



The Oil Shock and the New Political Economy of Development Cooperation

Andy Sumner & Stephan Klingebiel

Summary

The 2026 US–Israel–Iran war and the closure of the Strait of Hormuz have triggered one of the largest oil supply disruptions in modern history. Brent crude prices rose sharply, producing a major external shock for oil-importing developing economies at a moment when the international development system was already under severe strain. Petrochemical products shipped through the strait are also vital for agriculture, medicine and industry. The largest contraction on record of official development assistance (ODA) had already been recorded in 2025, while geopolitical tensions and rising defence expenditures are reshaping ODA spending priorities and development policy directions.

This brief examines how the oil shock will impact development cooperation. The significance of the oil shock lies not only in the price increase itself but also in its timing, and it arrives amid an ongoing reconfiguration of development cooperation. The analysis is organised around two postulates that underpin the post–Cold War development architecture. The first is the existence of states in the Global South with sufficient authority and developmental aspirations and capacity to pursue broad-based development goals. The second is the existence of donor countries willing and able to support those states' aspirations.

The oil shock weakens both postulates through different mechanisms. For many oil-importing developing countries, rising fuel, food and transport costs intensify fiscal stress, debt vulnerabilities and pressures on state capacity. Fragile states without strategic importance are especially exposed. At the same time, donor countries face mounting pressures

from fiscal tightening, defence spending, domestic cost-of-living politics and growing scepticism towards multilateralism. These dynamics risk reinforcing one another in the sense that weakening state capacity can intensify instability, while rising instability may further reduce political support for development cooperation in donor countries.

The brief argues that alternative financing sources such as Gulf finance, South–South cooperation and climate finance are unlikely to compensate for the scale of OECD donors' retrenchment. The likely result is a more fragmented, transactional and geographically selective development cooperation system, in which the countries most in need are increasingly among the least likely to receive sustained support unless they hold geopolitical importance.

Three policy implications follow from the war. First, the multilateral development financing architecture requires urgent bolstering. Instruments such as the World Bank's International Development Association and the IMF's Poverty Reduction and Growth Trust face growing pressure precisely as low-income countries (LICs) confront simultaneous food, fuel, debt and financing shocks. Second, the increasing concentration of concessional finance to strategically prioritised states should not be treated as inevitable. Fragile states risk declining concessional finance and multilateral reach despite acute humanitarian need. Third, European donors must decide whether development cooperation remains anchored in poverty reduction or becomes subordinated to defence, migration and geopolitical priorities.

Introduction

The 2026 US–Israel–Iran war has produced what the International Energy Agency describes as “the largest supply disruption in the history of the global oil market” (IEA, 2026). Brent crude rose from approximately \$65 to \$72 per barrel in late February 2026 to above \$100 and at times exceeding \$120 in April/May 2026. Meanwhile, ODA had suffered its largest annual contraction on record in 2025, a 23.1 per cent decline in real terms (OECD, 2026).

The oil price shock and other effects of the US–Israel–Iran war contribute to an already highly challenging global situation for countries in the Global South, shaped by earlier shocks such as Donald Trump’s trade policies since the start of his second term and Russia’s full-scale war of aggression against Ukraine since early 2022.

We ask how the oil shock may reshape development cooperation through to 2030. The shock matters not only for the socio-economic development of countries but also for development cooperation itself. It has arrived in a global political configuration in which a fiscal shock to net oil importers could accelerate the reconfiguration already underway in development cooperation and policy.

Furthermore, such a fiscal shock comes at a time when many LICs are already heavily indebted. Around half of the IMF’s list of 68 eligible countries are either in debt distress or at high risk of debt distress, according to the IMF’s debt sustainability assessments (IMF, 2026b). Other implications of the war, such as reduced remittances, are not addressed in this brief but nevertheless play an important role.

In sum, it is about the cumulative impact and timing of the shock, which, in some ways, matters less as an exogenous price event than as a political accelerant, arriving just when conditions for development cooperation are weakening. It is already possible to say that development cooperation is being reconstituted following the US pivot on policy norms and consensus (Sumner & Klingebiel, 2025).

