



## The Origin of Oil Plunge in Political Economy and Aftermath on the Oil Price

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### ABSTRACT

Since the past decades, humans watched the changes of politic and economy in the world from the small campaign into huge riot. This kind of events happened all over the world due to the demand for the better administration and ruler had increased until today. Nowadays, the world witnessed the effects of the political economic on the human needs. However, oil price is the major parts of the human needs which affected due to the world political economy revolution. As the revolution increase from time to time, the oil price faced challenges and dilemma in terms of the rise and fall of the oil prices. Oil industry plays huge roles on the social development and economy as it effects all the countries in the world as well. Nevertheless, the oil price cannot be analyzed theoretically and practically based on the political issues in the oil producer country while political economy hold the vital role in determining the right price of the oil in the world.

**Keywords:** Price, Economics, Politics, Fuel, Gas, War and Oil

**JEL Classifications:** Q21, P48

### 1. INTRODUCTION

According to the economic conceptual point of view, political economy seen as "political economy is the science of wealth" and need to "deals with efforts made by man to supply wants and satisfy desires" (Eatwell et al., 1987. p. 907) while in the classical Greek, the economic terms tells the terms rooted from *oikos* for house and *nomos* for law. Thus, this explained the economic was referred to household management while "political" is the Greek terms which stand for *polos* or the city-state. According to Steuart (1967. p. 2), he mentioned about the connection between economy and political economy as "what economy is in a family, political economy is in a state."

As defined by the dictionary of economic terms, political economy seen as a "branch of statecraft" but it is different in the present as it regarded as a study in which moral judgments

are made on the particular issues." On top of that, it also can be defined as social relation which is the power relations has the power to constitute the production, distribution and resources of the country. The social relation power has the power or ability to control the human, progress and systems in the organization as it concentrate on a specific set of social relation. In 1995, Heilbroner labeled the great economists as "no mere intellectual fustspots. They took the whole world as their subject and portrayed that world in a dozen bold attitudes - angry, desperate and hopeful."

On the other hand, Brennan and Buchanan (1985) stressed that economic is a study with broad understanding which focuses on the "how markets work" and "the coordination of individual behavior through the institutional structure." Thus, the subject in the political economy is to create the rules to governs the relationship between the individual and institution. By creating

the rules as the choice, it will governs everything from within the markets (goods and services) to the markets with consists of votes, spouses, children, sex, communication and others. According to Lazear (2000), this condition called as “economic imperialism” which is necessary to govern the markets from the traditional private markets to another phase of the markets.

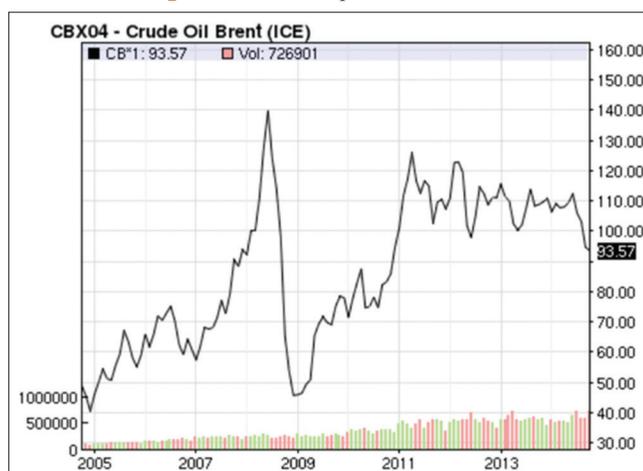
## 2. THE POLITICAL ECONOMY ON OIL PRICES

In the international energy markets, oil prices influenced by the political power as it affected the price mechanism all the time. However, predicting the oil prices is very hard due to the events that happened in the producers’ country especially the Saudi Arabia country, Middle East and others because of the internal and external events. On the other hand, Ghorbel and Boujelbene (2013) said the political instability in Bahrain during 2011 had showed negative correlations which a sharp decrease occurred later then between oil market and other stock markets.

