

# CHAPTER I

## INTRODUCTION

### **A. Background of the Conflict**

Arab Saudi, as the part of the Middle East, has significance impact for the world as an oil producing country. The Middle East is a region which has the biggest oil reserves and production, i.e. more than 66% of world oil production and reserves (Jatmika, 2007). This is because the Middle East region itself belongs to the Heartland region.

According to the British geopolitics, Heartland has a huge amount of mineral resources and they are not found anywhere in the world. In his thesis, Mackinder argued that anyone who can conquer the Heartland (World Island) in modern politics and the economy will be able to gamble toward global empire (Sugiyanto, 2005).

Another US geopolitical expert, Nicholas Spykman also has an incredibly similar view to Mackinder (Sugiyanto, 2005). Both figures are have a thought that whoever control the World Island will be able to control the world. The confidence on those view which is exactly has a possibility of pushing industrialized countries, especially the US, scrambling to establish close relations with the countries in the Middle East, because the countries that proved rich of "black gold".

After the oil discovery was done in Saudi Arabia, the country is much more developed and many countries in this world is rely on Saudi Arabia's oil maket to fulfilling their needs. As a huge oil producing country that have oil as their natural resources as well as their most capital incomes are come from oil production, Saudi Arabia itself has to feel that they are too dependent on the oil production as the first priority in fulfilling their country's income.

The drop in oil prices that began in June 2014 is now beginning to raise concerns the economic elite. International Monetary Fund (IMF) warned the impact of the decline of world oil prices in the Middle East, especially Saudi Arabia that they are may not survive by themselves forever from the cheap price of oil (IRIB, 2015).

The price of goods, especially oil, in the economic term is usually can not be separated from the demand and supply factors, such as the theory of economic law when demand rises while the offer was fixed, it is automatically rises as demand increases. On the contrary if demand is fixed while supply continues to increase, prices will tend to fall because basically the price level will be equal to the level of demand and inversely proportional to the level of supply. Along with the development of world economic conditions that always experience ups and downs indirectly will also affect the price of crude oil in the world. Changes in crude oil prices will certainly also affect the economic conditions both in oil-producing countries and in oil importing countries.

The development of world oil prices experienced many changes. This is because oil is the most important energy source and required by all countries in the world without exception. The need for energy in the form of oil is very massive, which is the problem is not all countries in the world have oil resources. In another mean, spread of the world's oil reserves is not evenly distributed.

The drop in crude oil prices caused by the United States which is now become the world's largest crude oil producer with a production of 8.5 to 9 million barrels of crude oil per day. These prices soared 65 percent since 2010. Compare by a total production of OPEC countries (consisting of Iran, Iraq, Kuwait, Saudi Arabia, Venezuela, Qatar, Libya, the United Arab Emirates, Algeria, Nigeria, Gabon, and Angola) which are only 35.84 million barrels of crude oil per day. In September 1960, the Government of Saudi Arabia, Iran, Kuwait, Iraq, and Venezuela met in Baghdad to build OPEC (Levy, 2006).

Furthermore, the effect of the declining world crude oil prices due to a number of oil reserves is not increased. This hypothesis has long been understood but each time the prediction of "the last drop of oil," the fact remains that there is still oil reserves available. Some predictions are wrong hypothesized in the book entitled *Peak Oil and the Second Great Depression, Peak Oil Survival and When Oil Peaked* published in the early 2000s (Xue, 2015).

The market price of petroleum revenue and profits decline means clearly decreased. OPEC member countries clearly feel the consequences. In the end, it will result in the economic balance of the country concerned. In fact, OPEC member nations that have offshore debt are having a possibility to have bad debts.

For this time, besides of a small number of oil exporting countries, the majority of their economies rely on sales revenue of oil and it is natural for them with the continuity of the decline in oil prices and foreign exchange income, so these countries will experience serious matter such as budget deficits, inability to fund all of the development projects, the absence of control of foreign exchange rates, and the declining value of the national currency and inflation.

In the midst of the declining global oil prices, world oil production actually recorded increases. Responding to the issue of the excess oil supply, Saudi Arabia chose to increase the supply of oil to their high production's record and continue to produce more oil again.

