the use of electric vehicles for running business. In 2022, Maersk, an integrated container logistics and one of the biggest supply chain services in the world has announced that it is deploying 300 electric trucks to operate in the North America network (Maersk, 2022).

With the increasing demand of electric vehicles, simultaneously, the demand for raw materials to produce batteries like Nickel, Cobalt, Lithium, and other precious minerals needed increases. Nickel, in particular, is an indispensable component to produce batteries. In 2020, the Ministry of Energy and Mineral Resources stated that Indonesia owns 52% of the world nickel ore reserves, followed by Australia (15%), Brazil (8%), Russia (5%), and other countries such as Cuba, China, Canada, and the Philippines makes up 20% of the world nickel reserves (Kementerian Energi dan Sumber Daya Mineral, 2020). That means, Indonesia, as the possessor of the largest Nickel ore in the world, plays a big part in the global nickel supply chain. However, in 2014 the Indonesian government imposed an export ban on raw mineral ore, which also includes nickel ore (Damuri et al., 2019). The reason for the export ban is to fulfil the wish of the Indonesian government to invite foreign investors to invest in smelting projects, hence, the goods exported shall have a value added or in the form of semi-finished or finished goods.

Although the export ban was deemed to be inconsistent, as in 2017, under the Government Regulation No. 1/2017, the government imposed a relaxation of nickel ore export (Pandyaswargo et al., 2021). Then to fully enforce an activation of nickel ore export ban again in January 2020 under the Law Number 3 Year 2020, which stipulated that all mining companies are obliged to increase the added value of minerals in mining business activities through processing and purification for metal mineral mining commodities domestically (Pandyaswargo et al., 2021). In other words, the goods shall have the 40% of *Tingkat Kandungan Dalam Negeri* (TKDN), building the whole upstream to downstream project in Indonesia territory.

In response to this export ban, China, as Indonesian biggest nickel importer, proactively built a ferronickel smelting industry in the nickel concentrated area in Sulawesi. The cooperation of the Chinese multinational corporations have already started since 2009, with the joint operation between Decent Group of China and PT Sulawesi Mining Investment (PT SMI) of Indonesia for nickel ore mining and export, which later developed into a smelting projects in response to the export ban. The cooperation was accelerated by the huge investment made by Bintang Delapan Group who owns PT SMI and Decent Group to establish an industrial park, named PT Indonesia Morowali Industrial Park (IMIP), dedicated for nickel-based industries. The industrial park covers more than 2000 ha of land, easy access to land, sea, and air transportation already has tenants resided there (Damuri et al., 2019).

IMIP itself uses Business to Business (B-to-B) schemes with little government involvement, and provides tenants with ready infrastructure facilities like the electricity,

telecommunications, ports, etc. The Shanghai Decent Investment owns 66.25% stakes in IMIP, while Indonesian company, Bintang Delapan Group owns 33.75%. The nickel deposits in Sulawesi are estimated feasible to be mined for decades (Damuri et al., 2019). Hence, it is followed by the B-to-B schemes for other nickel mining and smelting companies inside of the industrial park areas as well. This cooperation is technically in line with the government's interest in supporting downstream projects in the mining industry. However, throughout the recent years, there have been issues concerning the Chinese investments in Indonesia, or broadly seen as the Belt and Road Initiative (BRI) projects. Additionally, to the diversification of national collaborations and loans from the Indonesian government with China.

Hence, considering the Indonesian government outlook on the nickel downstream processing industry, it is plausible to look at the relations between multinational corporations and host state relations to assess the effectiveness of the downstreaming policies imposed to accelerate Indonesia's national interests. When a multinational corporations resided in the host country, especially on the extractive or natural resources industries are those who are bound to the obsolescing bargain factor. Obsolesce is synonymous of falling into disuse, thus, the factors are referring to the expiring bargain between multinational corporations (MNC) and host government over immobile resources that could be taken into "hostage" by the host government to leverage their bargaining power in the renegotiation term. Host country needs a huge fixed investment, sophisticated technology, and brand or marketing identification provided by MNCs direct investments.

It is imperative to assess the Chinese MNCs and its investments as they had incrementally dominating the industry through several strategic cooperations with the Indonesian government. To easily analyse the dynamics between MNC-host state relations, Raymond Vernon have developed an analysing tool called the *obsolescing bargain model*, which was developed from the obsolescing bargain factors. However, Vernon's obsolescing bargain model is deemed too simplistic and does not fit with the nature of the MNCs-Host States relations recent tendencies. The *political bargaining model* is the upgraded and reconceptualized version of the obsolescing bargain model, which stipulated the political bargains negotiation over a wide variety of government policies at the industry level (Eden et al., 2004).

Precedent issues on obsolescing bargain had happened during the renegotiation term between PT Freeport Indonesia and Government of Indonesia, the renegotiation deal shows that the Indonesian government has won politically, but has less relative economic benefit from the deal (Irawan, 2021). This is an important reflection and reference for Indonesian government's for fairly weighing both political and economy bargain in mind. Despite many differences in the cooperation conditions, it would eventually raise the questions for the effectiveness of Indonesian government in handling the abundant nickel reserves through Chinese direct investments. Therefore, this thesis will use the political bargaining model as a tool to analyse Indonesia's nickel downstreaming policies based on the relations between Chinese MNCs and Indonesian government as the host state through Liberal perspective.

1.2 Research Questions

Based on the preliminary information that is mentioned above, I suggest the following research question, “What is the nickel downstream processing policies based on the relations between Chinese MNCs and Indonesian government?”

1.3 Research Objective

The objective of this research is to identify the progress of nickel downstream processing policies based on the relations between Chinese MNCs and Indonesian government using the Political Bargaining Model to decipher the relative goals, resources, constraints and outcomes if both party happened to conduct a negotiation over industrial policies. The Political Bargaining Model is a policy analyzing tool coined by Lorraine Eden, Stenie Lenway, and Douglas A. Schuler, as the reconceptualization of the obsolescing bargain model derived from the obsolescing bargain factors of MNC-Host State relations by Raymond Vernon.

1.4 Research Significance

The purpose of this research is to provide a deeper insight on the complex interdependence between Government of Indonesia and Chinese Multinational Corporations through the nickel industry in Indonesia. In addition, this study will also be useful as a source of information to understand about Indonesian downstream processing policies on raw minerals, specifically on nickel. It is significant that this research will advance the knowledge of scholars studying international relations, particularly in the field of international political economy on Chinese Multinational

Corporations, China-Indonesia bilateral relations and cooperation, and as a contribution of perseverance for the political bargaining model.

