

Geopolitical Future of Oil Market in Shadow of USA Sanctions Policy

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ABSTRACT

Economic sanctions imposed on heterogeneous states have played an important role as a tool of pressure in recent decades. Considering that most states nonconforming with the US are important players on the energy market, large part of this country's sanctions policies has focused on the energy sector. With the evolution of the US shale oil industry, using energy as a tool of sanctions against target countries has received increasing attention by the US presidents in recent years. The US is using the geopolitical shift as an international strategy to compete with other powers in the energy sector such as Iran, Venezuela, and Russia. The US aims to use its energy embargo policy to curtail the influence of these players on the energy market and prevent their anti-American policies by fermenting economic crises within these countries. The question arises as to the extent of the effectiveness and sustainability of this US foreign policy strategy in a transitional international order. The article hypothesis is that due to inefficient unconventional resources in terms of market crisis, the rise of counter-hegemonic coalitions, and geopolitical tensions in regions such as the Middle East, one cannot be too optimistic about the sustainability of this situation. The authors of the article will endeavor to explain the above hypothesis within the framework of the hegemony theory and by using the trend-analysis technique while addressing the driving forces.

1. Introduction

Economic sanctions are a foreign policy tool for influencing or potentially changing the political behavior and performance of other countries. Among these, oil sanctions can be used to a wider extent for implementing economic pressures on certain countries in order to achieve geopolitical and political goals. The US is currently the world's largest oil producing country due to the US shale revolution, replacing major actors such as Saudi Arabia and Russia (Egan, 2018). By dominating the global energy market, it is currently using oil as a

weapon against other countries. Although using oil as a sanctions tool is not new to the US diplomacy, it has never been as powerful as it is today. Presently, the US dominates both the global energy market and its financial market. This combination has given the country unprecedented powers to use oil as a tool to sanction other powers on the energy market.

The US is using this geopolitical upheaval as an international strategy in its financial rivalries with other powers in the energy sector in order to secure its influence. It seeks to reduce Russia's economic impact in the European oil market and to hinder its role as a

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major power in the energy sector. The US has also used this shift against Venezuela by fueling its domestic economic crisis and preventing the anti-American policies of Caracas. The White House is using the same tool to implement its maximum pressure policy on Iran in order to reduce its oil revenues to zero. This begs the question of how much the US can progress in using the sanctions tool to maintain its hegemonic superiority on the global oil market. There is no clear answer to this question, but one cannot be too optimistic about the continuation of this situation given the influential driving forces and uncertainties such as inefficient unconventional resources in terms of market crisis and the rise of counter-hegemonic coalitions and geopolitical tensions in regions such as the Middle East. The authors have used the trend analysis technique to identify the decline in hegemony over the last two decades and to examine the events affecting the trend and the resulting changes in the future. The article has been divided into two parts to explain the above hypothesis. The first section deals with the role of energy, especially oil, in maintaining the US hegemony. In the second part, the authors try to map the geopolitics of the energy landscape by using the events that affect the future of the energy market in order to analyze the effectiveness of the sanctions strategy in maintaining the US hegemony.

2. Literature Review

Limited work has been carried out on the impact of sanctions on the future geopolitics of energy. Some argue that the US sanctions imposed on major oil and gas producers will help this country to export more energy (Shokri, 2018); certain authors point to the negative role of sanctions in blocking oil export routes and limiting the capacity of oil-producing countries (Pascual, 2015). Richard Nephew (2017) believes that sanctions imposed on countries such as Iran, Russia, Venezuela, and North Korea will have potentially significant consequences for the geopolitics of global energy. What will be discussed next is not the impact of sanctions on the energy market, but their future implications on the geopolitics of energy and the effectiveness of the US sanctions strategy.

3. The Role of Energy in Maintaining US Hegemony

The term hegemony in international relations means superiority and supremacy, evoking the dominance of a superior power in the international system. Although hegemony consists of a soft element and a hard element,

the use of the hard power is highlighted in times of declining hegemony. Joseph Nye has played an important part in introducing the concept of the hard power and the difference between it and the soft power. He has defined the hard power as “threats or payments” (Nye, 2004). Military and economic forces are the two main concepts of the hard power used increasingly on a daily basis to strengthen the US global hegemony. Hegemony is a system of political control that puts one state, especially a powerful one, in a position of possible predominance over other states. Krasner’s hegemonic stability theory also argues that the hard power is the key to a hegemon and entails benefits in trade and globalization for the player (Webb and Krasner, 1989). Without hard power, it is very unlikely that rival countries will be willing to follow a hegemon or cooperate with each other. Trading in energy is the key to the global economic system. The amount of force that the US can exert on the energy market reflects the amount of the extraordinary hard power that this country possesses. This economic domination is the cornerstone of the US global hegemony.