Because Saudi Arabia is too depending on income from crude oil trading, makes this country experienced a domestic crisis, especially when the price of crude oil dropped sharply. For the record, in mid-2014, the price of crude oil in the international market remained at a figure of US \$ 110/barrel. The figure then plummeted below US \$ 50 / barrel in 2015 and had even touched the level of US \$ 26 / barrel at the beginning of 2016 (ESDM, 2014).

There are several things that cause the decline in crude oil prices in the different periods, they are:

1. The global economic slowdown. In general, the real sector at the global level has decreased significantly. It is also associated with the strengthening exchange rate of US \$. The policy of the US central bank (the Federal Reserve / Fed) when it is started to stop the quantitative easing policy helped boost the value of US \$ in the international market.

2. The emergence of geopolitical risks, among others, related to the issue of annexation of territory of Crimea by Russia, which is dragging the involvement of the United States and the European Union. It should be noted that the United States and Russia are also the largest crude oil producer in the world.
3. Awareness of the importance of reducing exhaust emissions from the consumption of fuel that could harm the environment, in accordance with the purpose of the agenda of the Millennium Development Goals (MDGs), which is then followed by the Sustainable Development Goals (SDGs) (ajarekonomi, 2016).

Thus, due to the falling price of crude oil in the international market, the Saudi government budget deficit fell sharply, from the original deficit at 3.4% in 2014 up to 16.3% in 2015 (Number13, 2016). The impact of these issues leads to deterioration of domestic economic and social crisis.

Domestically, the Government is currently working hard to welcome the country's post-oil era and prepare a clearer road map through Saudi's 2030 Vision. Preparations to leave their oil dependence, accompanied by Saudi efforts to boost diversification of national income. The outline of 2030 Vision includes efficiency in government, a greater role for the private non-oil sector as well as more aggressive management of government assets.

## **B. Research Question**

From the background that has been explained above about the declining world oil prices and its impact on Arab Saudi's policy, the research question of this undergraduate thesis is "How does Saudi Arabia's create policy to manage the declining world oil price?"

## **C. Theoretical Framework**

In a thesis or research paper, theoretical framework is an important part. The theoretical framework is like a foundation of a thesis or research paper. If a thesis or research paper does not have a theoretical framework, then the writer will be difficult in completing the thesis because the writer does not have a standard measurement of their thesis or research paper.

In this undergraduate thesis, the problem has a multidimensional impact on both national and regional sphere, especially, this impact of the decline in world oil prices for the Saudi Arabia. They are may not survive by themselves forever from the cheap price of oil production. The purpose of this research is to observe the external economic security threats created by the problem. Internal issues of Saudi Arabia economic in declining oil prices are both from international and domestic. Therefore, it becomes the scope of making this International Relations issue. This research will be connected to International Relations theory. This research uses Carbon Democracy Theory as Theoretical Framework.

In this modern world, human beings can fulfill one of its necessities by consuming fossil fuels as an energy source to supply the need for the construction

of facilities and infrastructure. Today, in the global system of agriculture, transportation, industry and in everything else we all rely on fuel as the energy source of crude oil. In a book written by Timothy Mitchell entitled *Political Power in the Age of Oil* explains some theories of modern democracy that directly link energy production with the emergence of democratic politics, arguing that both democratic politics and energy production have been 'interwoven from the start' (p.8).

Mitchell explains how the development of the coal industry, and its dependence on energy derived from coal, enables a new political democratization. (Mitchell, 2011) Coal miners and other workers can make their demands heard and noticed because they are literally and physically in a position to make coal production undisturbed. With the oil as a substitute for coal, it is a form of response to this democratization. First, oil is selected as the successor to coal, among them to disable the worker that has a relation before with coal mining. Second, it is physically arranged in such a way as to make any disturbance in the oil mining and production that will appear to be more difficult.

