

# The new architects: Brazil, China, and innovation in multilateral development lending

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## Summary

Recent academic works have shed light upon the motives and negotiation dynamics leading to the creation of the New Development Bank (NDB) and Asian Infrastructure Investment Bank (AIIB). We know less about their day-to-day activities and if (and if so why) they are being innovative in the field of multilateral development lending. This article evaluates novelty in the two banks. It uncovers and suggests an explanation to the puzzle of why the NDB appears more innovative (in terms of institutional design, staffing, and lending policy guidelines) than the AIIB by exploring the cases of China and Brazil. The two countries played central roles in the set-up of each the AIIB and NDB. Drawing on extensive field research, the article proposes that their preferences and capability to engage in institutional innovation depend on interests, status, economic power, and regulatory capacity.

## KEYWORDS

AIIB, Brazil, China, development finance, emerging powers, MDBs, NDB

## 1 | INTRODUCTION<sup>1</sup>

It has been convincingly argued that BRICS states, namely, China, India, Brazil, and Russia, are playing an increasingly crucial and assertive role in international institutions (He & Feng, 2012; Hurrell, 2010). Although scholars have investigated the impact of the proclaimed power transition towards rising powers on their behaviour in long-established institutions of global governance (e.g., Conceição-Heldt, 2015; Cooper, 2016; Ikenberry, 2009), the creation of new institutions by emerging powers has been less systematically addressed. In addition to becoming more vocal in global organizations, the BRICS states (and particularly China) are actively engaged in institution-building. They have established new formal organizations that are often portrayed as alternatives to existing international

institutions: The Asian Infrastructure Investment Bank (AIIB set-up in 2015) and the New Development Bank (NDB created in 2014).

This trend indicates that these actors are moving beyond rule-making behaviour and towards full-blown institution-building, which has the potential to significantly alter the current workings of global governance (Stephen, 2017). The creation of new multilateral development banks (MDBs) raises questions about their potential to challenge, or innovate, with regard to existing development-lending practices. This may only occur if these new institutions are inventive, rather than replicating existing rules and practices. For this reason, this article seeks to answer the question of

*Whether, and if so, under what conditions do emerging countries create institutions that are innovative in the field of multilateral development lending?*

Given that multilateral development lending requires complex technical expertise, innovation is defined here as a “transfer of learned knowledge to offer better solutions that meet new requirements, unarticulated needs (Maranville, 1992; Powell, 1998), or existing social needs” (Cegarra-Navarro, Reverte, Gómez-Melero, & Wensley, 2016, p. 530). In this context, a key concern for countries of the Global South has been filling large infrastructure gaps, particularly as existing lenders have been often perceived as risk-adverse, cumbersome, and

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slow (Bhattacharya, Romani, & Stern, 2012; Griffith-Jones, 2014). Both the AIIB and the NDB have sought to innovate by focusing on infrastructure and by being faster and more adapted to the needs of developing countries, than what has been hereto the case with existing MDBs.

This article proposes that innovation (as defined above) occurs through institutional design, staffing, and lending practices. Taking these factors into consideration and the existing literature (Section 2), the article finds that the NDB is (thus far) the more innovative institution (Section 3). This is an interesting puzzle, given that the AIIB has captured most media and academic attention and has become a much larger bank (at least in terms of membership). Section 4 proposes a framework for institutional innovation to help answer this puzzle and the broader research question, based on interests, status, economic power, and regulatory capacity. The framework is evaluated empirically in Section 5, laying focus on China and Brazil, each of which played a central role in the set-up of the AIIB and NDB, respectively.<sup>2</sup> The empirical analysis draws on extensive field research to uncover these countries' preferences and influence in shaping the operation of the two new banks. In doing so, it evaluates official documents and relies on more than 40 semistructured interviews with key stakeholders,<sup>3</sup> carried-out in the two countries throughout 2016. Some concluding thoughts are offered in Section 6.

## 2 | STATE OF THE ART

Beyond broader works on the role of emerging powers on the contemporary global order (e.g., Cooper & Antkiewicz, 2008; Ikenberry & Wright, 2008; Lavenex, Krizic, & Serrano, 2017; Stephen, 2017), a nascent literature has started evaluating the role of emerging countries as institution-builders by looking at the AIIB and NDB. Most of these works focus exclusively on the AIIB, with the result that few comparative studies exist (a notable exception being Reisen, 2015).

Early works appeared as the Fortaleza Agreement was signed in 2014 and the AIIB was announced. This literature offers mostly descriptive analyses, laying emphasis on negotiation dynamics and the preferences of China and the other BRICS and/or the reaction of existing powers (especially the United States) to their creation (see Abdenur & Folly, 2015; Callaghan & Hubbard, 2016; Chin, 2014; Cooper & Farooq, 2015; Etzioni, 2016; He, 2016; Roberts, Armijo, &

Katada, 2018; Stuenkel, 2015; Tang, 2015). These works also underlined functional aspects driving their creation, such as the large infrastructure gaps existing in the developing world, often, relying on calculations by Bhattacharya et al. (2012) and Griffith-Jones (2014).

Another strand in the literature has searched for clues as to the goals of the new banks and potential to transform existing development lending practices; particularly, when compared with the IBRD/World Bank (Chin, 2016; Guimarães, 2014; Ikenberry & Lim, 2017; Khanna, 2014; Reisen, 2015; Ren, 2016). More recently, academics and practitioners involved in the set-up of these two institutions have offered rich accounts of the sources, challenges, and opportunities involved in their creation (see Lichtenstein, 2018 for the AIIB; Humphrey, 2015 and Humphrey, Griffith-Jones, Xu, Carey, & Prizzon, 2015 for the NDB). These more recent works show the complexities and trade-offs involved in having different governance arrangements, including the rules followed (e.g., the use of country systems vs. existing safeguards), shareholder capital (ultimately determining credit ratings and thus potential loan portfolios), and voting rights and membership criteria (e.g., regional/global and borrowing/nonborrowing).