Currently, the US is known as a hegemonic power predominating the global politics, economy, and military. While the US remains the sole hegemonic power in the world, its position has weakened over the past 20 years. Several criteria exist for this claim. For instance, the US dollar accounted for 72% of world financial transactions in the year 2000, but this figure has currently declined to 62% (Weichert, 2020). Trends also indicate a decline in the US economic growth based on its gross domestic product (GDP). For instance, the US accounted for 24% of the world’s gross domestic product in the year 2000. This figure decreased to just over 20% in 2010, and was just over 15% in 2018 (Focus Economics, 2020). The country’s soft power has also been declining globally in recent years. A survey of the views of people in different countries shows a rise in the negative attitudes and a drop in positive attitudes toward the US (Morris, 2017) (Figure 1).

There have been attempts by other players to undermine the US position in the global financial markets. For instance, over the years, the Chinese yuan and the euro have accounted for a significant percentage of the world trade. In such circumstances, resorting to the hard power to keep its hegemony is a key element for the US. The inability to resolve global crises, once the arena of the US power projection, is another sign of its weakening position.

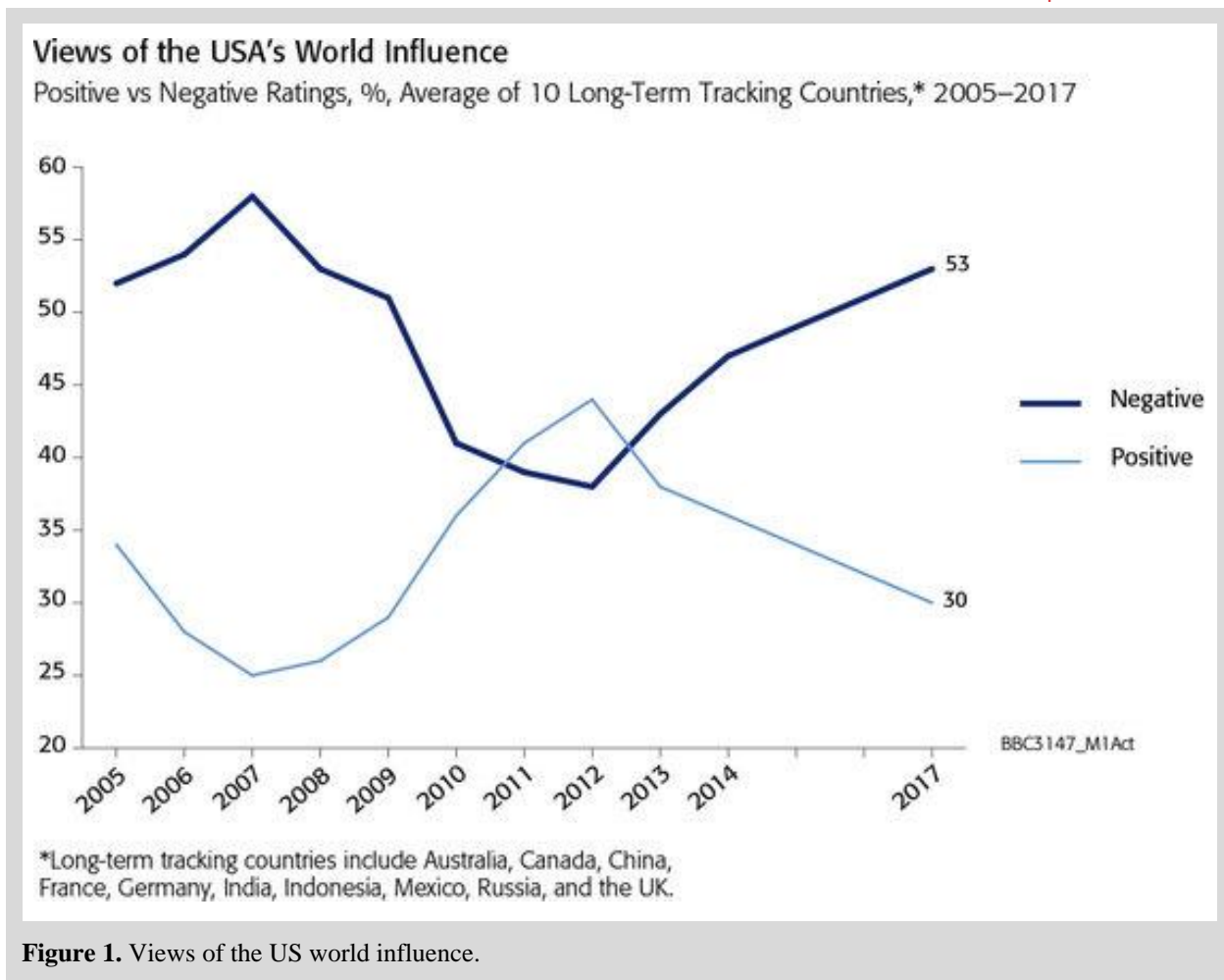


Figure 1. Views of the US world influence.

The US has turned into the world's largest oil producer in recent years due to the shale revolution. The oil is produced from oil shale rock fragments by pyrolysis, hydrogenation, or thermal dissolution. It has marked the beginning of a new chapter for the US and energy geography over the past two decades, so the US has recently overtaken Russia and Saudi Arabia in terms of oil production as a result of the upheaval in shale technology. Statistics show that the US crude oil production was approximately 13 million barrels at the end of 2019. The US oil production has more than doubled since 2008 (Brower and Sheppard, 2020).

