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## CAPACITY DEVELOPMENT IN AFRICA: NEW APPROACH MOTIVATED BY THINKING ON “ANIMAL SPIRITS”

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# **CAPACITY DEVELOPMENT IN AFRICA: NEW APPROACH MOTIVATED BY THINKING ON “ANIMAL SPIRITS”**

## **Abstract**

Animal spirits in modern economics has a specific meaning; it refers to the restless and inconsistent element in the economy as well as the peculiar relationship people have with ambiguity and uncertainty, which tends to lead to paralysis or incredible confidence and energy in decision-making and risk taking. Animal spirits have also been used to explain peaceful periods and instability or interpret track records of success and periods of disarray or spectacular failure, high levels of trust and confidence or extreme pessimism and distrust. Willingness to undertake extreme effort or self-sacrifice to get things done is another expression of animal spirits, which can again go in the opposite direction with people shirking responsibilities, and practicing generalized selfishness or individualism. Such behaviours can have visible effects on the performance of public agencies or civil service agencies, in the behaviour of leaders in the public or private sector, or in the economic performance of a country. Differences across agencies and countries over time can also be explained if one is able to distinguish the effect of animal spirits. Using a logistic model, this paper tests for the existence of ‘animal spirits’ in the capacity development interventions spearheaded by the African Capacity Building Foundation (ACBF)-funded institutions. The analysis and findings highlight, amongst others, the importance of non-economic factors in shaping the capacity development sphere. Understanding this nature of animal spirits is critical to designing and implementing effective programs for capacity development in Africa. It is particularly important to focus on issues of leadership and leadership development, including the capacity for leaders to instil confidence and piece together stories that motivate people into a common vision of the future or to achieve common objectives.

**Key words:** animal spirits, public/private sector performance, ACBF, capacity development

# CAPACITY DEVELOPMENT IN AFRICA: NEW APPROACH MOTIVATED BY THINKING ON “ANIMAL SPIRITS”<sup>1</sup>

## Introduction

Lord John Maynard Keynes appreciated that most economic activity results from rational economic motivations and “animal spirits” or non-economic motives. Keynes’ view of the role of government was that it should set limits to prevent over indulgence into animal spirits, and put its attention to encourage compliance with set laws, rules, and procedures. Keynes’ further elaborated that limits should be placed by government, but in such a manner as to allow independence to learn and be creative, thereby encouraging innovation and risk taking.

According to Akerlof and Shiller (2009), animal spirits in modern economics has a specific meaning; it refers to the restless and inconsistent element in the economy as well as the peculiar relationship people have with ambiguity and uncertainty, which tends to lead to paralysis or incredible confidence and energy in decision-making and risk taking. To Akerlof and Shiller, animal spirits can also be used to explain peaceful periods and instability or interpret track records of success and periods of disarray or spectacular failure, high levels of trust and confidence or extreme pessimism and distrust. Willingness to undertake extreme effort or self-sacrifice to get things done is another expression of animal spirits, which can also go in the opposite direction with people shirking and practicing generalized selfishness or individualism. Such behaviours can have visible effects on the performance of public agencies or civil service agencies, in the behaviour of leaders in the public or private sector, or in the economic performance of a country. Differences across agencies and countries over time can also be explained if one is able to distinguish the effect of animal spirits.

This paper explores the aforementioned issues and their implications for African development. The paper is divided into six parts of which this is the first. Part 2 provides an overview of capacity development challenges facing Africa. Part 3 examines the conceptual links between ‘animal spirits’ and capacity development and how these can be used to understand social transformation of the continent. Part 4 employs a logistic regression model to test for the existence of ‘animal spirits’ in the capacity development interventions supported by the African Capacity Building Foundation (ACBF). The results are discussed in part 5 and conclusions drawn in part 6.

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## Capacity Development Challenges for Africa

Many economic and social development challenges still confront Africa today, including marginalization from globalization, dependency on development financing, and vulnerability to the effects of climate change. Weak governance and poor leadership persist in many countries. Conflict and post-conflict reconstruction challenges also prevail in a number of countries and regions, though on a lower scale, hampering development efforts. The above-mentioned are long-term issues that require to be addressed if Africa in order for the continent to keep a positive development trajectory.

The recent Global Financial Crisis has significantly affected the regional economic outlook for sub-Saharan Africa by causing a slow-down in export-led growth sectors and weakening the financial and macroeconomic resilience of a large number of African economies. According to forecasts of the IMF (2010), the economic slowdown in sub-Saharan Africa looks set to be mercifully brief, as output is projected to expand by 4.75 percent in 2010 compared to 2 percent in 2009. The slowdown did however impose lasting costs on the region seen in rising unemployment and holding up of progress achieved in poverty reduction. This is evidence enough that the continent has not developed robust systems to respond to environmental shocks, even though it has developed stronger macroeconomic positions in most countries that attenuated the effects of the global slowdown. According to UNECA (2010), the effects of the financial crisis on the growth performance of countries have not been even (see Table 1). GDP expanded only by 1.6% in 2009 as compared to 4.9 in 2008.

Table 1: Real GDP growth (%)

	2005	2006	2007	2008	2009 (estimated)	2010 (projections)
Africa	5.9	5.9	6.0	4.9	1.3	4.3
Central Africa	5.0	2.6	5.6	4.5	0.9	3.8
East Africa	7.4	6.8	7.5	6.4	3.9	5.3
North Africa	6.0	5.9	5.3	4.7	3.5	4.1
Southern Africa	6.0	6.6	6.7	4.6	-1.6	4.1
West Africa	5.1	5.3	5.9	5.3	2.4	4.7
Oil-exporting countries	6.8	6.0	6.9	5.6	2.5	4.9
Oil-importing countries	4.9	5.9	5.1	4.2	0.5	3.6

Source: UNECA (2010). *Economic Report on Africa*. Addis Ababa: UNECA.