As shown in the Figure 1, the growing global economy in rapid speed in China and India has led to quick rise in oil prices. The highest oil prices rate was in 2008 as shown in the Figure 1 nevertheless it had plunged dramatically in 2009. This phenomenon was due to the economic crisis in the U.S and the oil prices began to increase since then. This event proved the political economy has affected the oil prices especially during economic crisis.

According to Temel (2012), the transformation of oil can be seen from an economic supply into a political economic goods. As in the 19<sup>th</sup> century, petroleum has become a significant commodity from domestic level to international trade and it also has triggered the political power with it. However, this political power has restrict the power of policy in many governments in international level and it caused unpredictable value in economic trade nowadays. In this event, petroleum is a source that comes with terrific possibility and impact on political and economic.

Figure 1: Crude oil prices, 2005-2014



Retrieved from the NASDAQ

Regardless the possibility and impact, Saudi Arabia assumed the petroleum as the price setting or “oil sword” while “energy superpower” is the term chose by Russia to describe the power of petroleum due to the influence on domestic and international (Bierman, 2012). Hence, the exploration of oil or petroleum increased as the commercial transportation and use of plastic rise in order to extract and hone the petroleum. In 1870, standard oil became the largest oil company and most expensive business in the world (Temel, 2012; Qureshi et al., 2014). The rise of exploration companies on petroleum increased in the following years as it driven by the drilling and exploration industry that led to monopolistic behavior (Manns, 1998).

Thus, the mechanism of price in the international markets shows that the political economy has the power on oil pricing since it has become one of the aggregate factors which determined the bids on crude oil prices (Temel, 2012):

- Economic (trading, supply and demand, technology, capacity, commodities and global economic growth).
- Environmental (climate, new extraction plants and quality of petroleum).
- Political (law and regulations, the quantity of oil or petroleum in the national reserves).

In addition, political economy could impact the oil prices through the international conflicts due to the oil interests among huge power countries. The war in Iraq had the probability in 10% increase of oil price by \$1 and standard and poor’s 500 (S&P 500) had decreased by 1.5% (Leigh et al., 2003). However, the price of oil increased by \$10 and S&P 500 had declined by 15% due to Operation Iraqi freedom in 2008. The conflict of oil does not only happen in the producers’ country but supply side as well as happened in the Middle East.

According to Barsky and Lutz (2004), the conflict break out in the producers’ country has caused the distributors to increase the oil stocks which the possibility of being interrupted by the conflict has increase. Due to the precautionary by the distributors, the producer unable to produce the new demands which caused the pressures manifests itself on prices. The prices of crude oil increased as a result of high demand in supply and it rose significantly during the Iran-Iraq war and invasion of Kuwait (Temel, 2012). The “Darfur Genocide” is another events that had created the oil conflict or oil politic as American government use the opportunity they have at that time to remove the current leadership (Sharife, 2009). In returns, President Jaafar Nimeiri gave an area to Chevron company for oil exploration and drilling. Hence, Malaysia has located some incentives to extend the life of crude oils.

## 3. THE AFTERMATH OF OIL PRICES PLUNGE

The impact of oil prices can be seen through some channels; trade, importers, exporters, commodity, monetary, fiscal and investment. Through these events, immediate consequences can be seen in the policy responses, fiscal and external balances.

Rapid changes in oil prices could reduce the numbers of investment and long-lasting goods usage. The uncertainty of oil prices could cause the firms to delay investment period while the level of capital expenditures could decrease (Kilian, 2014; Bernanke, 1983; Pindyck, 1991). This uncertainty driven by hike movements on oil prices could delay the durable goods consumption and lead to precautionary demand by the distributors (Anzuini et al., 2014).