The United States uses its energy position as a leverage against major oil actors such as Iran, Venezuela, and Russia, which oppose the US unilateralism. For example, at the plenary session No 113 of the US Congress in February 2013, the members of the Senate Committee on Energy and Natural Resources stressed

that an increase in shale oil and gas production had empowered US sanctions against Iran. At a meeting in May 2018, The US Congress also decided to export liquefied natural gas (LNG) to the European Union to reduce its dependence on Russia. It was also decided that the US should export LNG to Japan and South Korea, which are US allies in East Asia depending on the Middle East oil resources, especially Iran, to help secure their energy needs (Shokri, 2018). Data show that following the agreement between Trump and Juncker (President of the European Commission) in 2018, the US LNG exports to the EU has recorded the highest volume ever (Figure 2). In December 2019, the LNG imports from the US reached a monthly record as high as 3.2 billion cubic meters at an estimated value of 0.5 billion euros. Until early 2020, the EU had imported over 24 billion cubic meters of LNG from the US starting April 2016 (EU–US LNG Trade, 9 January 2020).

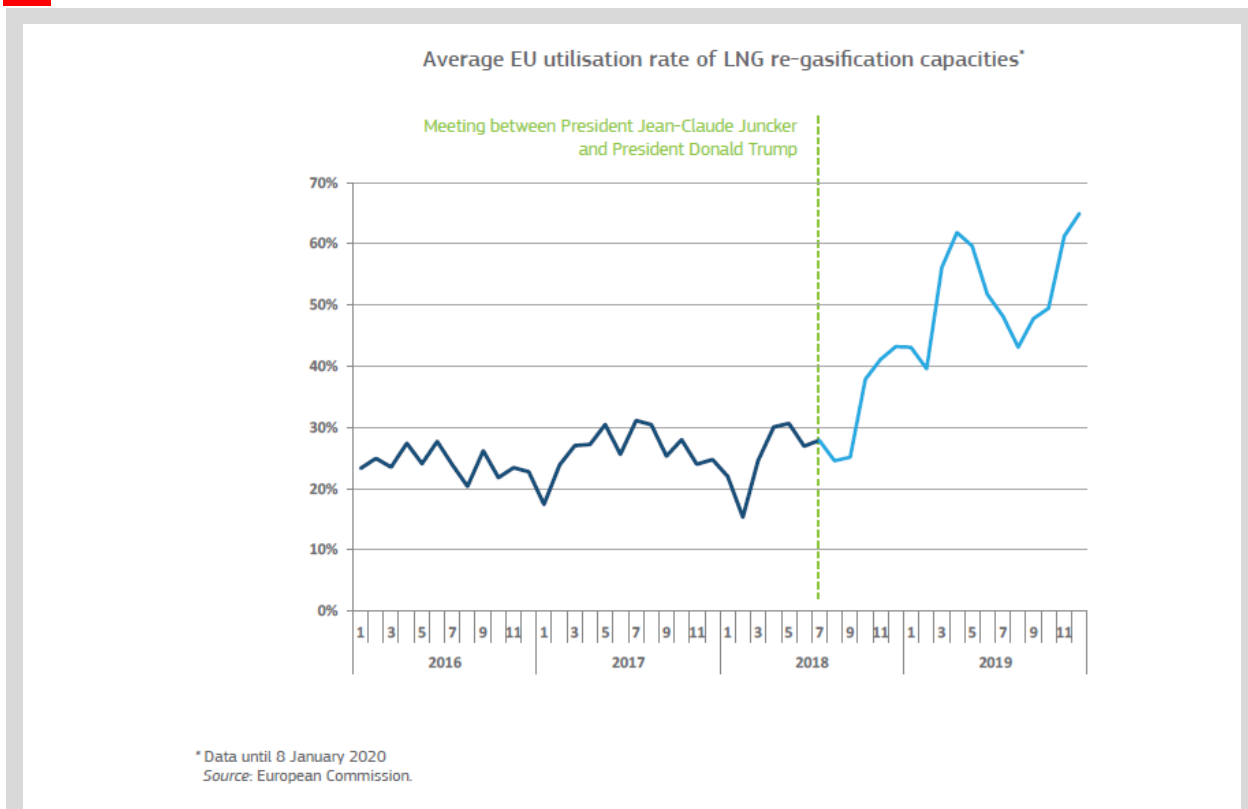


Figure 2. Average EU utilization rate of LNG regasification capacities; Data until January 8, 2020 (Source: European Commission)

Simultaneously, the US has stepped up its efforts to reduce the dependence of non-EU members on Russian oil and gas as part of its energy diplomacy. It also signed an LNG agreement with Poland and Ukraine in September 2019 to reduce their dependence on Russian gas imports. The fact that more than a third of Russia’s gas exports to the EU go through Ukraine shows the importance of this agreement.

