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Center for Applied Research in Partnership with the Orient

PULSE 10
11.05.2026

Saudi Arabia at a Crossroads: Economic Fragility Before and After the War

by Frédéric Schneider

The exit of the United Arab Emirates (UAE) from OPEC on May 1st has had global and regional ramifications on the oil market and energy supply, but the primary target has been OPEC's heavyweight and UAE-rival Saudi Arabia. By withdrawing from the organization, the UAE has opened up the long-term specter of adding 1.5 million barrels per day to the world market, depressing an oil price that has been on a long-term decline for years – barring the occasional crisis. This is only the latest blow to the Saudi economy. When US and Israeli forces attacked Iran in late February, Saudi Arabia found itself on the receiving end of Iranian retaliatory strikes hitting vital economic infrastructure and the effective closing of the Strait of Hormuz, constraining Saudi oil exports, for which it could only partially compensate through the East-West pipeline. However, these recent events are only compounding factors for longer-standing risks to the Saudi economy.

Why does it matter?

For years, Saudi Arabia's economy has been characterized by a mix of positive and negative signals that demonstrate economic fragility. High oil prices and the ambitious investments around the Saudi modernization agenda 'Vision 2030' contrast with an economy that remains deeply dependent on hydrocarbons: Fuels constitute more than 70 percent of Saudi goods exports, a share that has stagnated or trended upward since COVID-19. Despite falling oil prices and years of diversification efforts in non-oil sectors such as services, entertainment, tourism or sports, the growth of the Saudi gross domestic product (GDP) and hydrocarbon revenue remain intimately linked, and both the kingdom and the UAE continue to expand production capacity, betting on hydrocarbons even as the medium-term price outlook dims due to persistent overproduction.

That dependence creates a chronic revenue problem compounded by an equally chronic expenditure problem. The IMF pegs Saudi Arabia's fiscal breakeven oil price at USD 91 per barrel, a figure that still excludes oil revenue needed to fund the Public Investment Fund (PIF), Saudi Arabia's state fund, in contrast to the UAE with only USD 50 per barrel. To close the gap, the kingdom tripled its value-added tax from 5 to 15 percent in 2020, nominally as a temporary measure. Total public debt has risen from 5 percent of GDP in 2013 to around 33 percent in 2025, with (pre-war) IMF projections of 45 percent by the end of the decade. Government expenditure, meanwhile, remains elevated across military spending, giga projects, consulting, and sports – and the PIF has itself borrowed to finance investments, an unusual move for a sovereign wealth fund that reflects how tight the fiscal position has become.

Foreign direct investment, which the kingdom needs to complement public spending in its diversification drive, has persistently lagged relative to rival UAE. That gap was a key factor in the slow decline of NEOM, the flagship megaproject scaled back even before the war.

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Editing: Dr. Sebastian Sons

Now, the war and the Emirati OPEC exit are compressing these pre-existing pressures. GDP growth in Q1 2026 fell to 2.8 percent, with the oil sector growing just 2.3 percent against 10.8 percent the previous quarter as some wells were shut in response to export disruptions. The IMF cut its full-year 2026 forecast from 4.5 to 3.1 percent, or roughly USD 18 billion in foregone output. With no end of the conflict in sight, these numbers are set to deteriorate further. Defense spending, already at 7.3 percent of GDP and among the highest globally, is rising further through emergency procurement and operational deployment costs. The Saudi-Emirati rivalry in Yemen is adding further expenditure. The stability premium that underpinned Saudi Arabia's proposition to foreign investors, a reforming Gulf state pursuing a generational economic transformation, a safe haven in a region shaken by conflict, has taken a serious blow. While Saudi Arabia has suffered relatively less damage than the UAE, Kuwait, or Bahrain, the strikes on the Ras Tanura oil refinery and an East-West pipeline pumping station showed that Saudi energy infrastructure is not invulnerable. Every future investment decision about Saudi Arabia now carries a regional conflict risk premium that was priced at near-zero before February 2026.