Mitchell's thought of the development of a study object which is known as "the economy", which he thought it only existed in the mid-20th century. Instead of a political economy that pays attention to the possibility of exhaustion of natural resources, and the cost, we now have a "science of money":

*"its object was not the material forces and resources of nature and human labour, but a new space that was opened up between nature on one side and human society and culture on the other—the not-quite-natural, not-quite-social space that came to be called 'the economy'". (p.142)*

The concept of "*depended upon abundant and low-cost energy supplies*" (p.139) may seem absurd, but in fact, they become more self-reinforcing and had implications for how we perceive our world and act politically in it:

*“Democratic politics developed, thanks to oil, with a peculiar orientation towards the future: the future was a limitless horizon of growth. The horizon was not some natural reflection of a time of plenty. It was the result of a particular way of organizing expert knowledge and its objects, in terms of a novel world called 'the economy'. Innovations in methods of calculation, the use of money, the measurement of transactions, and the compiling of national statistics made it possible to imagine the central object of politics as an object that could expand without any form of ultimate material constraint.”* (p.152)

Looking at the above theory, it can be interpreted that an oil-producing countries can literally manage the price of an economy of their goods, in this context of petroleum, since petroleum itself has been regarded as a political object by all levels of society in the world because of the importance of an energy to live in everyday life even to help the development of a country.

Saudi will not decrease its intention to produce oil even though the price of peak oil down to 20 US \$ per barrel because it will cause the deficit of state revenue for years to come and it can be seen as a new gain seeking mentalities. The oil business, though in view of the theory strategy, is how the manufacturers make a profit as much as possible for domestic interests.

However, in reality it has a long history of the relations of power, conflict, and security, where the other purpose is exporting countries rather than the need to maintain the main absolutes objective i.e. revenue gains into the country. They

also have to contend with the aim of relative i.e. dynamical revenue varying played both competitors and opponents of political economy.

Their behavior is adjusted to the challenges of change in the constellation of these threats. That is the conclusion of the character that wants to make a profit or gain-seeking. Seeing what was done by the Saudi is not very easy to read. Furthermore, they were looking for the new challenging of constellation of threats. This is new challenging of constellation of threats is means that Saudi was playing a game on their strategy to threat the distribution partnership and distribution strength in the area of Middle East conflict that was changing drastically because of the oil price.

#### **D. Hypothesis**

As the above background and the theoretical framework have already explained, the Saudi Arabia's policy to manage the declining of world oil price in 2014-2015 is by:

1. Keep refusing to cut the production and keep the oil price cheap due to their oil market strategy for both oil producing country and non-producing inside OPEC,
2. Selling shares to the PIF (Public Investment Fund) and foreign countries for the national oil company (ARAMCO) up to 5% and adding new and renewable energy resources.

## **E. Research Purposes**

The purpose of this undergraduate thesis is to explain the strategy by Saudi Arabia towards the declining world oil prices. In writing this undergraduate thesis, when this research accomplished, this paper would comprehend that the consciousness of such problem must meet with the integrative strategic and tactical efforts to solve the problem effectively and efficiently.

The other important purpose of research purposed is to implement the knowledge which has already been obtained from the process of studying in the International Relations program by analyzing theory with the existing phenomenon in hope that it will give a positive contribution especially for the students of International Relations. This undergraduate thesis is required to achieve the undergraduate degree in International Relations program, Faculty of Social and Political Science, Universitas Muhammadiyah Yogyakarta.

## **F. Methodology**

This research was completed with two kinds of relevant data and/or information. First, official statements released by Saudi Arabia government about how to maintain this kind of problem. Second, statistical data collected mainly from U.S. Energy Information Administration as the main resource. The statistical data would be analyzed, interpreted, and manipulated into table and graphs to compare to the first in order to draw a conclusion.

This research is a descriptive research. The method was chosen to analyze the problems and to find the conclusion toward the issues. There are three main

steps of a qualitative research; there are data collection, data categorization, and analysis.

### **1. Data collection**

This research was conducted in a library and online research to collect secondary data that was obtained from literature such as books, journals, bulletins, magazines, newspapers, articles, and internet sources.

### **2. Data categorization**

After collecting the data, the data were classified in order to determine the appropriate and suitable data for conducting the analysis.

### **3. Analysis**

The categorized data were analyzed in accordance with the theory that has been described in the theoretical framework. From the analysis, the conclusion was asserted to answer the research question.

## **G. Scope of Research**

This undergraduate thesis will make a limitation by regarding the scope of the time which is in 2014-2015, when the first stage of the declining of world oil price and up to the time this research is conducted.