Furthermore, in order to maintain its hegemony over the oil market, the US formally supported two members, namely Saudi Arabia and the UAE, of Organization of Petroleum Exporting Countries (OPEC) as the countries which have agreed to impose oil sanctions on a third member of the organization (Iran) and to fill the void on the oil market. Since the US exited from the nuclear deal with Iran and the P5+1—known as the Joint Comprehensive Plan of Action (JCPOA)—these two countries have provided the main support for the US in its oil sanctions against Iran. They announced that they will fill the void created by Iran’s absence on the global market and have played a significant part in the successful imposition of the sanctions on Iran.

4. US Hegemonic Challenges in the Energy Sector

Although the transition to becoming the greatest crude oil producer in the world has strengthened the US position in terms of the economy and geopolitics, its oil industry will face challenges in the medium and long term. These will be discussed next.

4.1. Limited Shale Resources

The United States Energy Information Administration (EIA) has announced that an estimated 2.81 billion barrels of crude oil (7.7 million BPD) was produced from shales in the US in 2019. This amounted to about 63% of the total crude oil production in the US in 2019. Shale oil can be found in low-permeable shale rocks, sandstone, and carbonate rock formations (US Energy Information Administration, 2020).

The high reliance of the US oil production on the shale industry will be its Achilles heel in future energy market developments. Evidence indicates that the new US shale oil industry will likely be challenged in the short and long term. The growing need for continuous drilling, which is often based on specific geographical



and geological features, infrastructure requirements, and transport costs; the increasing cost of the environmental considerations; and, most importantly, the fact that excavation and hydraulic fracturing costs will lead to fluctuations in the price and demand of oil and gas and will reduce profits in the long term, are some of the issues which will impact the country's production capacity in the future.

In terms of cost, shale oil can place many constraints on the US activity on the energy market due to the technology involved in its production. Ultra-deep well drilling technologies play a major role in the faster

extraction of oil, but it should be noted that shale oil wells have very low efficiency. Technical research shows that the recovery factor of shale oil wells in the first year is between 65 and 90%, showing their low efficiency (Sandrea, 2014: 2) (see Figure 3). Under such circumstances, maintaining a high production rate requires drilling more wells, which consequently increases the cost of production. Due to the rapid decline in production, compared to conventional oil fields, companies producing shale oil must drill new wells quickly to maintain their production, thereby delaying dividend payments to investors.

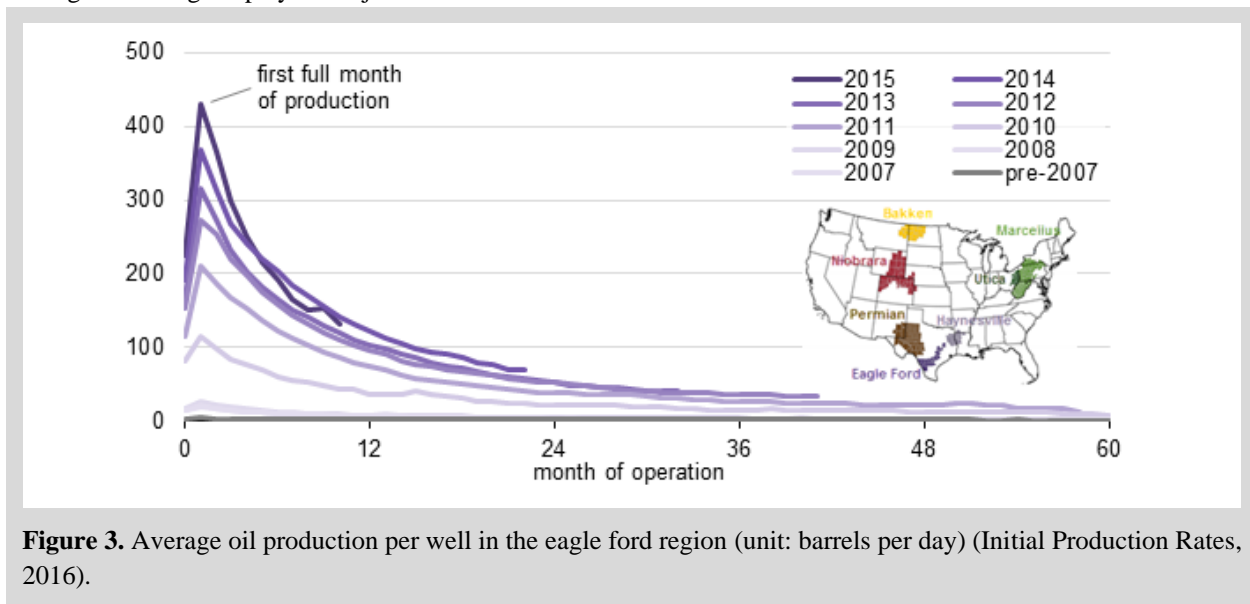


Figure 3. Average oil production per well in the eagle ford region (unit: barrels per day) (Initial Production Rates, 2016).