As noted by the IMF (2010), even in the normal course of events, variations in economic growth across sub-Saharan Africa are strongly associated with both idiosyncratic and systemic shocks. Droughts are a noticeable idiosyncratic shock that affected Kenya, Eritrea, and Ethiopia in 2009, whereas political instability is another idiosyncratic shock that affected Eritrea, Madagascar, and Niger in 2009.

The characteristics of population distribution and growth on the continent, as well as the differential country response to shocks, call for a strategy that has to be regional yet differentiated across countries. As noted by agencies such as UNECA, UNFPA and the

AU, Africa's population increased by 2.3 per cent between 2008 and 2009: from 987 million to approximately 1 billion. Seventy per cent of this population is aged 30 or under, making Africa the continent with the highest dependency ratio. However, with adequate capacity, this population would provide Africa with a large pool of labour upon which to draw for rapid economic growth. That said, the rapid population increase, coupled with increased rural-urban migration, does create many social and service-delivery problems, including inadequate provision of sanitation and social services, housing and employment as well as rising poverty. Although a gender breakdown is not readily available, it is generally agreed among development experts that women and children are more likely to be poorer than men; and therefore recent crisis was more likely to exacerbate the incidence and severity of poverty for African women and children. The needs for skills development to transform economies and employment creation to sustain existing population levels remain great. The effects of the 2007-2009 global economic and financial crises have put further pressure on unemployment and spending on skills development. Countries need capacities for both decentralized and regional management of growing and mobile populations to handle these effects.

The reduced global connectivity of the continent has been partially credited for the less sharp effects of the 2007-2009 financial crisis on the continent, compared to previous crises. Regional connectivity has been a critical saving grace further protecting the continent against global fluctuations. Africa's need for effective connectivity in order to link leading and lagging regions tests the continent's capacity to put in place labour migration policies and infrastructure investments across countries and regions. Regional and international integration remains critical with the requisite capacities to put effective customs policies, develop and engage in trade in intermediate inputs, and shape and implement the right remittance policy. The continent needs to develop capacities that allow it to capitalize on international migration, manage regional migration (labour policy), and balancing the effects of brain drain on innovation and exports.

A complex set of relations exists between food security, conflict, climate change, communicable diseases and socio-economic development of the continent (Sachs, 2008). Countries need to develop capacities for multi-sectoral policies that take cognizance of the complex interconnections between climate changes, water, the environment, communicable diseases and development. For example, according to the UNECA Economic Report on Africa 2010, "agricultural output is expected to decrease by 50 per cent in Africa, resulting in severe undernourishment as a result of unchecked climate changes" (UNECA, 2010, p. 12). The service-delivery burden and conflicts will increase as populations fight over dwindling resources. The need for Africa to develop adaptation and mitigation strategies becomes more immediate and urgent. For example, the continent may need to develop capacities for enhancing agricultural productivity, innovation in drought resistant technologies; managing food security, regional food markets and agricultural supply-chains.

The recent crisis has also put pressure on capacity development efforts for sound macroeconomic analysis and management, sustained economic growth, poverty reduction and general macroeconomic stability. Many countries in Africa put fiscal policy

on an expansionary footing to counter the effects of the 2007 to 2009 global economic slowdown (IMF, 2010). While this countercyclical tool is a welcome change from the past when economic downturns forced fiscal retrenchment with severe effects on the poor, with growth rates expected to rebound to recent highs in 2010-2011 policy makers need to plan for transition back to medium term fiscal policies (IMF, 2010). In that regard, there is a greater challenge for fiscal policy management against a backdrop of potentially increasing fiscal imbalances and limited options for deficit financing, as well as for prudent exchange-rate management in light of increased currency fluctuations. Indeed, capacity development for sound macroeconomic management turns on a cadre of individuals and organizations that can formulate, implement, and evaluate economic policy.

An important sector of capacity development for sub-Saharan Africa relates to the need to secure political and social stability across the region. Such capacity includes capabilities at the local, country and regional levels to aggregate and address citizens' needs as well as fostering participation of diverse stakeholder groups – including minorities, women and other under-represented groups – in the development process. Africa needs to invest in frameworks that improve governance and social inclusion. The main challenges to social inclusion of vulnerable groups include amongst other factors: the lack of implementation of commitments and policies; inadequate financial resources for social programmes; technical capacity constraints; lack of relevant data to support policies and monitoring of programs; and conflicts (UNECA, 2010).

Many countries on the continent have made attempts to enhance their productive capacities through investment in education and skills development. On average, net primary school enrolment in Africa increased from 71% in 2006 to 74% in 2007. Most of this expansion has been a result of strong government policy to increase the levels of primary education. However, primary completion rates have been markedly low and worrying. As UNECA Economic Report on Africa 2010 put it:

“The major reasons for dropping out of school include lack of resources to meet the costs, domestic care activities within households (particularly for girls), early marriages, child labour, teenage pregnancies, poor quality of education and long distances to school. The quality of primary education is further eroded by lack of school facilities such as books, computers, sanitation and water. The supply of teachers is also a major constraint particularly as a result of HIV/AIDS” (pp. 66-67).

Some of the above-mentioned factors may very well be affecting retention and achievement in the post-primary education sector.

Achievements in the health sector also remain mixed with average life expectancy for Africa being estimated to be 55 years for men and 57 years for women in 2009. Some countries have very high figures of more than 70 years for both men and women, for examples: Libya, Tunisia, Algeria and Mauritius. Others like Zimbabwe, Angola, Zambia and Lesotho have life expectancy of less than 46 years due to the impact of AIDS

mortality. Malaria also remains a leading cause of child mortality and of anaemia in pregnant women. Maternal mortality rates have remained high – at about 104 per 100,000 as of 2006. However, the continent has witnessed significant decline in infant and under-five mortality rates – whereby the figure for under-five mortality rate has been estimated to drop from 160 per 1000 live births in 2006 to 145 per 1000 live births in 2007. Essentially, the need to build capacity in the health sector – including enhancing access to clean water and sanitation remain not wholly fulfilled.