This policy brief is organised around two postulates that underpin development cooperation. The first concerns recipient states. There are bounded states (i.e. states possessing a reasonably coherent and recognised territorial, political and institutional order) in the Global South whose elites hold development aspirations and whose institutions possess at least a degree of territorial authority and integrity. Some have capable institutions and authority extending across their geography. Whether such bounded states exist among the poorest countries and fragile states in particular, remains an open question. In some instances, even this territorial integrity may be questioned. The second postulate is that a different set of countries have elites who perceive a strategic, collective or commercial interest in supporting the development aspirations of the other group and, in democracies, can convince their publics that such support is worthwhile. This is the Global North group of countries, where democracy is the typical governance structure. But this could be extended to new donors, too, where electoral autocracy or closed autocracy may exist, and thus sceptical publics do not need placating.

We argue that the oil shock weakens both postulates, but through different mechanisms. For the first group of countries (in the Global South), the effects are transmitted through terms-of-trade losses, fiscal squeeze and rises in food and fuel prices in net oil-importing developing countries, with implications for state capacity and developmental legitimacy. However, even for net oil or net commodity exporters, the forthcoming windfalls may not be converted into broad-based development gains. This is a pattern well documented in the literature about the resource curse (Frankel, 2010). For the second postulate, the shock compounds four reinforcing pressures on donor interest: growing ideological hostility to multilateralism, defence spending that crowds out aid budgets, cost-of-living politics and herd dynamics among bilateral donors, with governments increasingly following one another in reducing their aid commitments.

In keeping with discussions on global (dis)order or a “multiplex world order” (Acharya, 2025) and the contestation of norms and power, we can identify feedback connecting the oil shock and development cooperation. The oil shock deepens inequality between and within countries, which can erode state capacity and generate social unrest (potentially leading to the spread of electoral autocracy). Weakened governance produces further instability, reinforcing the disorder that generated the shock.

The oil shock

The economic outlook in late 2025 was, by recent standards, benign. The World Bank’s October 2025 Commodity Markets Outlook projected an “oil glut”, with Brent crude expected to fall from an average of approximately \$68 per barrel to an average of \$60 in 2026 (World Bank, 2025). The report also projected energy prices to fall by 12 per cent in 2025 and a further 10 per cent in 2026. The FAO Food Price Index in February 2026 remained below its level a year earlier (FAO, 2026). Food and oil prices tend to correlate, partly because agriculture depends heavily on energy-intensive inputs such as fuel, fertiliser and transport, and partly because financial investors treat oil and agricultural commodities as a single asset class. What has followed is an abrupt shift in the context, which will work gradually through the system as existing contracts expire.

The US–Israeli military operation against Iran, launched on 28 February, triggered Iranian retaliation that included missile strikes on US bases and neighbouring states, the closure of the Strait of Hormuz and the disabling of Qatar’s Ras Laffan liquefied natural gas (LNG) complex, which QatarEnergy estimates will require three to five years to restore.

The strait normally handles 20 to 25 per cent of world maritime oil trade (20.3 million barrels per day (bpd) in the first half of 2025) and approximately 20 per cent of global LNG trade (primarily Qatari exports). Brent crude (physical market) rose from approximately \$70 in late February to a

peak of \$140 on 7 April, before settling around \$100 to \$115 as of the time of writing in late May 2026. Global production contracted by more than 10 million bpd relative to February 2026 (for comparison, the 1990 Gulf War removed approximately 4 to 5 million bpd) (IEA, 2026). This is mostly concentrated in Gulf OPEC+ producers.

The macroeconomic data already reflect the price surge. The IMF’s April 2026 World Economic Outlook revised global growth down to 3.1 per cent in its reference scenario, assuming disruptions would end by mid-2026, and warned that a severe shock could reduce growth to 2 per cent (IMF, 2026a). The World Bank’s April 2026 Commodity Markets Outlook projects energy prices to rise 24 per cent in 2026 and fertiliser 31 per cent (World Bank, 2026). Container rates from Shanghai to Jebel Ali more than doubled within days, from \$1,800 to more than \$4,000, and in late March were reported as \$7,000 forty-foot equivalent unit (a standard measurement unit used in international shipping to quantify container capacity). UNHCR reported that its transport costs from Dubai to Sudan and Chad had roughly doubled, eroding the real value of every humanitarian dollar (UNHCR, 2026).