In its report dated April 2020, the Geological Survey of Finland announced that production in the US shale oil fields had risen at the cost of drilling more wells and fracking. While shale oil production in the US increased by an average of 28% from 2010 to 2018, injecting water and chemicals in these wells rose by 118% during the same period, indicating the growing cost of extracting shale oil in these fields. In its report, the center advises that we may see a slowdown in the growth or even a decrease in the oil supply to world markets in the near future due to the sharp increase in the debt of the US shale oil companies (Ahmed, 2020). The unfeasibility of shale oil excavation will mean a decline in production in the US, an increase in oil imports, and unemployment in its oil industry. For instance, in March 2020, Brent oil price crashed by 31.6% to finish at \$31.02 per barrel in one day for the first time in the past two decades. West Texas Intermediate (WTI) crude also decreased by 27% to finish at \$30 per barrel. Sharp drops in oil price may be good for the US in the short term, but the long-term consequences will entail raising unemployment in the

US shale oil industry because the gradual decline in oil price indicates that it is uneconomical to produce shale oil and leads to the closure of oil drilling rigs in this country (Shokri, 2020). The rivalry between Saudi Arabia and Russia to increase their market share has caused sudden losses of almost all shale drilling operations in the US. While Saudi Arabia insisted on cutting output to control the market, Russia opposed reductions in its market share.

The conflict between the two countries has shocked the market again. Saudi Arabia has increased production to 12.3 million barrels per day in March 2020. This amount was 9.7 million barrels per day in February 2020. The biggest losers in the Moscow–Riyadh market dispute, leading to inexpensive oil, will be the American oil companies which have invested in shale oil production. Rystad energy consultancy services in Norway has announced that only five companies in two US regions can keep production costs below the current oil prices. Wells drilled by companies such as Exxon Mobil, Occidental Petroleum, Chevron, and Crownquest

Operating LLC in the Permian Basin (the largest shale oil field in the US) along the western part of Texas and southeastern New Mexico can only be profitable if prices do not drop below \$31 per barrel (Adams-Heard and Crowley, 2020).

The Saudi–Russian rivalry and the resulting oil market instability more than anything else exposed the efficiency levels of the US shale oil in times of crisis. In other words, shale oil can only be an effective lever for the US energy market under normal and controlled conditions. Given that the energy market responds more quickly to political developments than other economic markets, this will provide an uncertain background for the US as a player in the future energy market.

4.2. Cooperation Levels Between Producers and Consumers

In recent years, in collaboration with other oil producers such as the Arab states of the Persian Gulf, the US has succeeded in imposing sanctions on opposing countries and controlling oil price fluctuations. It has also been able to fill the gap created by the lack of Iran and Venezuela oil on the market by aligning itself with other oil-producing countries such as Saudi Arabia and the United Arab Emirates. However, it should be noted that this cannot be a good strategy support for the US foreign policy in the long run for two reasons: first, the inability of the producers to fill the oil gap created by sanctioning the countries; second, the extent of their political will to continue this partnership.

In recent years, Saudi Arabia has supported the US policies in sanctioning and isolating Iran, especially its oil industry, to a large extent. In order to prevent fluctuations caused by the lack of Iran oil on the global market, the US has increasingly injected its oil into the market (Cildir, 2019). However, findings show that the US oil capacity has reached its peak. The Geological Survey of Finland reports that Saudi Arabia oil production is probably approaching its maximum output. The report cites the increase in the number of the oil rigs despite a decline in Saudi Arabia oil production as the reason for its claim: the amount of oil extracted from the Saudi Ghawar oil field in the initial supply report by

Aramco is 1.2 million barrels per day less than what is previously announced (Ahmed, 2020). Moreover, the refineries of the oil customers of sanctioned countries such as Iran are technically and qualitatively built based on this oil, while the quality and type of Saudi Arabia oil and other producers is different from Iran oil; although the oil consuming countries can mix and use several types of oil to overcome this, this method will only increase their costs.

The second issue is the extent of the political will of the other producers to continue this partnership based on their domestic policies. For instance, the Saudi Vision 2030 has been designed by this country to reduce its dependence on oil and move towards an oil-free economy. Thus, the country's alignment with the US in increasing production to compensate for the oil of countries such as Iran and Venezuela contradicts the country's macro strategies in the long term. At the same time, the role of the US allies on the energy market depends in part on their coordination with the other producers such as Russia within the framework of the OPEC Plus.

On the consumer side, powers such as China, India, and the EU are not in full compliance with Washington's policies, especially as the recent unilateral policies of the US, the trade war with China, and disputes with the European allies have increasingly dimmed the prospects of the engagement of large oil consumers with the US. For instance, although the US aligned the EU with itself to sanction Russia for its illegal annexation of the Crimean Peninsula in 2014, Europe continues to consume Russian oil and gas and has had no choice but to increase its gas imports from Russia in recent years (Figure 4). In 2018 and 2019, Russia was the major gas supplier of the EU, and its share of satisfying the needs of the European Union has been more than 38% (Eurostat, 2020).

Russia continues to be a main trading partner for the European Union in terms of oil. As shown in Figure 5, the European Union has imported on average 25% of its oil requirements from Russia in 2018 and 2019 (Eurostat, 2020).