This article draws from the abovementioned literature, regarding Articles of Agreement, negotiation dynamics, and the sources inspiring the creation of the two banks. It expands these works by going beyond the negotiated outcomes to include more recent (but equally important) developments related to their operation. The latter include informal rules (e.g., staffing procedures) and guidelines (e.g., lending, project assessment, and environmental and social standards) comprised in the roll-out of projects. These factors are evaluated in the following section to ascertain whether innovation has taken place or not in the two new lenders.

## 3 | INSTITUTIONAL INNOVATION IN THE AIIB AND NDB

To be able to assess whether institutional innovation has taken place or not, I operationalize the latter in terms of institutional design, personnel recruitment, and lending practices. Institutional design is assumed to have long effects in the functioning of organizations through path dependence (Hall & Soskice, 2001; Hall & Taylor, 1996; Koremenos, Lipson, & Snidal, 2001; Skocpol & Pierson, 2002). It has been shown by sociological theories of organizations that personnel recruitment (staffing) choices have long-lasting influences in the priorities and policies followed by the existing MDBs (e.g., Babb, 2003; Babb, 2009). Lending practices in projects should reflect whether new rules are at play or not, when looking at safeguards and the implementation of guidelines (e.g., environmental or social impact assessments). Taking these three elements together, I suggest that it is possible to discern the extent to which the AIIB and the NDB are followers or innovators with regard to existing MDBs.

### 3.1 | Institutional design

The institutional design (see Koremenos et al., 2001) of both lenders is similar to that of existing regional and MDBs, all of which roughly

<sup>2</sup>China was the initiator and key driver at the AIIB, whereas Brazil played a key role at the NDB by taking secretariat functions throughout the negotiations leading to the establishment of the bank.

<sup>3</sup>In Brazil, interviews were made with top-ranking officials and diplomats from the Brazilian National Development Bank (BNDES), Ministry of Finance, Ministry of Foreign Affairs (Itamaraty), Ministry of Development, Industry and Foreign Trade, Chief of Staff (Casa Civil), academics and think-tanks (USP, CEBRI, Instituto Igarapé, FUNAG) in Rio de Janeiro and Brasilia throughout September and October 2016. Interviews in Beijing and Shanghai were carried-out from June to August 2016. In Beijing, interviews were made at the Ministry of Finance, the Ministry of Commerce, the New Silk Road Fund, the China Investment Corporation, CITIC Investment, and the Chinese Academy of Social Sciences. In Shanghai, with academics from Fudan University and the Shanghai Institute of International Studies. The author also participated in the First Annual Meeting of the NDB in Shanghai (July 21, 2016).

follow the Bretton Woods institutional model (World Bank/IBRD created in 1944). This includes aspects such as membership (size, exclusivity, and categorization), scope (vision and mission, priority, funding sources, and services), control (governance structure and voting schemes), and flexibility (membership conditions). Similarities thus include the Articles of Agreement, their governance structure (board of governors and directors), presidency, professional committees, weighted voting powers, inequality among members (i.e., veto powers for some of its members), and business scope. Some differences also exist, such as a political mandate for the EBRD (created in 1991), the NDB's limited membership (and lack of individual vetoes), and CAF's (set-up in 1970) openness to members from the private sector. An interviewee went as far as to suggest that

*the AIIB is essentially a copy of the World Bank, only that it is China-dominated. It is a response from China to its lack of weight in the existing institutions, but if you look at not only institutional design but also other guidelines and documents these are all essentially a copy of the existing ones.*<sup>4</sup>

Another interviewee explained that after difficult negotiations, the high social and environmental standards (i.e., safeguards) of the World Bank were applied to the AIIB, as this was a precondition for European countries to take part in the bank.<sup>5</sup> It was also explained that the Articles of Agreement of the World Bank and other existing MDBs were taken as templates for the NDB.<sup>6</sup>

A comprehensive assessment of the existing MDBs escapes the aims and limits of this article (for a good comparative evaluation, see Faure, Prizzon, & Rogerson, 2015; Lichtenstein, 2018). For our purpose of measuring institutional innovation, differences in relation to the NDB/AIIB and other MDBs should be underlined. The NDB with five members (BRICS countries) is an odd case compared with the other lenders, all of which (including the AIIB with currently 86 accepted members) have larger affiliations.<sup>7</sup> The NDB is also the first bank with global scope set up exclusively by emerging countries.<sup>8</sup> This provides more equal power and a stronger sense of ownership among shareholders than what is the case in other banks, all NDB lenders (so far) are borrowers too.<sup>9</sup> However, this also makes the bank dependent on the successful continuation of the BRICS alliance.

Considering that other MDBs have a larger membership, it is not surprising that almost all include both borrowing (developing) and nonborrowing (industrialized) countries. The AIIB follows this pattern; it was suggested that the rapid inclusion of the more conservative

European countries is one reason why the AIIB is unlikely to innovate much.<sup>10</sup> However, the NDB also foresees to include nonborrowing countries (up to 20% of voting shares based on its Articles of Agreement). The expansion of the NDB will thus be a critical issue in its future evolution and perhaps its capacity to innovate. Both AIIB and NDB are in principle open to expansion (to United Nations members in the case of the NDB, IBRD, and ADB members for the AIIB).

The scope of both banks is more limited than most of the other MDBs, which often have wider goals such as poverty reduction, social inclusion and inequality, innovation, gender equality, diversity, and climate change. As CAF, both the AIIB and NDB's focus is on infrastructure (although the NDB additionally emphasizes sustainability and the AIIB promoting regional cooperation). This may be innovative, because as an interviewee suggested,<sup>11</sup> the World Bank has many resources, but these are used in other issues such as conflict prevention not infrastructure, which implies a different understanding of development needs.