The shock is supply-driven and thus closer in character to 1973 and 1979 than to the demand-led boom of 2003 to 2008. Supply-driven oil shocks are transmitted primarily as terms-of-trade losses for oil importers. Historical parallels with the oil shocks of the 1970s are important because oil-importing developing economies again face rising import bills alongside high debt-service burdens and limited fiscal space.

Three additional features distinguish this shock from its historical predecessors. The first is institutional fragmentation in the oil market itself. The UAE’s departure from OPEC and OPEC+ reflects growing divergence in petrostate strategies and suggests that future oil-price adjustments may become more volatile and less coordinated.

The second is the simultaneous compression of humanitarian logistics. The shock is a price phenomenon alongside fiscal and food-security

events. Food prices have so far not been affected by the full impact of the oil and fertiliser shock, partly due to good harvests (FAO, 2026), but that buffer is unlikely to hold. The FAO estimates that 41 countries, most in Africa, already require external food assistance (FAO, 2026). In the poorest countries, 70 per cent of household expenditures are allocated for food, and even in middle-income countries (MICs), households spend approximately 50 to 60 per cent on food (Smith & Subandoro, 2007, p. 76).

The third is that the oil shock has been delayed somewhat because two offsetting forces have absorbed most of the lost output so far. The rise in US exports and decline in Chinese imports (driven by lower demand and reserve draw-downs) have so far offset 9 million bpd of the supply loss caused by the Hormuz disruption. However, this “shielding” is unevenly distributed and does not extend to oil-importing developing economies that lack strategic reserves or alternative supply relationships, nor can reserves be drawn down indefinitely (The Economist, 2026).

The state of the development cooperation system amplifies this shock. The OECD’s preliminary 2025 ODA data show total DAC aid at \$174.3 billion, down from \$214.6 billion in 2024, equivalent to a 23.1 per cent decline in real terms (OECD, 2026). The five largest donors (the United States, Germany, the United Kingdom, Japan and France) accounted for 95.7 per cent of the decline. The United States alone – under the Trump administration’s dismantlement of USAID and the agency’s formal absorption into the State Department on 1 July 2025 – drove more than three-quarters of it (US ODA fell from approximately \$63 billion to just under \$29 billion in 2025). Humanitarian aid fell 35.8 per cent, and bilateral ODA allocated to development programmes, projects and technical cooperation fell 26.3 per cent, indicating that cuts have moved beyond variable components to structural ones (OECD, 2026). The OECD projects a further 5.8 per cent decline in 2026, a figure that does not yet incorporate the war’s fiscal effects.

The oil shock and the foundations of development cooperation

The oil shock affects the two postulates of development cooperation independently and in combination (see Table 1). It weakens the bounded-state postulate across parts of the Global South while simultaneously eroding the donor-interest postulate across major provider countries. The feedback between these two dynamics could mean that weakened states generate the instability that further erodes the willingness of the publics in donor countries to support them and retreating donors leave states more exposed to the next shock.

The first postulate: bounded states with developmental aspirations

The first postulate assumes that there are bounded states in the Global South that possess sufficient territorial authority and institutional capacity to effectively pursue their developmental aspirations. The oil shock places pressure on the bounded-state postulate by weakening state capacity and fiscal autonomy.

The direct channel operates through rising import and transport costs. Oil-importing economies face worsening balance-of-payments pressures, inflation and rising external financing needs. According to statements by Pakistan’s prime minister, Shehbaz Sharif, Pakistan’s weekly oil-import bill increased from roughly \$300 million before the conflict to around \$800 million following the price rises.

Food-price effects amplify the shock. Agriculture depends heavily on fuel, fertiliser and transport inputs, and fertiliser prices typically lag behind energy prices. Fuel rationing and energy shortages have already emerged across parts of South Asia and sub-Saharan Africa. Countries in East and southern Africa remain especially exposed due to their dependence on Middle Eastern fuel imports.

The fiscal implications are potentially destabilising, with social unrest likely. Governments face

simultaneous pressures to maintain subsidies, preserve social spending and continue servicing external debt. In fragile settings, these trade-offs can weaken state authority and intensify conflict risks. Even in MICs they can be costly. India, Brazil, Indonesia and China have each deployed a combination of tax reductions, price caps or freezes, and export restrictions (Tortarolo, 2026).