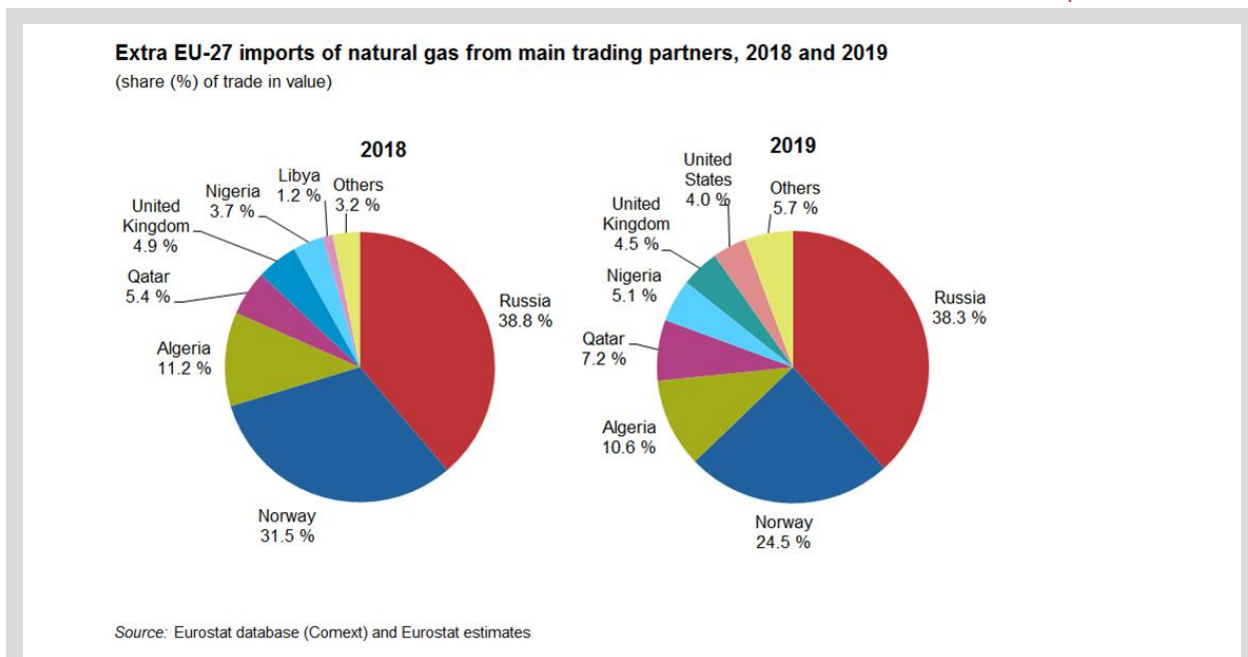


Figure 4. Extra EU-27 imports of natural gas from the main trading partners, 2018 and 2019 (percentage of trade in value).

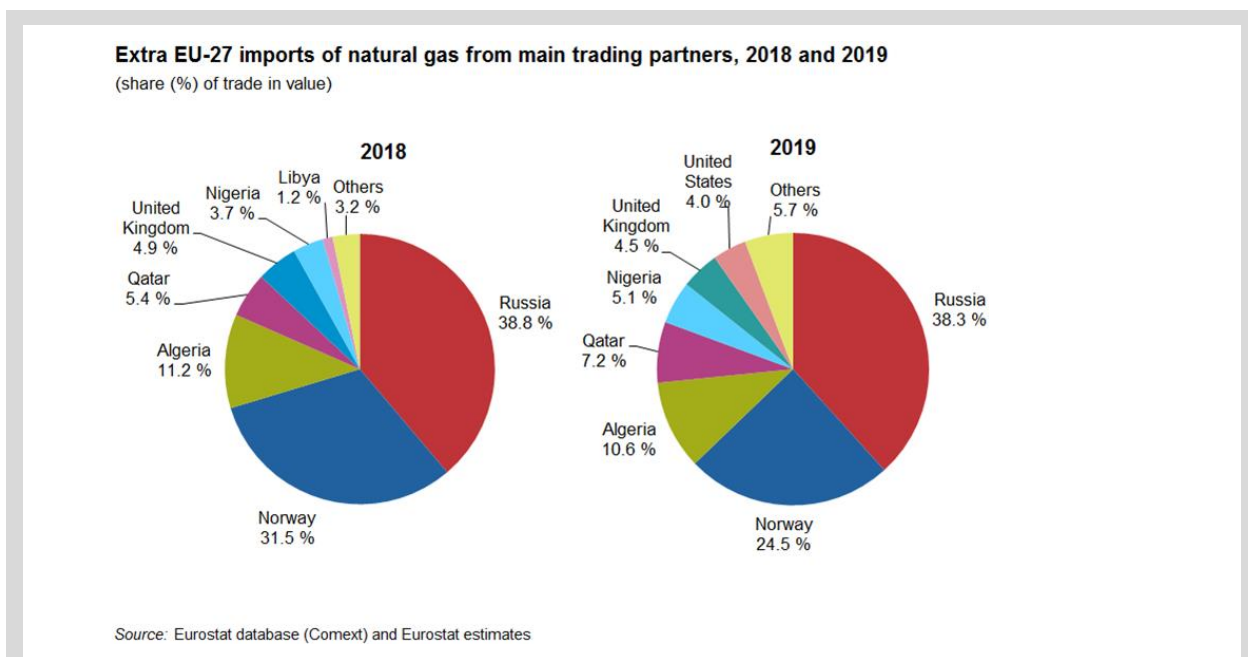


Figure 5. Extra EU-27 imports of petroleum oil from the main trading partners, 2018 and 2019 (percentage of trade in value).