In terms of control, in virtually all MDBs one or a subgroup of members have de facto veto power. In the AIIB, it is China with 28.7% of voting power (key decisions require a 75% supermajority), although the country has announced that it is willing to give its veto away with the expansion of the bank (which in itself would be novel). The next largest members are India 7% and Russia 6%, whereas Brazil has a 3% share. For the NDB, even if at present all members are equal and thus no veto power exists, its Articles of Agreement would in principle (once the bank expands) allow for a collective veto for the BRICS countries (55% of voting shares). However, this presupposes the BRICS act in unison, which may not always be the case. An important difference (reflecting the recent creation of these institutions) is that both the AIIB and the NDB have non-resident governing bodies. This gives in principle member states more control over the institutions. Resident boards and the bureaucracies they engender tend to become powerful agents on their own, with priorities that can deviate from those of their principals.

The NDB and AIIB's Articles of Agreement allow for cofinancing and to work with all kinds of financial instruments, unlike other existing multilateral lenders (particularly the World Bank) that are more rigid.<sup>12</sup> Additionally, interviewees suggested that the NDB is more open to a lower credit rating (double, instead of triple A) although there is disagreement among the BRICS on this respect.<sup>13</sup> According to another interviewee, Brazil and Russia face limits in their capital contributions to the NDB and as a result are unwilling to provide sovereign guarantees to the proposed loans, which will in turn adversely affect the rating of the NDB in international markets.<sup>14</sup> This matter also affects the selection of future members, as expanding to highly scored nonborrowing members would help raise the overall

<sup>4</sup>Interview, high-level Brazilian official I, Ministry of Finance. September 30, 2016, Brasilia.

<sup>5</sup>Interview high-ranking government official from a European country AIIB founding member. October 28, 2016.

<sup>6</sup>Interview, high-level Brazilian official II, Ministry of Foreign Affairs (Itamaraty). October 3, 2016, Brasilia.

<sup>7</sup>World Bank (189 members), EIB (28), IDB (48), ADB (67), AfDB (80), CAF (19), EBRD (65), and ISDB (56).

<sup>8</sup>Remarks made by one of the NDB's vice presidents at the First NDB meeting, Shanghai, July 21, 2016.

<sup>9</sup>Interview, UNCTAD senior economist, Geneva, November 24, 2016.

<sup>10</sup>Interview, high-level official from a BRICS country, Fall 2016.

<sup>11</sup>Interview, Chinese scholar. August 1, 2016, Beijing.

<sup>12</sup>Interview, high-level Chinese official, Ministry of Finance. July 19, 2016, Beijing.

<sup>13</sup>Interview, high-level Brazilian Official, Ministry of Foreign Affairs (Itamaraty). October 3, 2016.

<sup>14</sup>Interview, high-level Chinese official II, Ministry of Finance. July 28, 2016, Beijing.

credit rating of the bank. However, nonborrowing members have different priorities, in particular the inclusion of environmental and social safeguards, at odds with the current nonconditionality approach of the NDB.<sup>15</sup>

A lower credit rating would make loans more expensive but could increase flexibility (enlarging the pool of projects that may be financed, because keeping a triple A rating means having a lot of capital blocked that cannot be used). The NDB has also started talks with Moody's and not Standard and Poor's whose criteria are considered more stringent. The AIIB followed the WB/IBRD and other large MDBs in seeking a high credit rating and obtained the prized triple A rating from Moody's on June 29, 2017. Since then, all major ratings agencies have given the AIIB triple rating. Additionally, both AIIB and NDB seek to raise capital in local capital markets to be able to lend in domestic currencies, and thus minimize borrowers' exchange rate risks. This is a relevant innovation because many developing countries have been wary of borrowing in foreign currencies and of related capital account deficits. These elements taken together show a degree of operational flexibility and innovation that is not present in other large MDBs.

Additional operational characteristics that differ from other MDBs include the possibility for the AIIB's president to approve (small) loans independently and the scale of both NDB and AIIB that provide an environment where "everyone knows everyone, making it possible to shape things, to ask questions and get ideas through."<sup>16</sup> This is significant when compared with the World Bank, which has personnel of approximately 10,000 (and a similar number of consultants).

### 3.2 | Recruitment

Interviewees have suggested that both the NDB and the AIIB have largely drawn personnel from the existing MDBs and that the AIIB has done so more than the NDB. Both banks had approximately 150 permanent staff in Beijing and Shanghai by mid-2018. An important factor at the NDB has been that Brazil and Russia pushed for an equilibrium of posts at the different levels in the bureaucracy and for higher salaries.<sup>17</sup> Keeping a balance in terms of country of origin can increase the bank's diversity. Recruitment was a politicized issue in the set-up of the bank. For this reason, the NDB has made use of a private recruitment company, Los Angeles based Korn Ferry Futurestep.

I have examined and coded a large sample of management positions in both banks (50 for the NDB and 29 for the AIIB) to have a more detailed picture of recruitment patterns.<sup>18</sup> Although not

complete, the sample includes the bulk of the two banks' management. The results, which are shown in detail in Tables A1–A3, suggest that both AIIB and NDB have to a large extent followed traditional recruitment paths (in terms of disciplines, academic institutions, and occupational background). An interviewee explained that the AIIB employed an important number of recently retired World Bank personnel, as consultants, for a quick start of the bank.<sup>19</sup> The NDB also made use of consultants but additionally was supported by personnel from the national development banks from the BRICS. The expertise from the BNDES, Brazil's development bank (and the oldest one in the Global South), was relevant in this context.<sup>20</sup> There are some interesting differences too.

