

A Strategic Exit

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When the UAE announced at the end of April that it was exiting the 12-member Organization of the Petroleum Exporting Countries (OPEC) and its 22-member OPEC+ extension, the news should not have surprised anyone. The UAE, which, at the time of exit, had been earmarked a production quota of 3.4 million barrels per day (bpd) under OPEC's production fixing and sharing system, had for long been unhappy with that allocation. Already the third largest producer among OPEC members, the UAE has been expanding capacity beyond its production quota. Its capacity is currently placed at 4.8 million bpd and is slated to rise to a target of 5 million bpd by 2027. If that capacity is to be utilised, either the UAE's quota will have to be substantially enhanced, or the UAE will have to exit the OPEC production arrangement.

OPEC was formed in 1960, when five countries Saudi Arabia, Iraq, Iran, Kuwait, and Venezuela took control of their oil reserves and formed a cartel to control production and supply to ensure they received "fair" prices, leading to a dramatic increase in oil prices during the "shocks" of the 1970s. Even though both the demand and supply scenarios have changed dramatically since, OPEC did manage to implement a version of its original mandate by bringing in more producing countries into its stable, setting new production and supply targets based on trends in demand, and sharing that aggregate production in the form of quotas for each member. But for OPEC in its many avatars, the benefits that the oil-producing countries would have derived from the exploitation of their reserves would have been much lower than has actually been the case.

One problem has been that available reserves, and therefore the capacity to raise production without quickly exhausting those reserves, vary across members. So, countries with a much higher share of proven reserves may see the benefit in increasing production to raise their national income and government revenues.

Therefore, while a country with larger proven reserves may expect to be handed a bigger quota, it must rein in that demand to accommodate holders of smaller reserves, or else they would stay out of the cartel and weaken its market influence. Thus, the setting of production targets and quotas is inevitably a delicate process, involving consensus on where targeted supply is set and agreement on allocation of production quotas based partly on material criteria like a country's proven reserves and production capacities, and partly on negotiations to agree on sharing of responsibilities and benefits.

Seen against this background, the UAE's decision to exit OPEC+ seems easy to understand. With its proven oil reserves having risen from just above 32 billion barrels in the 1970s to more than 110 billion barrels currently, the UAE's thirst for quotas has increased, especially given its decision to increase production capacities rapidly. While OPEC members have been reticent to accede to the UAE's demands, they have been forced by the UAE to increase the latter's quota, most recently in 2021, when it threatened to leave if ignored.

However, the UAE's announcement is surprising for a different reason: its timing. The announcement came during a tenuous ceasefire in a war that disrupted oil production and at a time when the Iranian leadership's decision to almost completely shut off transit through the

Strait of Hormuz has severely affected global oil supplies. This has resulted in a sudden reduction in global oil supplies, including sales by the UAE, despite the latter's access to an alternative supply route for part of its production through a pipeline that runs from Habshan to Fujairah, bypassing the Strait of Hormuz. Seeking freedom to expand production in this environment makes no sense since the UAE is unlikely to be able to ship out the additional output.

That raises two questions. First, what implications, if any, does the UAE's move have for the future and relevance of OPEC? Second, what explains the UAE government's decision to make this announcement at the current juncture?

Despite the dramatic changes in global oil markets over the six decades since its formation, OPEC as an organisation has survived and evolved. It may not wield the power it exercised in its early years, but it is by no means irrelevant. Other players like Indonesia, Qatar, Ecuador, and Angola have left OPEC in the past, but the cartel has survived. So, it is more than likely that even the exit of the UAE, while changing the cartel's role and position in oil markets, will not threaten OPEC's survival or relevance.

On the other hand, there seems to be clear intent and strategy in the UAE's decision. The intent is clearly to expand production either as an OPEC member with enhanced quotas or by opting out of OPEC. The strategy appears to be one of maximising short-term revenues to undertake investments that will help it diversify away from fossil fuel dependence for GDP growth and government revenues. The vision is to monetise oil reserves to diversify into a host of new areas, starting with tourism, finance, education, and renewable energy and moving on to hi-tech areas like artificial intelligence and technology-intensive manufacturing.

Funding the future

The assumption here is that the constraint on ensuring such diversification is financial resources. That, however, ignores the fact that access to revenues from oil exports, ever since the 1980s, did not ensure diversification either in the UAE or in other major oil-exporting Gulf Cooperation Council countries. A fundamental reason for this failure was the decision of the Gulf states to invest much of their enhanced revenues they garnered after the 1970s in international financial markets rather than in creating domestic capacity. What was needed for successful diversification was a long-term strategy that built capabilities through indigenous firms, even if those firms were initially managed and manned in substantial measure by foreigners.

The failure to ensure that has meant that today the UAE lacks the indigenous capability to create domestic capacities in innovative industries. So, any strategy of quick domestic diversification would require reliance on foreign firms. The UAE can play host and invest hugely in infrastructure and other facilities to be an attractive investment destination, but it must rely on foreign players to implement the diversification strategy.

This dependence of a cash-rich UAE on foreign players has, over time, pushed the state to seek closer relations with the US, to enhance its credibility as a financial, technological, manufacturing, and cultural hub. That effort seems to have generated a dynamic of its own, catalysed by worsening relations with erstwhile ally Saudi Arabia, with the two countries ranged against each other in what are proving to be proxy wars in Sudan and Yemen. The outcomes of these changing geopolitical trends have been significant, including, not least, the UAE's growing friendship with Israel.

In 2020, towards the end of Donald Trump's first term as US President, the UAE (together with Bahrain and, subsequently, Morocco and Sudan) was led by the US into signing the Abraham Accords, a formal agreement with Israel that established state-to-state relations involving economic and security cooperation. What followed was a growing military partnership with Israel, involving the use of oil surpluses to purchase advanced military equipment deployed in the UAE's more assertive interventions in the region.

Closeness with the US and Israel made the UAE a special target when Iran decided to regionalise the conflict it was pushed into with drone and missile strikes, more than 2,500 of which were directed at the UAE. That provided a reason (or an excuse, since it was not the only Gulf state targeted) for the UAE to cement its ties with the US and Israel, which provided it with the equipment and the personnel to manage the protective Iron Dome it had erected to deal with those air attacks. It also led to the UAE's complaints that Saudi Arabia and other Gulf states were not willing to retaliate against Iran as punishment.

It was this geopolitical moment that the UAE has exploited to declare its allegiance to the US-Israel axis. It hopes to use this moment to regain the "economic" creditability it lost because of the uncertainties created by military conflict and facilitate its foreign firm-driven diversification strategy, which is under threat. It is this need to make multiple declarations—of aligning with the US and Israel against Iran and to an extent against Arab nations worried about Iran but also wary of Israel, of saying that the UAE is open for business, and of declaring itself a safe destination for business by virtue of protection from the US and Israel—that in all probability explains the timing of the UAE's announcement of its exit from OPEC+.

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