Some progress has been made in strengthening civic participation on the continent. A number of countries made progress in enhancing women’s representation in national parliaments. The biggest achievers as of 2009 were: Rwanda (56.3 per cent), Angola (37.3 per cent), Mozambique (34.8 per cent), South Africa (33.0 per cent), Uganda (30.7 per cent), Burundi (30.5 per cent), the United Republic of Tanzania (30.4 per cent), Namibia (26.9 per cent), Lesotho (25 per cent), Seychelles (23.5 per cent), Tunisia (22.8 per cent), Mauritania (22.1 per cent), Eritrea (22 per cent), Senegal (22 per cent), and Ethiopia (21.9 per cent). However, there remains little and ineffective representation of women in key public and civic positions; gender-based violence, sexual abuse, trafficking of children and women, and harmful traditional practices all persist in many countries.

Historically, Africa faced challenges in financing development, and this is likely to be worsened, albeit if even only marginally, as the global economic crisis decreased both internal and external resources in 2009. With respect to domestic resource mobilization, the ratio of gross domestic savings to GDP is estimated to have dropped from 25 per cent in 2008 to 19.3 percent in 2009, while the ratio of tax revenues to GDP decreased by 21% in sub-Saharan Africa. Over the years, African countries have made attempts to increase government revenues by improving tax and customs administration – especially by setting independent revenue authorities. Trade-related revenues, which have been the main source of development finance in Africa, decreased in 2009. For some selected African countries, both export revenues and imports fell by about 25 per cent. The decline in export revenues as well declines in private capital inflows can be attributed to the global economic crisis, which decreased demand for commodities, with a consequent collapse in commodity prices. Because of financial pressures on donor countries, there has also been a suppression of aid for capacity development in Africa. In 2008, ODA flows to Africa reportedly increased by 12.5 per cent over 2007. However, current estimates show that the member countries of the Development Assistance Committee of the Organisation for Economic Cooperation and Development will cut ODA to all developing countries by US\$ 22 billion in 2009, potentially leading to a decrease in their aid to Africa (UNECA, p. 11). ODA data for Africa for 2009 is not yet available. But one can anticipate that in the next few years, there will be increased demands for skills to manage risks and financial reserves including “how to” skills in managing the financial system and ensuring stimulus packages work effectively. Table 2 overleaf shows the total net ODA flows to Africa, 2000-08.

Table 2: Total net ODA flows to Africa, 2000-08 (billions of current \$US).

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Net ODA disbursements</b>	15.6	16.8	21.8	27.3	29.7	35.5	43.5	39.1	44.0
<b>ODA Total excl. Debt</b>	14.5	15.3	18.6	20.5	25.3	26.6	28.3	35.4	42.0

Source: OECD, 2009 – Online database.

Empirical studies confirm the link between economic cycles and aid flows, particularly during downturns, further showing a lagged effect of downturns on aid allocations when crises are long-lasting (World Bank, 2009; Hallet, 2009; and IMF, 2010).

These challenges call for sustained efforts at capacity development for strategic planning, sound macroeconomic policy, and effective institutions to make significant impact on poverty and improve governance. Indeed, sound macroeconomic policies *per se* cannot and will not put African countries on the path of strong and sustainable growth; and sustained social transformation. There must also be complementary structural and institutional efforts and support, including strengthening capacity in budget execution; and in monitoring and reporting reforms of public utilities. The business cycle in advanced economies tends to have a major impact on foreign direct investment (FDI) flows to developing economies (IMF, 2010). Cross-country variations in the effect of FDI on economic growth have been shown to depend on differences in economic fundamentals, the strength of the business environment reforms, and commitment to macroeconomic discipline (IMF, 2010). Improving the business climate, including streamlining procedures and better contract enforcement as well as management, are paramount to promoting private sector development, investment and trade, economic diversification, growth recovery, employment generation and poverty reduction. The capacity to put in place such an environment is hence much needed not only to attract FDI when aid flows are constrained and the environment for FDI is highly competitive but also to underpin FDI's effect on economic growth.

### Animal Spirits and Concepts of Capacity Development

The previous section provided a broad overview of the capacity development challenges in Africa. In this section we explore how capacity development concepts relate to animal spirits. Five key aspects of animal spirits can be distinguished according to Akerlof and Shiller (2009): (i) confidence and its multipliers; (ii) fairness; (iii) corruption and bad faith; (iv) money illusion; and (v) stories.

**Confidence** is what determines whether individuals expect a rosy or bleak future, and has an impact in their level of trust or belief in a system or an outcome. As such, confidence drives perception and motivation as well as memory, if relying on gut reactions to make choices, depending on past learning for setting priorities, or using intuition for decision making. Confidence, when used in the context of capacity development would relate to the adoption of a scenario for the future for strategic choices at the country level for instance. If a significant group of leaders believe the future of their re-election to political positions to be rosy, they may make decisions for regional integration that are



binding; otherwise they might not. Confidence could also be used to interpret the approach to decision-making in the absence of data or facts, which is required of most leaders in the arena of development, where the paucity of data makes it impossible to make evidence based decisions.