An important difference in the background of personnel of the two banks is educational institutions. Although the AIIB tends to be dominated by alumni from well-known international institutions (especially Ivy League graduates), the NDB has a more diverse profile. This is particularly salient in the case of China whose nationals at the AIIB have mostly international backgrounds, whereas a large part of those recruited by the NDB studied in Chinese universities. That being said, most positions at the NDB have been filled by graduates from a relatively small number of top BRICS universities (see Table A2). This is particularly salient in the case of India where graduates from the Indian Institute of Management (albeit from various locations) are strongly represented.

A significant number of AIIB personnel had previous job experience in established multilateral development lenders (e.g., WB, EBRD, ADB, and EIB), whereas most NDB personnel has a background in the private sector in their country of origin (see Table A3). In the case of the NDB, some differences exist between the different BRICS countries. The most notable is the large number of Indian nationals (six out of 14) that held previously positions at ICICI bank (India's largest private bank). This is likely to be related to the fact that the NDB's president was CEO of that bank from 1996 to 2009.

Other relevant patterns are age and international profile. During a speech at the first annual meeting of the NDB, the bank's president emphasized the aim of recruiting younger personnel than other MDBs.<sup>21</sup> This can be confirmed when looking at recruitment patterns. The AIIB for its part has been very careful in keeping an image of openness and emphasized its international profile. In doing so, it is setting a limit to the proportion of Chinese nationals that can work at the bank (initially at 35% and at a later stage reducing it to 25%).

### 3.3 | Lending

Lending is an area in which differences between the two banks and other MDBs are significant. Traditional donors dedicate at much

<sup>15</sup>Interview high-level government official from a European country AIIB founding member. October 28, 2016.

<sup>16</sup>Interview high-ranking government official of a European AIIB member country. October 28, 2016.

<sup>17</sup>Interview, high-level Brazilian Official, Ministry of Foreign Affairs (Itamaraty). October 3, 2016.

<sup>18</sup>The total headcount of the banks is around 150, which means most management positions have been accounted for. I have not considered top positions at the board of governors or of directors given that these have not been recruited by the banks but rather appointed by national governments. I also have not considered administrative personnel, which is more likely to be domestically sourced. The coding was made on the basis of LinkedIn profiles throughout the month of September 2017.

<sup>19</sup>Interview, high-level Chinese official, Ministry of Finance. July 19, 2016, Beijing.

<sup>20</sup>Interview, high-level Brazilian official, Brazilian National Development Bank (BNDES). September 22, 2016, Rio de Janeiro.

<sup>21</sup>NDB's President K. V. Kamath remarks made at the First NDB meeting, Shanghai, July 21, 2016.

10% to infrastructure, and this is an issue that emerging countries have sought to change for a long time. For example, China and South Korea have pushed the ADB to increase its investments in infrastructure. It is thus not surprising that this is the focus of both banks. Variation also exists in operational policies and practices.

The current size of the two banks in terms of personnel and the absence of a research arm have raised questions regarding the banks' ability to implement due diligence provisions with regard to good financial management and governance by borrowers (i.e., adequately assessing project feasibility and oversight). This lack of expertise may explain why the AIIB has partnered with existing MDBs for almost all of its projects to date and why the NDB's loans have until now mainly been linked to pre-existing projects that were in the pipeline of the BRICS' national development banks.

An issue in which the NDB differs substantially from the existing MDBs (including the AIIB) is that it has not developed detailed environmental and social safeguards but relies instead on those of the borrowing countries (i.e., a country systems approach). Although this is one of the most innovative aspects of the NDB, it remains to be seen how the bank will deal with borrowers with low national standards (financial, social, or environmental). The reason for following the country systems approach is nonconditionality (i.e., an explicit aim not to "impose" policies on receiving countries or intervene in their domestic affairs). This aspect has been criticized by civil society organizations, who worry it could undermine existing standards and lead to negative social and environmental impacts. It also affects their participation, given that the bank has remained vague on what it will do in cases where domestic law does not envisage civil society participation in projects. The bank has however made a strong emphasis on sustainable development (although its definition remains vague), in particular sustainable infrastructure.

The AIIB for its part began joining forces with other MDBs by signing cofinancing agreements with the WB, EBRD, and ADB. As of January 2017, two thirds of its projects (six out of nine) were being conducted with other MDBs.<sup>22</sup> Its focus is regional (Asia—largely conceptualized as projects have been funded in Oman and Georgia), although there has been some speculation of a possible wider global role (e.g., in projects in Latin America). Lending focuses on infrastructure, especially energy, water, and transport. Although the bank has also stressed sustainability in its projects, the "greenness" of the latter remains a debated issue among its shareholders (especially with regard to coal projects). The AIIB has adopted safeguards like those of existing MDBs and recently published an energy strategy designed to bring transparency to this matter. Additionally, so far, all projects have been approved by consensus, and the norm has been close cooperation (rather than competition) with existing MDBs.<sup>23</sup>

<sup>22</sup>See Global Times "AIIB's first year shows efficiency" <http://www.globaltimes.cn/content/1029153.shtml>. Last accessed: 5.03.2017 and Caixin, "AIIB: Lean, Mean, Funding Machine" by Wang Liwei and Liu Xiao. July 7, 2017. Available at <http://www.caixinglobal.com/2017-07-07/101112093.html>. Last accessed August 14, 2017.

<sup>23</sup>Interview high-ranking government official from a European AIIB founding member. October 28, 2016.