Table 1: How the oil shock may undermine the foundations of development cooperation

	Postulate 1: Recipient states (Global South)	Postulate 2: Donor countries (Global North and new donors)
Foundation	There are bounded states in the Global South whose elites hold development aspirations and whose institutions possess at least a degree of territorial authority and integrity	There are a set of countries with elites who perceive a strategic, solidarity or commercial interest in supporting the development aspirations of the other group and, in democracies, can convince their publics that such support is worthwhile
Oil shock channels that may undermine the postulate	Terms-of-trade losses Food price escalation Fiscal squeeze / debt distress State fragility / conflict	(Partly) Ideological hostility to multilateralism and development spending Defence spending crowding out aid budgets Cost-of-living pressures at home Herd dynamics among bilateral donors

Source: Authors

Research on rentier states and the resource curse suggests that commodity dependence can weaken institutional capacity and developmental incentives, particularly where governance structures are already fragile, and that oil-rich states are more likely to be ruled by autocrats than comparable resource-poor countries (Ross, 2012). Oil windfalls may therefore stabilise some exporting states fiscally while simultaneously undermining longer-term state capacity and accountability.

The second postulate: donors with interests

The second postulate assumes that donor countries perceive a strategic, commercial or normative interest in supporting development cooperation and can sustain domestic political and public support for it. This postulate is also weakening: Research shows that aid flows are vulnerable to macroeconomic downturns in donor countries and often decline following fiscal crises. For example, Dang, Knack and Rogers (2013) show that banking and fiscal crises in donor countries are associated with substantial declines in aid flows (typically 20 to 25 per cent). The current oil shock reinforces these pressures through slower growth, inflation and rising defence expenditures.

Political dynamics amplify the fiscal squeeze. The dismantling of USAID under the Trump administration, which has been combined with broader European shifts towards securitisation, migration control and defence spending, reflects a broader reorientation of development policy towards strategic objectives (Klingebiel & Sumner, 2026). Several European governments have already linked aid reductions explicitly to increased defence spending.

Cost-of-living pressures also have a domestic political impact. Public support for development cooperation tends to weaken during periods of inflation and economic insecurity, and evidence suggests that framing aid in terms of domestic benefits may moderate this effect. Heinrich,

Kobayashi and Bryant (2016) show that economic downturns reduce public support levels for foreign aid and thereby increase pressure for aid cuts.

At the same time, donor retrenchment may spread through herd dynamics. As major bilateral donors reduce commitments, other donors may follow, turning national budget decisions into system-wide contraction across the aid architecture.

The result is a potentially self-reinforcing process. As development and humanitarian programmes contract, fragile states may become less stable. Yet the resulting instability may further strengthen political arguments in donor countries for securitised and nationally focused spending rather than global development commitments. High-profile instability and fragility sometimes attracts donor attention, though that may depend on the strategic significance.

What this means for development cooperation

The weakening of both postulates is producing a structural shift in the architecture. Concessional finance is detaching from the poverty-reduction mandate that defined the post-Cold War consensus. Three dynamics are evident: stress on multilateral institutions, a partial petrostate counterweight and geographical reconcentration of remaining flows.

The multilateral architecture

The multilateral development finance architecture entered 2026 with insufficient pledges.

IDA21's \$100 billion envelope was calibrated to a benign baseline that no longer holds. Further, this was well below the African heads-of-state request of \$120 billion. The Trump administration subsequently reduced the US pledge (a revised request to Congress) from the Biden administration's promise of \$4 billion to \$3.2 billion in May 2025. The IMF's October 2024 reform of the Poverty Reduction and Growth Trust (PRGT) secured a long-term lending envelope of Special Drawing

Right (SDR) 2.7 billion per year (IMF, 2025). SDRs have not flowed through regional development banks because of an informal ECB position advising European Union member states against rechanneling their SDR allocations through multilateral development banks and thereby creating a de facto constraint. There is also the absence of US Congressional authorisation to deploy US SDR holdings in this manner (Berensmann et al., 2024).