Using the definition of confidence suggested by Akerlof and Shiller (2009) can help explain a number of conundrums on capacity development. For example, why do we see varied performance in the level of effort of civil servants in countries with roughly the same level of skills? Has it to do with the differential level of self-sacrifice people are willing to make in a given civil service structure? Why are some leaders able to make decisions, take risks, and act to implement policies and programs within the same bureaucratic setting while others do not? A better understanding of the way confidence functions in varied settings could help explain the differential effectiveness and level of performance across countries that have adopted similar organizational processes. It could also help understand why some organizations with similar functions and processes are able to discover and implement new ways of doing things while others are not.

**Fairness** as conceptualized by Akerlof and Shiller (2009) relates to social expectations. Fairness has its origins in sociology and is associated in economics to equity theory and exchange theory. Social expectations and norms could come from tradition, societal expectations, or from organizational practices. When expectations clash, they can lead to lack of coherence. For example, in a societal context, people like to be seen to be following expectations, say of generosity, which could lead them to practice patronage, as they may be made to feel insulted if they are judged not to be supporting their peers. Societal pressure for patronage could override organizational pressure of meritocracy in such instances (Akerlof and Kranton, 2005). In the context of capacity development, fairness can be used to explain why peer-to-peer learning works. People learn better from peers because it is easier to admit not knowing to peers than doing so to others, such as superiors who could judge them on not knowing (Blau, 1963).

**Corruption** is perhaps the type of animal spirit that has been most treated in issues related to capacity development. Corruption arises when there is asymmetry in information, particularly with regard to expenditures and revenues. It could also arise due to complexity of reporting and monitoring systems, and when oversight systems or bodies are weak. Many times, corruption can occur when there are fluctuations in personal commitment to principles of good behaviour or opportunities for fraudulent activities due to lax accountability systems. Sometimes corruption can occur because the penalties for bad behaviour are weak or non-existent, the probability of getting caught is low, or there are brand new opportunities to disregard the law without consequence.

**Money illusion** has been rarely related directly to challenges in capacity development. Akerlof and Shiller (2009) present two illustrations of money illusion which have relevance; mainly the lack of awareness on the risk of delaying decisions that are related to investments and the issues surrounding approaches to debt management. A delay in finalizing policy choices, service delivery arrangements, or implementation of projects has a cost that is rarely acknowledged in the discussions on capacity development. Due

to the time value of money, policy makers that can make choices in an expeditious manner would have better efficiencies as they can spend less to get similar results as policy makers who incur significant delays in decision-making. Yet, such an argument is rarely made in the context of capacity to make policy decisions. There is generally limited understanding of the long-term consequences of borrowing, including the role of inflation on debt; both of which have serious consequences on the efficacy of public spending. The capacity to factor in and explain these issues in order to speed up decisions is a critical gap that needs to be considered as well.

**Stories** and storytelling have enjoyed significant coverage in issues related to leadership development and communication, but not so much in the subject of capacity development. Akerlof and Shiller (2009) expose the manner in which human motivation comes from living through a sequence of events, unified by a set of narratives. As such, stories create a framework for motivation and action. Stories and storytelling are important for developing and sharing a common vision about the future or building confidence about the future. A cohesive story that unites people can allow countries to make great leaps, even when coming out of conflict. Stories can also be used to speed up learning and innovation by attaching facts to stories in such a manner as to encourage application in similar situations. The whole concept of field trips in the area of capacity development can be explained in the context of stories. The key issue is how to use storytelling as form of capacity development.

Storytelling can be used to motivate higher levels of effort in organizations, or to build confidence and transform entire societies (Schank and Abelson, 1977). At a country level, storytelling can be employed to explain how leaders can get their countries out of conflict or why in some settings conflicts persist for long periods of time. At an organizational level one can use storytelling to motivate higher levels of effort. At the societal level storytelling can even create an avalanche of change through the contagion rates of good stories (this effect can go in reverse in terms of negative stories as well). The role of the media is particularly relevant in this regard.

### **Testing for Animal Spirits in Capacity Development Practice**

The African Capacity Building Foundation (ACBF) has been studying the patterns of performance of its portfolio of projects/programs across a wide range of factors, and has found the use of animal spirits to be relevant for that assessment when comparing the performance of its portfolio across countries and areas of competence.

The Foundation finances interventions for capacity development in 44 countries in Africa, of which 25 are classified as fragile or post conflict countries, the remaining being either intermediate states or reformer states, based on the OECD classification (OECD, 2007). The interventions are generally aimed at enhancing the effectiveness of the public sector through support to policy units and think tanks and grants for improving public sector administration; strengthening accountability and transparency by strengthening financial management and control systems and supporting programs aimed at improving national

statistical systems; promoting participation of non-state actors in development through the work with civil society, the private sector and national parliaments; and strengthening the capacities of regional economic communities and regional institutions. The Foundation has an active portfolio of projects and programs of about US\$250 million which is regularly assessed for performance. Assessment of the portfolio involves a consideration of the key risk factors that are apparent to establish patterns across country contexts and project types and devise management actions to mitigate these risks. The outcome of such a portfolio assessment provides a good basis for mapping the degree to which animal spirits effect impact on capacity development.

As of December 2009, there were 111 active projects and programs in the ACBF portfolio assessed. All projects were scored using a set of 202 criteria. The criteria were then regrouped into 26 indicators, which formed the basis for rating and ranking projects on a decreasing 5-scale risk from ‘Highly Satisfactory’ to ‘Unsatisfactory’ (see Annex 2). Out of a total of 111 projects, 22% were ranked ‘Unsatisfactory’ and thus considered at risk.

For this study, the variable of interest is the status of risk i.e. whether a project is at risk or not. The variable is noted as “unsatisfactory” by the letters US and coded as follows:

US= 1 if the project was ranked Unsatisfactory, US = 0 otherwise.