In sum, both NDB and AIIB show a certain degree of innovation, offering better solutions than the existing lenders, including faster and better adapted funding to existing social needs (e.g., loans denominated in local currencies). Innovation results largely from a focus on infrastructure rather than "program lending" (i.e., governance and policy architecture of receiving countries). However, most other aspects ranging from institutional design to recruitment and cofinancing indicate a large degree of institutional isomorphism (Powell & Di Maggio, 1991).

What is particularly interesting from this overview is that the NDB, and not the AIIB, has shown a larger degree of innovation (by inter alia refusing individual vetoes, wider flexibility in recruitment patterns, and seeking a balance in personnel originating from member states in positions at all levels). Most importantly (and controversial) has been the bank's use of a country systems approach, rather than the existing safeguards. These differences are puzzling inasmuch as it is the AIIB, which has been overwhelmingly described as the potential challenger/innovator to existing institutions and practices in academic and media accounts. The NDB has received less attention. To answer this puzzle, and further clarify the wider research question guiding this article on the conditions under which emerging countries seek institutional innovation, an explanatory framework is proposed below.

## 4 | A FRAMEWORK OF INSTITUTIONAL INNOVATION BY EMERGING COUNTRIES

I argue that broadly speaking, the choice by emerging countries with regard to innovation will be either between creating a new institution with similar rules (i.e., institutional isomorphism, see Powell & Di Maggio, 1991) or one with alternative and/or competing rules (institutional diversity). I suggest that the decision made by an emerging country to take either of these two alternative paths is contingent upon configurations of interests, status, power, and regulatory capacity, none of which is sufficient, but several of which may be necessary for specific outcomes (see Figure 1 below). Among these conditions, I posit that interests and status will necessarily drive the choice outcome whereas power and regulatory capacity will condition an actor's interpretation of its capability to act in the name of interests and status. This framework is tested empirically for the cases of China and Brazil in the next section.

### 4.1 | Interests, status, power, and regulatory capacity

I expect interests to derive from the domestic political economy, foreign policy considerations, and ideational factors (prevailing ideology/worldviews of ruling elites). Interest may not be consistent, as it is likely that fragmented or even conflicting positions exist in the country cases examined. Another factor that may determine whether an emerging country decides to play the role of institutional innovator or not is status. The latter has been shown to be a powerful determinant in the foreign policies of postcolonial states (Chatterjee-Miller, 2013; Deng, 2010). In this case, I expect that countries with status



concerns are more likely to seek being treated as equals, rather than becoming institutional innovators. The two cases examined have had direct (Brazil) or indirect (China) experiences of colonization (see next section). In addition, they display an acute awareness of the importance of their standing vis-a-vis the United States, as the primary global hegemonic power, for adjudicating their international status.

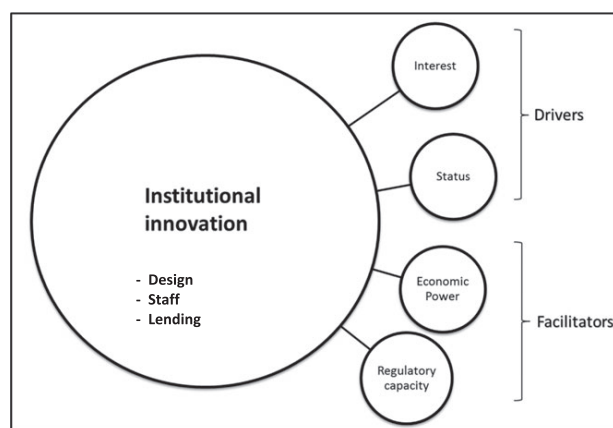
I assume that interests lead to institutional innovation, whereas status is more likely to translate into institutional isomorphism. The reason for this is simple, if status is the primary concern, the form a new institution takes is ultimately of less importance than being able to be at a similar position to established powers. On the other hand, if interests are the main drivers, existing institutions are unable to accommodate the interests of that given country, and thus, a new institution will necessarily seek a different form more attuned with the interests of the latter.

A willingness to innovate (or even to create a new institution) does not mean that a given country is capable to do so. It is likely that emerging states with large economic resources and expertise will be able to create new institutions and (if they wish to do so) to make them innovative. Economic power depends on availability of resources (given the large paid-in capital sums required) and the ability to raise capital in domestic and international markets (often dependent on credit ratings). Expertise, on the other hand, depends on regulatory capacity (or the extent to which a country or an administration can define, uphold, and promote international rules in a consistent and effective manner). This requires coherent domestic rules, as well as the competence, expertise, and resource base of pertinent domestic regulatory bodies (Bach & Newman, 2007, 2010; Lavenex & Serrano, 2016).

The ultimate shape a new institution takes thus depends on the relative importance of these four factors, in particular of interest and status, which are the drivers for such a choice. On this basis, the following conjecture is proposed. If a country is able to do so (given economic power and expertise),

*A country's diverging interests will lead to institutional innovation whereas status concerns will translate into institutional isomorphism.*

Figure 1 below summarizes this framework.



**FIGURE 1** Institutional innovation

## 5 | TESTING THE ARGUMENT: DRIVERS FOR CHINA AND BRAZIL'S PERSPECTIVES ON INSTITUTIONAL DESIGN, RECRUITMENT, AND LENDING

### 5.1 | China and institutional isomorphism: A wider pragmatic view

China has taken a pragmatic approach towards innovation in the AIIB and the NDB, seeing both lenders as ways to further economic and foreign policy objectives (status and reform of existing MDBs). China's preferences lean clearly towards institutional isomorphism. Particularly, creating similar institutions, but ones in which China can play a central role. Various interviewees suggested the launching of the AIIB a few months after the NDB reflects this impatience, as the latter was seen to evolve too slowly and lack ambition. This is not to say that China has not seen an added value in the NDB. In fact, the country is keen to promote BRICS cooperation given that this is the only multilateral forum where China plays a dominant role and sees the NDB as a relevant way of promoting a more equal global governance.<sup>24</sup> China is thus keen to rapidly develop and expand the NDB as it has done with the AIIB. Without expansion, wider use of European and American capital markets, and cofinancing, the medium- and long-term strategic goals of the bank remain limited.<sup>25</sup> China is also keen to avoid the NDB (and BRICS) becoming a talking shop.