What is the big picture?

The war has thus revealed a fundamental tension at the heart of Saudi Arabia's economic strategy: a transformation premised on stability, openness, and investor attraction, in a region that is demonstrably neither stable nor predictable. Vision 2030's associated investments total approximately USD 840 billion, spread across megaprojects from the Red Sea coast to the NEOM desert site and the construction of substantial infrastructure in preparation to the Riyadh EXPO 2030 and the FIFA World Cup 2034. The underlying premise was that Saudi Arabia can attract global capital and talent, diversify away from oil, and build a high-value service and knowledge economy. How true this premise will remain in the future relies mainly on the outcome of the present conflict.

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The Saudi government is, of course, aware of the situation, and has been for a long time. Even before the conflict, Saudi Arabia had begun shifting toward a more pragmatic economic strategy. PIF revised its approach, scaling back giga projects and sports extravaganzas in favor of domestic investments in non-fossil industries like green hydrogen and computing, as well as "Made in Saudi" import substitution in sectors such as defense manufacturing. Cuts to lavish consulting contracts, long blamed for the stumbles of 'Vision 2030,' have coincided with a reinvigoration of Saudization of the job market, channeling opportunities toward domestic talent rather than imported expertise. Saudi Arabia has also reinvigorated its diplomatic networking through a nascent quadrilateral mediation framework with Egypt, Turkey, and Pakistan, giving Riyadh leverage in the conflict that it did not previously hold.

However, that pivot remains a work in progress, and the war is making completion harder. Renewable energy investment continues to lag far behind hydrocarbon spending despite repeated commitments. A turn toward austerity and privatization, including the private management of schools, risks cutting precisely the productive public investment that a successful economic transformation requires. Universally accessible, high-quality education is a growth factor but is treated as a line item to optimize. Privatization without effective regulation typically brings escalating costs, declining service quality, but without delivering the kind of state capacity that Saudi Arabia needs to stick the landing of its economic transition. Recent events have made competent economic stewardship only more important.

What comes next?

By creating both acute and long-term economic stress, the war on Iran and the Emirati OPEC exit have complicated Saudi policymaking by making strategic mistakes more costly.

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The pragmatic turn in Saudi economic strategy is sound, but it requires strict execution to follow up the announcements. Green hydrogen investments with solid industrial applications, Red Sea coast development as an alternative economic geography less exposed to Hormuz disruption, and Saudization push all need commensurate funding and rigorous vetting instead of headline management. Tried-and-tested development strategies, like Gulf-adapted variants of the export-oriented industrialization models that propelled German and South Korean industrial growth, should complement grander ambitions.

Saudi Arabia's delicate development task, transitioning a hydrocarbon-dependent economy of 37 million people in a volatile region, demands a government that can plan, execute, and evaluate. While the current economic situation may seem to call for austerity and a push for a "lean state," this must not come at the cost of state capacity and competency. The Asian development experience, from South Korea to Singapore, rested on a competent state in charge of the commanding heights. A government that strips itself of that capacity cannot correct course when new crises arise.

That same logic applies to diplomacy. Saudi Arabia holds real cards: US basing access, oil-market weight, the nascent quadrilateral mediation role, and back-channel access to Iran through third parties as well as direct communication lines as diplomatic ties have not yet been cut. Those assets are powerful but need to be deployed with care to stabilize the geopolitical and geoeconomic position of the Arabian Peninsula. A region perpetually under threat cannot attract the capital, talent, and confidence that 'Vision 2030' requires. Active de-escalation is, for Saudi Arabia, an economic imperative as much as a strategic one.

Saudi Arabia stood at an economic crossroads before the war began, but the current conflagrations across the Gulf – and across the Gulf monarchies – have raised the stakes even higher.

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Editing: Dr. Sebastian Sons

 | ISSN 2944-7437

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