After the US House of Representatives approved a plan to sanction companies operating in the Nord Stream 2 project in the autumn of 2019, Germany voiced its strong opposition to it. The Nord Stream 2 gas pipeline will run from Russia to Germany across the Baltic Sea.

The US opposes the construction of Russia's Nord Stream 2 pipeline project and has been actively pursuing diplomacy to persuade Germany to abandon it; nevertheless, it has failed to suspend or cancel the project thus far. In the latest move, the US State Department and Senate have put anti-Russian and anti-European plans

related to Nord Stream 2 on the agenda to prevent its completion under the CAATSA Act; a move which will throw European independence and rights into question.

Another example is China's non-cooperation with the US in sanctioning Iran. China has always been one of Iran's largest oil buyers. Despite the US sanctions, Iran oil export to China continues through the gray market and is repeatedly protested by Washington. However, there are no exact statistics for Iran oil export to China on the gray market. According to a report by Reuters, China imported about 405,000 tons of oil from Iran, equivalent to about 100,000 bpd, in December 2019. The report adds that in 2019, China's oil import from Iran was about 14.77 million tons, equivalent to 300,000 bpd. In February, Reuters also reported that Iran had sold 250,000 bpd to China on the gray market (Shaban, 2020). Moreover, China's 25-year deal with Iran, most of which is related to investments in Iran oil and gas industry, shows China's disregard for the consequences of sanctions on Iran oil industry. Based on the deal, Chinese companies can expand their presence in Iran oil and gas industry. Under the deal, Beijing will be able to secure a steady supply of oil from Iran for a quarter of a century. China can also develop free trade zones in strategic areas in Iran, linking Iran to global trade and its Belt and Road Initiative (Tharoor, 2020).

4.3. Genesis of Counter-Hegemonic Alliances

Many scholars believe that the US hegemony is on the decline (Walt, 2018; Posen, 2014; Mearsheimer, 2018). More than two decades after the collapse of the Soviet Union and the unipolarity of the international system, domestic and external conditions have paved the way for a revival of the debate over the US hegemony within the international structure. Gaps in the unipolar structure of the world power have been exposed by the wars in Iraq and Afghanistan, by the 2007–2008 financial crisis, by the emergence of great new powers on the international stage, and by the growing number of nationalist leaders around the world, especially in the US where Trump has spent the past four years speaking about the need to increase the costs of the hegemony in order to make America great again. These gaps are such that it can be said the international system is currently going through a transition period.

The emergence of other powerful countries such as China and Russia has directly challenged the US status as the sole hegemon. In return, the US has sought to consolidate its position as a hegemon by strengthening its presence in various sectors, including the energy market, and by preventing its decline. Nevertheless, the

use of oil as a weapon against other oil actors has led to the formation of coalitions against the US. A coalition between Russia, Iran, and China in various sectors will seriously challenge the continuation of the US hegemony. The position of each country in the international system has made it possible for them to work together to minimize the negative effects of the US sanctions. China's position in the global economy and its oil market, Iran's geopolitical and geostrategic position in the global energy markets, and Russia's military position, as well as its energy economics, have created overlapping interests between them. The overlap between their interests, as opposed to the aggressive US policies in the form of economic sanctions, encourages them to pursue counter-hegemonic policies of resistance.

Iran–China relations are being strengthened as a result of the aggressive policies by the US. China needs access to oil resources in the Persian Gulf and Iran is the best country for this objective. It ranks second and fourth in terms of gas and oil reserves respectively and is therefore highly regarded by China. In return, Iran also needs a powerful ally for its economic development, especially in the oil industry. Confronted with the sanctions, Iran is seeking to strengthen its position within the framework of its resistance economy. As the world's second largest economy with a global GDP of 15.5% (Silver, 2020), China can help Iran in this area. Presently, the countries are set to strengthen their cooperation in the energy sector under a 25-year deal. The strategic deal between Iran and China will connect and intertwine the extraordinary capacities of both countries, eliminating their current shortfalls due to the US sanctions in the short term. In the long term, it can create an economic pole in the region and in the world.

In Sino-Russian relations, the US sanctions policy has also encouraged the two countries to form a counter-hegemon coalition. Although this is still on a case-by-case basis to curb the US unilateral regulatory policies, it has the potential to adopt a more serious strategic form. The economic sanctions imposed on Russia by the US and the EU following its annexation of the Crimea have shone a new light on Beijing in Moscow's eyes as a new opportunity. The director of the Carnegie Moscow Center, Dimitri Trenin, believes that the post-communism era of Russian integration with the West is over and Russia's confrontation with the US will help reduce the rivalry between China and Russia (Nechepurenko, 2015, June 15).