The AIIB, in contrast, has been both quicker and broader; already in its first 2 years, it had 57 members and 16 projects. Currently, its approved members include 86 countries in six continents, and by 2018, the bank has funded 24 projects and disbursed more than 4.4 billion. Interests and status have driven China's choice for institutional isomorphism. Economic power served as a strong incentive for other (particularly European) members to join the bank, whereas a lack of regulatory capacity (multilateral lending experience) translated into following orthodox preferences. The AIIB's nonideological, nonconditional, and "not-too-difficult to operate" approach reflect particularly well Chinese economic and foreign policy interests, together with status concerns, its economic power, and regulatory capacity.

On the AIIB, one knowledgeable interviewee<sup>26</sup> argued that

*AIIB is not doing something new or different. It is trying to fill the gap that the existing MDBs have failed to do so. The demand in infrastructure is huge but the existing MDBs are not able to fund. AIIB is taking the best parts from the MDBs and trying to make improvements on those shortcomings ... The Operational Policy on Financing was drafted by experts from ADB, EIB, EBRD, WB.*

<sup>24</sup>Interview, Chinese scholar IV, Guangzhou, November 6, 2016.

<sup>25</sup>High-level Chinese government official remarks made at the First NDB meeting, Shanghai, July 21, 2016.

<sup>26</sup>Interview, high-level Chinese official, Ministry of Finance. July 19, 2016, Beijing.

On the NDB, the same interviewee argued:

*In terms of internal management and governance structure, NDB cannot be compared with AIIB. Seemingly NDB is more political and its current structure has resulted from the coordination among the BRICS.*

### 5.1.1 | Interests and status

China's interests regarding institutional innovation have been shaped by economic and foreign policy objectives. On the economic side, concerns on overcapacity that resulted from a credit binge following the 2007–2008 global financial crisis have been paramount. The current “supply-side reform” means reducing capacity in sectors such as steel and cement and finding new markets for managing excess supply. Given that the Chinese economy has seen leverage rapidly increase following the global financial crisis and that the real estate market (that used to take a large share of this excess capacity) has overheated (prompting the central government to limit its growth), finding outlets for production oversupply has become a priority. Additionally, after many years of promoting private public partnerships, China has enacted a massive clawback of private public partnerships because of their fiscal implications (because these are often used to hide local government debt).<sup>27</sup> The Belt and Road Initiative, in which both NDB and AIIB are expected to play a part, not only is an economic project but also has a geopolitical dimension as a reaction to former President Obama's pivot to Asia. Beyond Belt and Road Initiative, Xi Jinping's administration has strived for China to play a more active role in shaping global governance.

Status is a relevant factor, given the slow (and partial) reforms of the Bretton Woods institutions both institutionally (voting shares) and in terms of management positions. These have drawn critiques from the BRICS (and other emerging countries) whose importance (status) in the global economy and the international system is not recognized under current arrangements. China, given its fast-economic growth, has been strongly under-represented in existing lenders. Status may thus explain both the launching of the NDB and AIIB as means to democratize global governance.

### 5.1.2 | Economic power and regulatory capacity

China's economic power has been central for the launching of the two banks. The banks would not have been possible without China's participation. China's sovereign debt is not only the highest rated among the BRICS, but China's vast foreign reserves and massive savings (the highest in the world) gave the project a solid footing. The AIIB, as a China-led project, additionally strongly relies on the gravitational pull of its market to attract members. The clearest indication of the importance of this factor was that European countries (starting with the United Kingdom and Luxembourg) and other U.S. allies (e.g., Australia and New Zealand) joined the bank despite warnings and substantial pressure exerted by the United States.

Regulatory capacity, especially a lack of expertise in multilateral lending (as opposed China's long experience in bilateral assistance),

translated into an open perspective on membership and the initiatives by partners at the NDB/AIIB. In the case of the NDB, the active role taken by Brazil (despite its limited economic power and economic woes) can be explained by the experience of the BNDES (the South's oldest development bank) and its highly regarded diplomatic service (*Itamaraty*). At the AIIB, it is notable that the lender was originally envisaged as a small international bank (comprising China and some regional partners such as Pakistan, Thailand, Bangladesh, Cambodia, and later India).<sup>28</sup> No western partners were expected at the time. However, as the project advanced and the potential of bringing other partners became evident, the Chinese leadership recognized the gains to be made by including the long experience of countries such as the United Kingdom and other nonborrowing lenders.

China as an institutional architect has promoted cooperation between development banks, coresearch, cotraining, cofinancing, and combating corruption.<sup>29</sup> In doing so, it has sought to fulfil its economic and foreign policy interests but has also been keen that all large MDBs are treated as equals, which reflects status concerns. Whereas its institutional preferences are in line with existing lenders, China has a different conception of development (shared by the other BRICS) that sees governance not as a precondition of economic development but rather as part of a process. Infrastructure is a key part in this process and is considered to lead to rapid poverty reduction.<sup>30</sup> As such, even if institutional isomorphism prevails, the selection and implementation of projects may lead to some innovation in development lending practices.