Many parameters could be considered to explain why projects are unsatisfactory. The most relevant are the following:

Areas of ACBF intervention

- Economic Policy Analysis and Management (EPAM)
- Financial Management and Accountability (FMA)
- Public Administration and Management (PAM)
- National Statistics and Statistical System (SNS)
- National Parliament and Parliamentary Institutions (SNP)
- Professionalization of the Voices of the Private Sector and Civil Society (PVP)

Project environment

- Type of country (Fragile State, Not Fragile State)
- Locus of the project (Regional; National)
- Age of the project (Phase 1; Phase 2; Phase3; Phase 4)

A logistic regression model was fitted to identify the factors associated with the probability of being rated unsatisfactory. The general model relates the probability that a project will be rated unsatisfactory during implementation to the area of policy intervention and the environment in which the project is being implemented. The model specification including all expected explanatory variables is the following:

$$\text{Logit}(p_i) = \log\left(\frac{p_i}{1-p_i}\right) = \beta_0 + \beta_1 X1_i + \beta_2 X2_i + \beta_3 X3_i + \beta_4 X4_i + \beta_5 X5_i + \beta_6 X6_i + \beta_7 X7_i + \beta_8 X8_i + \beta_9 X9_i$$

$i = 1, 2, \dots, 111$

- X1 = EPAM (1 if the project is in EPAM core competency area, 0 otherwise)
- X2 = FMA (1 if the project is in FMA core competency area, 0 otherwise)
- X3 = PAM (1 if the project is in PAM core competency area, 0 otherwise)
- X4 = SNS (1 if the project is in SNS core competency area, 0 otherwise)
- X5 = SNP (1 if the project is in SNP core competency area, 0 otherwise)
- X6 = PVP (1 if the project is in PVP core competency area, 0 otherwise)
- X7 = Fragile (Fragile = 1 if the project is implemented in a Fragile State, 0 otherwise)
- X8 = Regional (Regional = 1 if the project has a regional coverage, 0 otherwise)
- X9 = Phase for the age of the project (Discrete variable with four values: 1, 2, 3 and 4)

With this model specification, the prior hypothesis is that there is no significant effect of the area of policy intervention or the environment in which the project is being implemented on the risk of it being successful. With such a model, we expect to uncover the effects of animal spirits on capacity development. For example, does confidence, as measured by the level of effort in undertaking reforms in a given project have an effect on the risk in getting results in the area of economic policy analysis and management? Does the effect of peer-to-peer learning, which is an example of the principle of fairness in animal spirits, have any effect on interventions relating to public administration and management interventions?

We first fitted a logistic regression model on a constant only.

$$\text{Logit}(p_i) = \beta_0 \quad i = 1, 2, \dots, 111$$

Then we alternatively added to the model one of the 9 variables X1 to X9. Nine models with only one explanatory variable ( $X\alpha$ ) and an intercept were so fitted.

$$\text{Logit}(p_i) = \beta_0 + \beta_1 X\alpha_i \quad i = 1, 2, \dots, 111 \quad \alpha = 1, \dots, 9$$

The deviances on fitting the 10 logistic regression models above are given in table 3 below.

Table 3: Deviances on fitting logistic regression models

Variable in model	Deviance (-2LL)	DF	Difference in Deviance	df	Sig. (P)
Constant only	115,901	110			
Phase	111,153	109	<b>4.748</b>	1	<b>0.029</b>
PAM	112,189	109	<b>3.712</b>	1	<b>0.054</b>
EPAM	113,655	109	<b>2.246</b>	1	<b>0.133</b>
SNP	114,197	109	1.705	1	0.192
PVP	114,780	109	1.121	1	0.290
FMA	115,874	109	0.027	1	0,869
SNS	115,436	109	0.465	1	0,495
Regional	115,757	109	0.144	1	0.704
Fragile	115,347	109	0.554	1	0.457
Phase+ PAM+ EPAM	<b>108,703</b>	<b>107</b>	<b>7.199</b>	<b>3</b>	<b>0.066</b>

LL= log likelihood

As table 3 shows, there are no significant reductions in deviance when, SNP, PVP, FMA SNS, Regional, or Fragile are added to the model that contains a constant only. However, the decrease in deviance on adding Phase to a model that contains a constant term alone is 4.748 on 1 degree of freedom (df), which is highly significant (P = 0.029). The reduction in deviance is significant at 10% for PAM (P = 0.054) and significant at 13% level for EPAM (P = 0.13). As shown by the last row of the table, when the 3 variables Phase, PAM and EPAM are added together to the model that contains a constant term only, the reduction in variance is 7.199 on 3 df, which is significant at the 10% level (P = 6.6%). No further variables lead to a significant reduction in deviance.

The chi-square test did not reject the null hypothesis of the status of risk not being influenced by the type of country (Fragile State or not)  $df = 1; \chi^2 = 0.548; P = 0.459$

The final logistic regression model we fitted is the following:

$$\text{Logit}(p_i) = \log\left(\frac{p_i}{1-p_i}\right) = \beta_0 + \beta_1 \text{Phase}_i + \beta_2 \text{PAM}_i + \beta_3 \text{EPAM}_i \quad i = 1, 2, \dots, 111$$

SPSS software was used. The Enter method was employed.

Equation of the fitted logistic regression model for the probability of a project being risky:

$$\text{Logit}(\hat{p}_i) = -0.386 - 0.703 \text{Phase}_i + 0.848 \text{PAM}_i - 0.240 \text{EPAM}_i \quad i = 1, 2, \dots, 111$$

Goodness of fit:

*Hosmer and Lemeshow Test*

Step	Chi-square	df	Sig.
1	0.251	4	0.993

The H-L goodness-of-fit test statistic is 0.993, greater than 0.05. The Hosmer and Lemeshow chi-square test of goodness of fit shows that the model adequately fits the data.