The plunge of oil prices effect the overall energy costs which reduce as the competitiveness in energy products are forced down and the products become cheaper. The effect of plunge caused the fall of prices directly impacts on the wide range or semi-processed input especially in various sectors. In addition, consumers will enjoy lower costs in energy and fall of inflation as it increase disposable income and support consumption. In the global activity, the plunge of oil prices helps in an environment of enhance labor markets and increase consumer confidence. In United States of America, the plunge in oil prices could help them in increasing the gross domestic product (GDP) by 1¼% in 1 or 2 years. However, the European Union faced different situation where the plunge in oil prices did not help in increasing the GDP but it decline into smaller due to deflation (European Commission, 2015).

In responding to the oil prices plunge, Venezuela had call for OPEC emergency meeting in October in order for the failed of price hikes which is to gain grip as Saudi Arabia and Kuwait. Some members of OPEC countries urged the OPEC to find the solution to boost prices but it failed in the OPEC meeting on November 27. As said by Abdullah al-Badri who acted as OPEC's Secretary General, "OPECS's oil production is unlikely to change much in 2015 and there is no need to panic at the crude price drop" (Arnsdorf, "Oil: Saudi Arabia's Risky Price Play").

This remained low oil prices has weaken some activity in exporting countries especially in trade and tourism. As for example, the weakening of Gulf Cooperation Council (GCC) in Venezuela might put at risk their financial accounts nevertheless Russian and GCC faced slowdown growth as the numbers of visitors has decline. Inflation is another event that can be seen as aftermath of oil plunge and pass-through to inflation seems to be declined over certain of years (De Gregorio et al., 2007; Blanchard and Gali 2008; Qureshi et al., 2015). The plunge of oil prices has leads to significant plunge in the some commodities prices in Asia and Europe. The liquefied natural gas (LNG) prices in Japan has fall 11% and European countries did not suffer from the plunge because they are partly linked to oil. Unlike United States, oil prices play vital role where they are happen determined by domestic supply and demand conditions. The changes in non-oil commodity has effect some countries as the lower agricultural commodity prices helps in developing large market shares.

Differ than Venezuela, the other members of OPEC has taken different actions to overcome the plunge of oil prices in their countries. In Saudi Arabia, this OPEC leader has standardized their oil prices starting in the beginning of oil crisis in the 1970s.

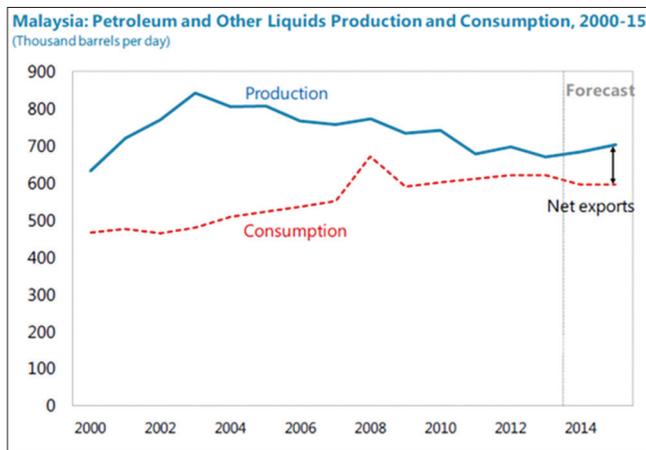
As the leader of the OPEC, they had shift the oil prices from time to time as Saudi Arabia seen the stability of oil prices as crucial element in balancing the global economy and they used the spire production to decrease the instability of oil markets. Saudi Arabia also took several action to overcome the oil crisis such as decrease the oil production by 2.3 million barrel per day from 10 million barrels in 1985. UAE responded to slow global economy by cut government spending (Christopher., "Saudi Arabia: Background and U.S. Relations"). According to IMF (2014), UAE reduced the government spending in order to balance the budget and they were also reviewed cuts especially on subsidies (electricity and water). Cutting oil exports and fluctuating to process naphtha was an action taken by Qatar and they also offered a flexible contract to Asia by selling 80% of its LNG (DiPaola and Tuttle, "Qatar Shifts Export Strategy as U.S. Light Oil Competes").