## 5.2 | Brazil and institutional innovation: Interests and regulatory capacity

Despite being only the third largest economy in the BRICS, limited market appeal, lower credit ratings, and facing at the time a worsening economic situation (economic power), Brazil used its expertise and resources (regulatory capacity) and well-regarded diplomatic service to take de facto secretariat functions throughout the NDB negotiations.<sup>31</sup> This gave the country a high degree of influence in the institutional design of the bank and beyond (e.g., in recruitment practices), which reflect some of Brazil's key interests (economic, foreign policy related, and ideational). With regard to the AIIB, the role of Brazil has been negligible given that it has not yet ratified the AIIB's Articles of Agreement. Brazil missed the deadline (alongside South Africa) to join at the end of 2016. The bank agreed to give these two members more time to complete the accession process. At the time of writing, none of the two countries have ratified their membership.

Raising funds for the two institutions involved bureaucratic challenges as that they have to come from Brazil's existing (and limited) development aid budget. The NDB was seen to be of higher relevance from an economic perspective, given procurement

<sup>28</sup>Interview, Chinese scholar I, Beijing, July 14, 2015.

<sup>29</sup>Senior Chinese economist, Beijing, August 1, 2016.

<sup>30</sup>Interview, Chinese scholar II, November 24, 2016.

<sup>31</sup>Interview, high-level Brazilian official II, Ministry of Foreign Affairs (*Itamaraty*), October 3, 2016, Brasilia.

<sup>27</sup>Interview, UNCTAD senior economist, Geneva, November 24, 2016.

opportunities to Brazilian construction firms. From a foreign policy perspective, the NDB is linked to BRICS, traditionally more important for Brazil than Sino-Brazilian relations, the focus of the AIIB. Additionally, the focus of the AIIB is Asia, which is a long way from Brazil's traditional area of South-South cooperation (Latin America and Lusophone Africa). In addition to these economic and foreign policy interests, ideational factors (worldviews of policymakers) matter greatly and help explain why Brazil promotes institutional diversity. Unlike China, Brazilian interests have gone beyond status concerns and sought to transform multilateral development lending practices involving a greater respect for sovereignty and avoiding any form of conditionality.

### 5.2.1 | Interests and status

As already mentioned, economic interests strongly relate to Brazil's large construction firms. The NDB's procurement is open only to members, whereas the AIIB has opened it to non-members too, thus diminishing the appeal of this factor for membership. Foreign policy and ideational factors are relevant too. As the other BRICS, Brazil has been keenly aware of the need to democratize existing MDBs (status) and sees both NDB and AIIB initiatives as relevant means to further this objective. In the case of the NDB, the former government of Lula da Silva was keen in strengthening cooperation between the BRICS, and the NDB was perceived a way to institutionalize the grouping.

Beyond foreign policy objectives, the worldviews of Lula (and other policymakers involved in the creation of the bank) are relevant. Many of the Brazilian nationals involved in the creation of the bank were members of the Labour Party and shared with Lula the aim of not only democratizing development institutions but also bringing new non-Western concepts of development into these institutions. Particularly influential and representative of these views was Brazil's NDB Vice President in charge of strategy, Paulo Nogueira Batista (until recently, when he was forced to resign from the bank). It must be said that the current Brazilian government has taken a different approach (it recently submitted a request to join the OECD) and it is an open question whether Brazil's influential developmentalist position in the NDB will continue or not.

An aspect where Brazil has had a strong interest and where it was able to influence the bank was ensuring equal participation in staffing. This was one of the biggest successes for Brazil in the Bank's set-up process, joining efforts with Russia to push for an equilibrium of posts at the different levels in the bureaucracy.<sup>32</sup> The reason for this had to do with the location of the bank (Shanghai) and the Indian presidency, which raised fears that the bureaucracy could end up being dominated by Chinese and Indian nationals. An informal overall balance across all levels of the institution was proposed and approved despite strong opposition from India.

### 5.2.2 | Economic power and regulatory capacity

Brazil has limited economic power, both in terms of the overall size of its economy and its credit rating. It is fair to say that without China, the bank's creation would have been very difficult. Given China's

insistence on having a larger share in the NDB (which would have made the bank's lending capacity, and thus importance, much larger), it is notable that Brazil and South Africa were able to resist it. Additionally, with regard to personnel selection, Brazil could bring its interests forward, and it could push (so far) for more flexibility towards the rating of the bank (both China and India seek triple A ratings).

All of the above suggests that despite the headquarters being established in Shanghai and the first President being an Indian national, Brazil managed to exert influence throughout the negotiations and after them through its role in defining the bank's strategy. This is largely explained by regulatory capacity. Brazil offered quite early to take secretariat functions in the organization. This gave the country a strong control of the set-up process, because (with some changes) the secretariat has remained. Brazil could also benefit from having a long experience in development lending through the BNDES. Personnel from this Brazilian development bank (together with that from other national development banks from the BRICS) was sent to the NDB for capacity building.<sup>33</sup> Additionally, Brazil's well-respected and well-connected diplomats (in part because unlike the other BRICS they can spend multiple continuous postings abroad) provided crucial expertise in setting-up the NDB.

## 6 | CONCLUSIONS

This article has made a twofold contribution to the existing literature. It has shed light into operational aspects (e.g., informal rules, recruitment patterns, and project implementation) of the two banks, which are relevant to determine their degree of innovativeness. In addition to this empirical contribution, the article offers a theoretical one, comprising a novel approach to institutional innovation (as a function of interests, status, and made possible through economic power and regulatory capacity). This approach has been tested in the cases of China and Brazil to help explain the puzzle of why the NDB appears more innovative than the AIIB. The results suggest that conjectured status concerns tend to translate into institutional isomorphism whereas diverging interests tend to drive institutional innovation. To be able to draw any meaningful conclusions about the generalizability of these findings, more case studies are needed. That being said, given the importance of the two cases evaluated, as the two first multilateral efforts by emerging countries to create new institutions, the deeper insights provided in this piece are by themselves valuable.