The oil shock cuts across the multilateral architecture at multiple points. PRGT subsidy resources are coming under increasing pressure precisely as oil-importing LICs require emergency support. At the same time, the new tiered interest-rate structure introduced in May 2025 raises borrowing costs for countries transitioning from concessional to non-concessional financing. Because PRGT concessionalism relies on subsidy contributions from wealthier IMF member states rather than regular IMF quota resources, rising demand during simultaneous crises places growing pressure on the trust's subsidy envelope.

The G20 Common Framework for Debt Treatments, already slow, is now encountering a shock that may push additional oil-importing African economies into distress. Potential feedback runs through the multilateral development finance architecture, too. As multilateral instruments deplete their concessional resources, recipient states face more stringent borrowing terms, which worsen their debt positions and, in turn, reduce their creditworthiness for future MDB lending.

The petrostate counterweight?

The most apt historical analogy is from the 1970s. Arab donors averaged 1.5 per cent of combined GNI as ODA from 1973 to 2008 and supplied roughly one-third of all ODA in the 1970s (World Bank, 2010). The institutional infrastructure built during that price rise (e.g. the Kuwait Fund, the Abu Dhabi Fund, the Saudi Fund, BADEA, the Islamic Development Bank and the OPEC Fund) remains operational and active. The Arab Coordi-

nation Group provided \$19.6 billion in 2024, making it the world's second-largest development finance grouping, and the Islamic Development Bank's 2024 commitments rose 12.3 per cent to \$13.2 billion (Islamic Development Bank, 2025). The OPEC Fund annual report noted \$2.3 billion in new commitments in 2024, up 35 per cent year on year (OPEC Fund, 2025).

A repeat of this magnitude is unlikely. Sovereign wealth funds (SWFs) now buffer commodity windfalls. When oil prices collapsed in 2014, some Gulf donor flows contracted and some did not because SWFs stabilised fiscal positions. The same logic applies in reverse. Windfalls are increasingly captured by SWFs rather than channelled into ODA expansion. Second, the UAE's withdrawal from OPEC and OPEC+ on 1 May signals a divergence in the petrostate strategy, which complicates collective action on development finance, just as it does collective supply management. Qatar's LNG infrastructure damage compresses its capacity, meaning that global gas prices could rise by 50 to 100 per cent (Tan, 2026). Third, Gulf food-import vulnerability is a new constraint. GCC states rely on food imports transiting the Strait of Hormuz for 70 to 80 per cent of their caloric intake, and the blockade is likely to redirect fiscal attention inward.

Chinese overseas development finance is roughly \$6 billion (post-2020 average) (Boston University Global Development Policy Center, 2025). The Belt and Road Initiative, which might have been expected to expand during a period of geopolitical flux, is instead undergoing a significant change in profile: Beijing is pivoting towards North Africa to secure alternative energy supply lines while blending fossil-fuel security with green-technology cooperation. This is strategic investment, not broad-based concessional poverty reduction. There was a failure to reach a consensus on the Iran war at the BRICS Delhi meeting held on 23 and 24 April, pointing to the limits of BRICS+ as a coordinated geopolitical bloc and, by extension, as a coordinated financing one. The New Development Bank's portfolio has reached approxi-

mately \$40 billion in cumulative approvals across 120 projects, and its target of 30 per cent for local-currency financing represents a genuine institutional innovation, having risen to 44 per cent of total approvals (NDB, 2025). But BRICS+ coordination remains aspirational rather than operational for emergency development response. In sum, there is a shift in the geography of concessional finance. However, it is not large enough to compensate for OECD-DAC retrenchment, and it is shaped by different conditions.

The geographical reconcentration of concessional finance

The combined effect of weakening both postulates is a likely geographical reconcentration of whatever concessional finance remains. Countries with strategic salience to major donors retain access.

Although humanitarian and securitised aid continues to flow to some strategically salient fragile states, including Yemen and parts of the Sahel, these responses are being eroded in real terms by rising operational costs and declining overall humanitarian funding.

Fragile states without strategic salience face simultaneous declines in donor attention, fiscal capacity and food security, further limiting the ability of the international system to respond proportionately to need. The self-reinforcing cycle is most destructive in exactly those settings where development cooperation was most needed and is now least available.