They also rescheduled some target dates for infrastructure projects which is worth US\$660 billion as it related to the 2030 National Vision Development plan. Kuwait faced the same situations as the other since they also relies on oil export but they remains in good financial shape. Nevertheless, Kuwait Finance Minister stated that they need to improvement the spending as the oil price plunge by diversify their sources and not rely on the oil production. In October 2014, Kuwait took an action by increased the kerosene and diesel prices from 19 cents to 57 cents as the impact affected the electricity and water ("There's no going back: Kuwait quietly triples diesel and kerosene prices," 2014).

Furthermore, as the smallest oil producer which produced 48,000 barrels a day, Bahrain faced the same event as the others. However, Bahrain is not a member of the OPEC but their petroleum is the most important export. In the political stand point, the plunge of oil prices affected by the Shias as the majority in Bahrain and they are dominating the oilfields while the rise of ISIS and the conflict between Shias and Sunnis could threat the oil production in Bahrain ("U.S. Energy Information Administration - EIA - Independent Statistics and Analysis," 2013). Hence, the conflict between these parties could threaten the economy of Bahrain.

As one of the oil producer in South East Asia, Malaysia faced the same phenomena due to the oil plunge issue as well as other Asian countries. The decline of oil production approximately in 590,000 barrels per day (bbl/d) from 844,000 bbl/d (the peak production) in 2000s. This phenomena was caused by the maturing of oil fields and the joint ventures was prompt by Malaysia in order to improve oil exploration. As the below, the volume of petroleum and other liquids from 2000 to 2015 showed the incline of the consumption and decline of the production. The fall of production volume from 2000s could not cover the consumption volume which caused the oil plunge and it has forced Malaysia to seek for oil exploration venture. The year of 2014 showed the forecast period which Malaysia expected the higher volume in oil production and lower consumption volume in the subsequent years. Although the negative impacts are on the oil and gas sectors and other sectors but these sectors will enjoy the benefit from lower energy costs and the decline of exchange rate due to the positive impact on

**Figure 2:** Malaysia: Petroleum and Other Liquids Production and Consumption, 2000-15



Retrieved from International Monetary Fund: Malaysia (March, 2015)

exports that could be increased by improving outlook in trading partners (Figure 2) (IMF, 2015).

#### 4. CONCLUSION

In conclusion, Nations experiencing the asset curse show greater rates, levels of defilement, asset extraction, monetary fixation, government reliance, swelling, destitution, newborn child mortality, furthermore, starvation; and show lesser degrees of straightforwardness and responsibility, per capita pay, proficiency, also future after some time. Comprehended in this setting, the asset condemnation serves as a valuable structure for emphasizing how a relative wealth of regular assets is inadequate alone to advance monetary improvement and clarifies why numerous resource rich nation like Arabian countries have performed ineffectively at different focuses.

The decline in oil price has serious macroeconomic, monetary and arrangement suggestions. On top of that, it will bolster development and lessen inflation, external, yet financial loads in an expansive number of oil-importing countries. Hence, pointedly lesser oil costs will drain monetary, outer positions and diminish financial in a couple oil-trading nations. These changes could be unexpected at times. The lessening in oil price has essentially hosed speculator feeling about oil-sending out rising business sector economies, and rapid generous irregularity in money related markets.

Then again, lessening oil prices additionally exhibit huge chance to change fuel sponsorships, which are important in a few creating nations, and life charges, and to revive changes to broaden oil-dependent economies. However, forecasts on the advancement of oil markets remain exceptionally dubious. Thing costs, including oil, have a tendency to be unpredictable, making determining inclined to blunders. For oil, the unconventionality is further intensified by better geopolitical pressures and sudden change in OPEC's strategy destinations. As time goes on, physical (topographical) limitations ought to put upward weight on the genuine cost of oil, albeit mechanical advances could moderate

the increment. Forcefully separating judgments on recoverable stores and on future value versatilities of oil request and supply infer that oil value estimates as time goes on are liable to wide blunder groups (Benes et al., 2012).

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