Summarizing the findings, both NDB and AIIB appear to share a common understanding of development needs (due to their focus on infrastructure) and appear more flexible than established MDBs. The true extent to which these innovations will change development finance (or not) will be seen in time, with the successes and mishaps of the two-lender's ongoing and future projects. Until now, the AIIB appears to be on a more solid footing than the NDB, whereas the latter appears more innovative. A central challenge for the NDB, and one likely to define its future evolution, will be its expansion beyond the BRICS alliance. This should help it become a truly unified bank. Given its current structure (which gives the BRICS a collective veto and a much larger share than other members), it may be hard

<sup>32</sup>Interview, high-level public official. Ministry of Finance, Brasilia October 1, 2016.

<sup>33</sup>Interview, Brazilian scholar, Guangzhou, November 6, 2016.



to convince other large emerging countries to join. The inclusion of nonborrowing members would however make the bank more similar to established MDBs (and the AIIB), while giving it a more solid footing, thanks to higher credit ratings. Thus, it may be said that although these new lenders have brought some innovation and dynamism, challenges and trade-offs remain, which will make it difficult for them to radically depart from established practices.

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## APPENDIX A

**TABLE A1** Academic background (highest degree) personnel NDB and AIIB

NDB discipline	NDB	AIIB discipline	AIIB
South Africa	4	France	2
Accounting & Finance	1	Business	1
MBA	1	Public administration	1
MBA Finance	2	Australia	1
Brazil	5	Fintech	1
Economics	2	China	10
Law	1	City and Regional Planning	1
MA. Finance	1	Communications	1
Military	1	Economics	1
China	16	Economics/management	1
BA Financial Management	1	Finance	2
Business	1	Intl. Business	1
Engineering	2	Law	1
Finance	1	Money, banking, and finance	1
HR	1	Sociology (economic)	1
International Business	1	India	2
Law	2	Management	1
Management	1	Urban Studies	1
MBA	1	Korea	1
MBA Finance	1	MBA	1
MBA/Finance Economics	1	Malaysia	3
n.a.	2	Economics	1
n.a.	1	n.a.	1
United States (consultant)	1	n.a.	1
Development Econ.	1	n.a.	1
India	14	Development	1
Accounting	2	Netherlands	1
Business & Finance	1	Economics	1
DBA	1	New Zealand	1
Economics	1	Law	1
Finance/Economics	1	Pakistan	1
HR	2	Project management	1
Management/Finance	1	Philippines	2
MBA	2	Business Economics	1
PGDM	1	Public policy and management	1
PGDM Finance	2	Portugal	1
n.a.	1	Economics & Organizational Soc.	1
Economics	1	Russia	1
Russia	9	Physics/Finance	1
Development Economics	1	United Kingdom	3
Economic Sociology	1	Mathematics/Philosophy	1
Economics	1	MBA	1
EMBA/Law	1	Public policy, conflict resolution	1
Exp. Nuclear Physics	1		
Finance	1		
Finance	1		
MBA	1		
MBA Finance	1		
Total	50	Total	29

Note. NDB: New Development Bank; AIIB: Asian Infrastructure Investment Bank; n.a., not applicable.

**TABLE A2** University (highest degree) personnel NDB and AIIB

NDB education	NDB	AIIB discipline	AIIB
South Africa	4	France	2
Henley Business School	1	ENA	1
University of Cape Town	1	ESSEC Business School	1
University of the Witwaterstrand	2	Australia	1
Brazil	5	MIT, Univ. Wollongong	1
Academia Militar das Agulhas Negras	1	China	10
Harvard Law School	1	Case Western Reserve	1
Peking University	1	Columbia University	1
Sorbonne Paris	1	George Washington	1
Federal University of Rio de Janeiro	1	Manchester	1
China	16	MIT	1
Chongqing University	1	MIT, Tsinghua	1
Flinders University	1	Renmin/NUS	1
Huzhong University of Science and Technology	1	Simon Fraser	1
James Cook University Australia	1	Tsinghua	1
Lancaster University	1	University of Birmingham	1
Mississippi College	1	India	2
MIT	1	JNU	1
n.a.	2	Pandit Deendayal Petroleum Univ.	1
Peking University	1	Korea	1
Shanghai Jiao Tong	1	George Washington	1
Shanghai University	1	Malaysia	1
Tsinghua University	1	Cambridge	1
UBC Sauder School of Business	1	n.a.	1
Waseda University	1	n.a.	1
Xi'An Polytechnic University	1	n.a.	1
United States (consultant)	1	n.a.	1
LSE	1	Netherlands	1
India	14	Erasmus Univ. Rotterdam	1
Chartered Accountant Australia & NZ	1	New Zealand	1
Delhi School of Economics	1	Harvard	1
Indian Institute of Management	1	Pakistan	1
Indian Institute of Management	1	NUS	1
Indian Institute of Management	1	Philippines	2
Indian Institute of Management	1	Southern California (USC)	1
Indian Institute of Management	1	University of Asia and the Pacific	1
Indian Institute of Management	1	Portugal	1
Institute of Chartered Accountants	1	Lisbon School of Economics	1
Manchester Business School	1	Russia	1
MIT	1	Lomonosov (LMU)	1
n.a.	1	UK	3
Sikkim Manipal University	1	Tel Aviv University, Tsinghua, Sheffield	1
XLRI Jamshedpur	1	Tsinghua	1
n.a.	1	University of St. Andrews	1
The New School	1		
Russia	9		
American University	1		
CASS Business School	1		
Finance University Russia	2		
Harvard University	1		
Hult International Business School	1		
MIPT	1		
Notre Dame	1		
Академия Народного Хозяйства (ANE)	1		
Total	50	Total	29

Note. NDB: New Development Bank; AIIB: Asian Infrastructure Investment Bank; n.a., not applicable.