*Omnibus Tests of Model Coefficients*

		Chi-square	df	Sig.
Step 1	Step	7.199	3	0.066
	Block	7.199	3	0.066
	Model	7.199	3	0.066

As already shown in table 3, at 10% level, the model with the predictors is significantly different from the model with only the intercept ( $P = 0.066$ ). The three explanatory variables, namely Phase, PAM and EPAM jointly predict the probability of a project being risky. The variable Phase is highly significant (Deviance = 4.748,  $p = 0.029$ ), PAM is significant (Deviance = 3.712;  $p = 0.054$ ) and EPAM has an acceptable degree of significance (Deviance = 2.246;  $p = 0.13$ ). As the Enter method was employed, there is no difference for Step, Block, or Model.

The table below presents the summary of the predicted probability of a project being risky, in association with the predictors.

Table 4: Predicted probabilities of a project being risky

	Phase 1	Phase 2	Phase 3	Phase 4	Irrespective of the phase
<b>PAM</b>	44%	28%	16%	9%	43%
<b>EPAM</b>	21%	12%	6%	9%	15%
<b>Other core competence areas</b>	25%	14%	8%	4%	

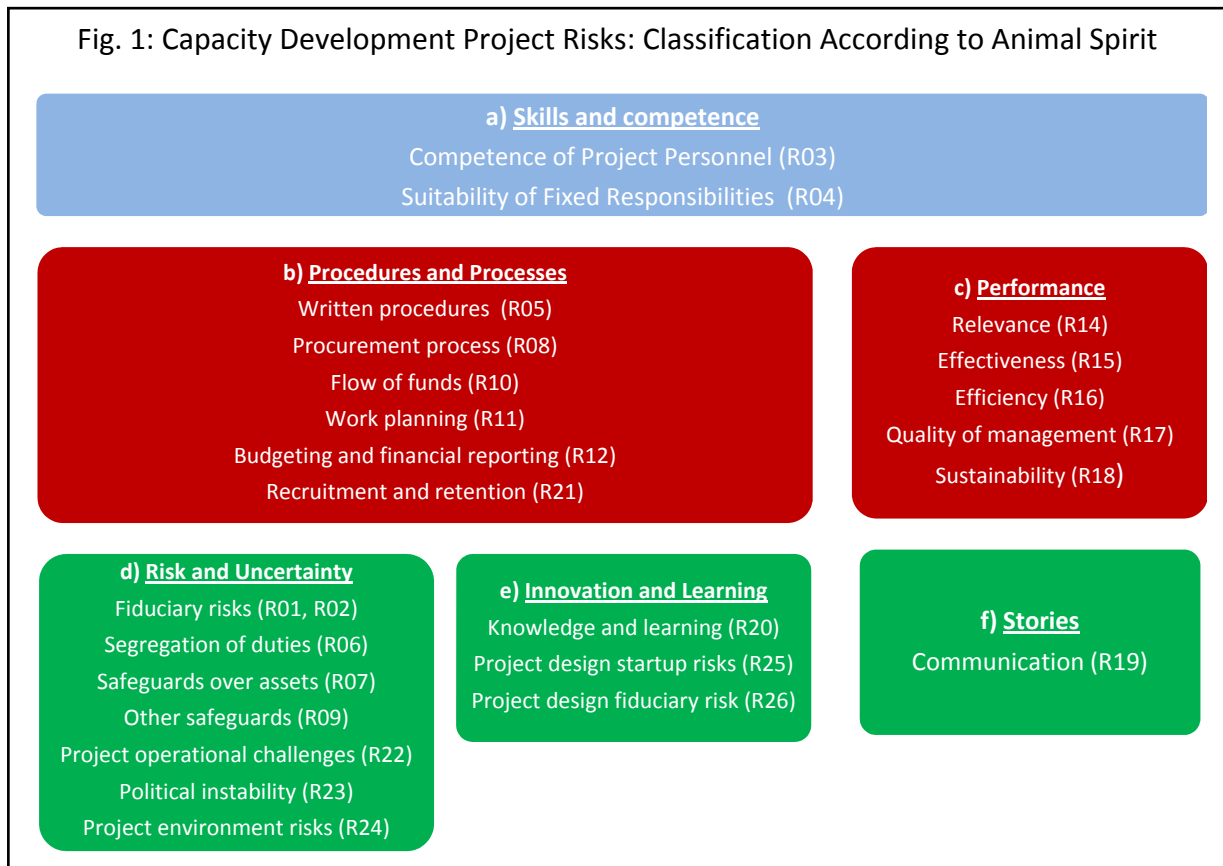
The table above reads as follows: the predicted probability of a project being risky in PAM and during 1<sup>st</sup> phase is 44%.

### Evidence of Animal Spirits in Capacity Development Practice

From the test conducted above, is it possible to uncover evidence of animal spirits in the practice of capacity development?

Consider Figure 1 which shows a classification of the risk categories according to broad themes that can be related to instances of animal spirits.

Fig. 1: Capacity Development Project Risks: Classification According to Animal Spirit



The first three themes in this figure are related to objective measures that can be measured and assessed, which are mainly: (a) skills and competencies which is an objective measure of the level of risk inherent in human capacities available for project implementation and is related to the issue of fairness in animal spirits to the extent that skill level is used to assign people to functions and meritocracy is used to promote them or whether patronage systems that seek to reward specific groups are at play; (b) procedures and processes that drive organizational performance and are related to the issues of confidence and corruption in seeking whether there are written procedures in place, procurement processes that are followed, a flow of funds that makes sense, work planning, budgeting and financial reporting that is effective or whether recruitment and retention processes are effective. This aspect of risk is also related to whether people shirk, ignore existing procedures, or commit fraudulent and illegal activities; and (c) performance of the projects and programs as it relates to the relevance, effectiveness, efficiency, sustainability and quality of management which relates to the aspect of money illusion, in that speedy action and efficient action recognizes the value of money while slow responses and ineffective or inefficient activities underplay the value of money.