Conclusions

The 2026 oil shock is consequential not because price shocks automatically determine development cooperation flows, but because of their cumulative interaction with other challenges and their timing. This shock serves as a significant accelerant in a political configuration that is already leaning away from global development norms. The post-Cold War development architecture rested on two postulates being in place simultaneously: enough states in the Global

South pursuing developmental aspirations, and enough actors in the Global North and among new donors willing to support them. The oil shock weakens the first postulate unevenly and the second more broadly, precisely at a moment when substitution mechanisms are insufficient, shaped by different conditions, or both.

As a result, the development cooperation landscape is likely to become more fragmented, more transactional and more geographically concentrated in the coming years. States with strategic salience will retain access to concessional finance from a narrower donor base. States without it, including even those with strong development track records, will most likely face further ODA cuts. Fragile states with security spillovers will receive lower humanitarian flows in real terms as operational costs outpace nominal budgets. Fragile states without strategic salience risk the simultaneous failure of both postulates: abandoned by donors and left to absorb the shock alone.

The petrodollar-recycling approach of the 1970s will not repeat. SWFs now capture windfalls that previously flowed outward. Chinese development finance has seen a contraction in lending volumes from its BRI peak and is pivoting towards strategic supply-chain investment. BRICS+ has not yet established itself as a coordinated bloc. The political conditions that once sustained a more generous, global development cooperation system are unlikely to be reassembled in the foreseeable future. What is at stake is not a temporary disruption but a structural reconfiguration.

These analytical conclusions point to three policy implications that decision-makers need to acknowledge and act upon.

- First, the multilateral architecture requires additional emergency support. Although prior to the oil shock the IMF had implied that the available PRGT resources were adequate, efforts to secure additional subsidy resources remain ongoing and need expanding as LICs face elevated debt-service burdens, declining concessional flows and heightened exposure to food, fuel and financing shocks. IDA21 was agreed before the latest deterioration in the external environment and may need to be reassessed against these changed conditions. Donors with fiscal capacity and political will should therefore prioritise targeted multilateral recapitalisation as a high-impact intervention.
- Second, the increasing concentration of concessional finance to strategically prioritised states should not be treated as inevitable. Several fragile and conflict-affected countries, including Sudan, South Sudan, Haiti, Mali and Yemen, continue to face severe humanitarian and financing gaps despite acute human suffering. In many of these cases, limited financing reflects not only operational constraints but also political and strategic priorities of donors and multilateral actors.
- Third, European and other OECD donors need to recommit to the development aspirations of developing nations. Across many donor countries, ODA has been cut, while development institutions are being more closely aligned with strategic, security and economic objectives. A continued shift in this direction could amount to an abandonment of the post-Cold War development consensus.

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Professor Andy Sumner is a professor of International Development at King's College London and President of the European Association of Development Research and Training Institutes.

Email: andrew.sumner@kcl.ac.uk

PD Dr Stephan Klingebiel is head of the Inter- and Transnational Cooperation department at the German Institute of Development and Sustainability (IDOS). He previously headed the UNDP Global Policy Centre in Seoul and the Kigali office of KfW Development Bank.

Email: stephan.klingebiel@idos-research.de

The German Institute of Development and Sustainability (IDOS) is institutionally financed by the Federal Ministry for Economic Cooperation and Development (BMZ), based on a resolution of the German Bundestag, and the state of North Rhine-Westphalia (NRW) as a member of the Johannes-Rau-Forschungsgemeinschaft (JRF).

Suggested citation:

Sumner, A., & Klingebiel, S. (2026). *The oil shock and the new political economy of development cooperation* (IDOS Policy Brief 18/2026). IDOS. <https://doi.org/10.23661/ipb18.2026>

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IDOS Policy Brief / German Institute of Development and Sustainability (IDOS) gGmbH

ISSN (Print) 2751-4455

ISSN (Online) 2751-4463

DOI: <https://doi.org/10.23661/ipb18.2026>

© German Institute of Development and Sustainability (IDOS) gGmbH

Tulpenfeld 6, 53113 Bonn

Email: publications@idos-research.de

<https://www.idos-research.de>

Printed on eco-friendly, certified paper.