The economy is one of the strategic areas where the two great powers are strengthening their relations.



During Russia Victory Day celebrations in May 2015, the Russian President and his Chinese counterpart signed 32 economic cooperation agreements. The Eurasian Economic Union of Russia and the Chinese Silk Road are part of this cooperation (Nechepurenko, 2015). Both countries are also keen to challenge the US dollar in the global trade. In fact, Russia is currently accepting the Chinese yuan for its oil sales. As a result of the EU sanctions, the ruble–yuan market has also reached a historic conclusion (Galouchko, 2014). China's interest in Russia is more focused on energy imports. After the UAE, China is Russia's second largest trade partner. For the first time, Russia took over Saudi Arabia as the main oil supplier to China. Both countries are trying to partner in the energy sector although they still face difficulties in building gas pipelines to connect their territories (Graham-Harrison et al, 2015).

4.4. Geopolitical Tensions in the Middle East

Considering the geopolitical and geostrategic position of the Middle East and its vast energy resources, it has always been a center of attention for the US. Statistics show that over 48% of the world's proven oil reserves and nearly 40% of its proven natural gas reserves are in the Middle East (Dudley, 2019). Following World War II, this region has been the center of the US energy imports and, therefore, has played a prominent role in the US national security strategies.

Although the trend of crude oil production in the US has reversed in recent years, especially with the increase in shale exploration and excavation, and it no longer needs to purchase energy with a rise in its oil production and exports, in particular crude oil, this does not indicate that the White House is unaware of the developments in the Middle East as the beating heart of the global energy. In fact, the developments in the global economy over the past decade and lagging behind competitors such as China, the EU, and India have led Washington to define the oil-rich countries in the region as a tool to control the growth and development of its rivals. Nonetheless, in reality, the Middle East has always been a hotbed of political tensions.

Amid the political tensions between Iran, Saudi Arabia, and the UAE in recent years, the US has been able to persuade the latter two to pursue its anti-Iran policies. However, it should be noted that the policy of aligning the Persian Gulf Arab states in imposing oil sanctions on Iran will ultimately lead to insecurity in the Persian Gulf and the Strait of Hormuz. Repeated threats by Iranian officials to close the Strait of Hormuz or attack the Saudi Aramco refinery are due to political tensions

between these countries above all, fueled by the US sanctions. If either war begins between Iran and the US or the region is faced with a larger confrontation, 29 million barrels of oil per day could be in danger, placing geopolitical risks at the top of market concerns. Should oil supplies encounter difficulties, the US shale oil will not be able to fill the gap at an ideal speed. Even if the US catches up with Saudi Arabia in production, it will not be a flexible producer unlike this country. In other words, it is not a country with idle capacity it can move quickly (in the case of disruption in supply) to change the market. Unlike Saudi Arabia, shale oil production in the US is not centralized since there are 9000 independent shale oil producers, and it has no idle capacity, that is, a significant amount of oil in storage that can be sent to market quickly for a relatively stable period. It is true that the US government has huge strategic oil reserves which can be used to fulfill the domestic demand by the presidential decree in the case of major disruptions in production, but the reality is that the US is neither entirely immune to raise oil price caused by geopolitical risks nor can it completely offset the consequences (Nuqi, 2020). Thus, the US leaders are unable to ignore the changing role of the Middle East geopolitics in terms of oil in the short and long term.

5. Conclusions

The geopolitics of energy is shifting due to new developments on the oil market such as the increase in shale oil production and the entry of the United States into the market as an oil exporter. The US is taking advantage of this opportunity to manage oil markets in order to maintain its favorable market price while increasing its oil exports. It is also using sanctions to reduce oil exports by other countries to create new markets for its shale oil.

It is noteworthy that due to the counter-hegemonic approach of countries like Iran, Venezuela, and Russia on the international stage and their reliance on the energy economy, the US has been able to overtake these countries in the oil market in recent years by investing in its shale industry and becoming the world's largest oil producer. Being in this position allows it to minimize the role of countries that influence the energy market and oppose its hegemony. By pursuing the oil sanctions policy, the US is trying to salvage its hegemony in the international system. However, maintaining this position is challenged by the inefficiency of shale oil under critical market conditions, strong counter-hegemonic coalitions forming, and regional geopolitical tensions. Washington's simultaneous confrontation with the

governments of Iran, Venezuela, Russia, and China has left the country with a complex geopolitical game which will ultimately force countries importing energy to abrogate the US sanctions; competing exporters will endeavor to take advantage of this opportunity for more profits. Moreover, most of boycotters have a political will to counter the US unilateralism. This is evident in the pending 25-year deal between Iran and China; the strategic rapprochement between China and Russia to counter the aggressive US approach to regulatory, institutional, and international regimes; and Iran's decision to sign long-term strategic agreements with China and Russia, and its efforts to revive Venezuela as another pole of resistance against the US unilateral policies.

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