There are three other themes in the figure that relate more directly to animal spirits, mainly: (d) risk and uncertainty including fiduciary risks, segregation of duties, safeguards over assets and other safeguards, project operational challenges, political stability and project enforcement risks, which link to the aspect of confidence and how people behave in the presence of ambiguity and uncertainty; (e) risks related to lack of

innovation and learning such as project design and start-up risks and project design fiduciary risks, or how knowledge and learning is embedded into operational objectives of the grants, which links also to the aspects of confidence that leads to creativity and learning; and (f) risks related to communication gaps and shortfalls which relates to the aspect of stories and storytelling.

These last three risks are more closely parallel to the definition of animal spirits than the first three. Communication risks relate to the issue of stories and the capacity for effective storytelling. Innovation and learning is one of key aspects in the earlier definition of animal spirits by Keynes, which calls for government to leave sufficient room for creativity, innovation and learning, while controlling the key aspects of bad behaviour that can result from animal spirits. The presence of risks and uncertainty relates to the reaction people have with ambiguity and uncertainty and the impact that has on the level of confidence. The computed percentages for risks categories are presented in the following table below:

Table 5: Percentages of projects rated Unsatisfactory (US) by categories

Theme	Percentage of US projects facing the risk category (at least one of the risk indicator in the category)	Percentage of Projects facing the risk category that are rated satisfactory (HS, S, MS, PS)
a) Skill and competence	45.83%	3.45%
b) Procedures and processes	79.17%	22.99%
c) Performance	75.00%	41.38%
d) Risk and Uncertainty	83.33%	22.99%
e) Innovation and Learning	83.33%	35.63%
f) Stories	58.33%	5.75%

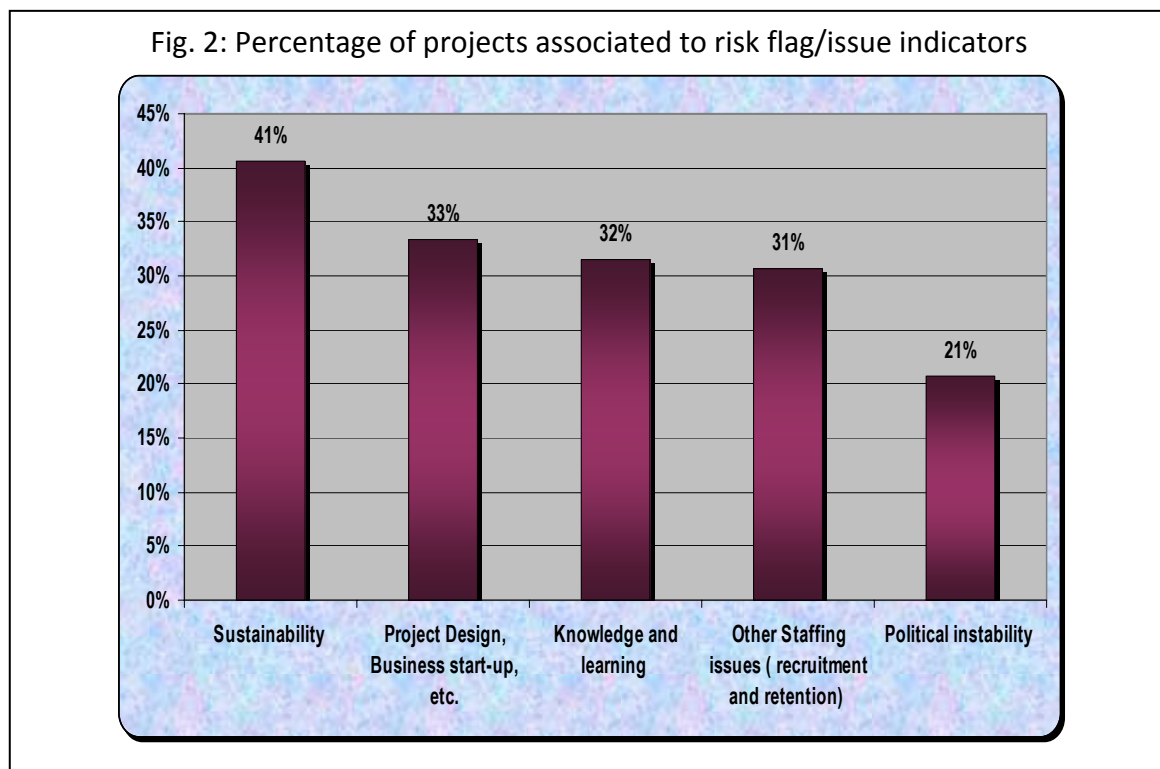
As can be seen from the table above, the highest percentages are observed for “Risk and Uncertainty”, “Innovation and learning” (83.33%). These results are quite conclusive in showing that the indicators most closely associated with the definition of animal spirits are the most prevalent in the US category of projects (with the exception for Stories). A further breakdown of the risk categories is presented in Appendix 2. These details do inform the grouping of indicators into the six themes. For example, the two highest percentages are under Innovation and Learning. One may also notice that under Innovation and Learning, there appears a significant difference between R26 (Project Design Fiduciary Risk), which is less than 21%, and the two other risk indicators are respectively 71% and 75% of risky projects.

The experience of the Foundation indicates that the activities that featured most distinctly in the portfolio at risk and the reasons for risk depend first, on a great deal on



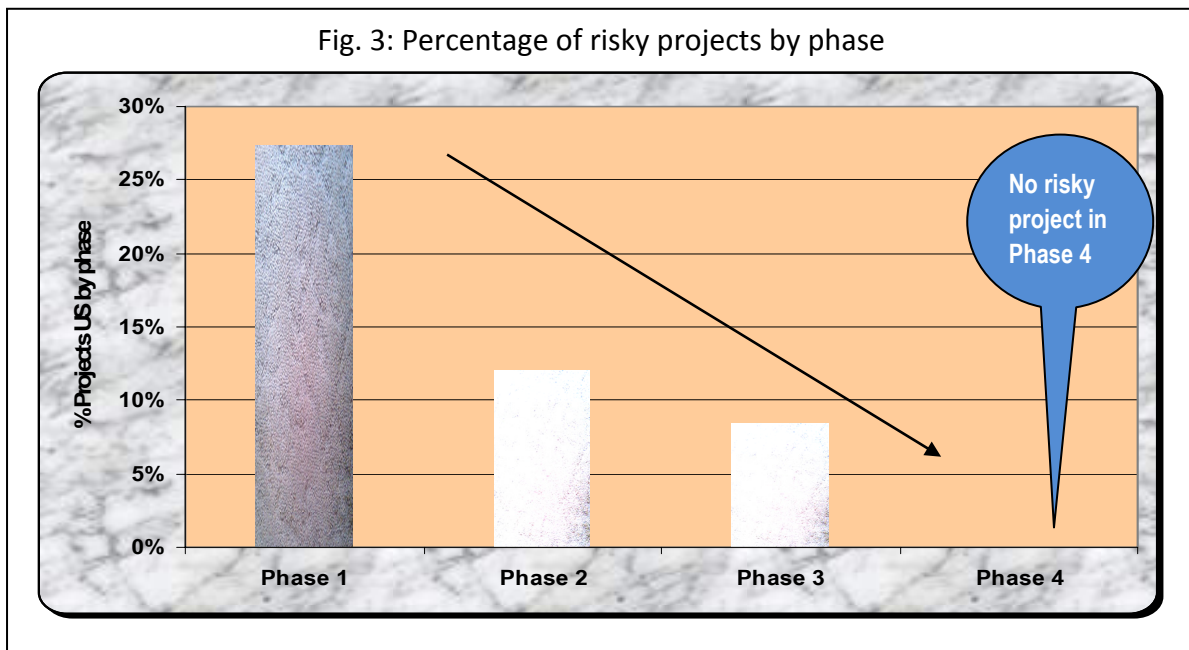
the quality of leadership and the effectiveness of implementation, and second, on weakness in design and staffing issues (Figure 2 below). The two top most risk categories hence relate most to the instances of animal spirits than to easily observable and measurable factors like staffing issues. The presence of leaders who can motivate (through storytelling) and create an environment of confidence and common direction is clearly at play in the risk outcomes of the Foundation’s portfolio as is the issue related to the overall manner in which the projects financed by ACBF are governed. Implementation difficulties resulting from poor utilization of processes and procedures and the reliance on informal and patronage based decision-making are another area that seems supported by the data presented in the chart below.

Sustainability and start up risks are also high – both related to the elements of animal spirits highlighted earlier. In fact the highest risk ratings are related to issues classified under the “animal spirit” categories of uncertainty and ambiguity, learning, and overall environment that leads to instability.



As depicted in Figure 3, a learning curve features very strongly as a factor for mitigating risks; with projects in subsequent phases of financing showing lower risks than those in the first phase of financing. The ability of managers in the public sector to create a space for learning and creativity seems to be evident in these results as the riskiness of the Foundation’s portfolio declines with the phasing of the financing; first phase projects are more risky than follow on projects as learning takes place among the grantees and within the Foundation as well. It is also possible that bad projects get terminated early, introducing “selection bias” in interpretation of the results. However, the fact that there

is a dramatic drop in riskiness at the second phase is a good indicator that the risk level really does drop with subsequent phases independent of selection bias as most ACBF projects go to at least the second phase of financing.



The probability of risky projects at start up phase is higher in the areas of public administration and management (PAM) than in the areas of economic policy analysis and management (EPAM), potentially signifying that it is harder to change organizational culture than to institute policy changes—another manifestation of animal spirits at work as they relate to behavioural change in organizations. More importantly, the probability of risky projects is independent of the type of country (fragile or not fragile states) or locus of the project (national or regional). Such results further support the idea of “patient capital” in order to achieve fundamental change as decisions made to terminate projects after early phases can miss the chance for lasting transformation.

These results indicate that it is possible to achieve a high level of performance of capacity development activities even in risky environments if the project designs properly accommodate for the implementation environments. Moreover, it seems easier to get important change when working with autonomous entities (such as policy units and think tanks that undertake economic analysis and policy design aspects of the work of the Foundation) than to get large-scale change in existing civil service organizations and public sector departments (such as the work supporting broader public administration reforms). The fact that these results are independent of the type of country provides further support to the idea of putting resources where there is good leadership and a chance for transformation.

## Conclusions and Implications

The analysis and findings in this paper highlight, amongst others, the importance of non-economic factors in shaping the capacity development sphere. Understanding this nature of animal spirits is critical to designing and implementing effective programs for capacity development. It is particularly important to focus on issues of leadership and leadership development, including the capacity for leaders to instil confidence and piece together stories that motivate people into a common vision of the future or to achieve common objectives. It is equally significant to embed opportunities for learning and creativity in the design and implementation of capacity development programs. Also vital is the need to be mindful of the nature of intervention – being prepared for the presence of animal spirits in areas related to public sector performance and reform and designing programs that take those factors into consideration. Furthermore, the results indicate the need for patient capital in order to derive lasting change when learning happens and provide support to the idea of piloting and innovation to discover the best ways to harness animal spirits for the advantage of longer term capacity development and transformation.

## Appendix 1: List of Indicators

R01	Project Implementation Fiduciary related risk
R02	Internal and External Audit Fiduciary risk
R03	Competence of Project Personnel
R04	Suitability of Fixed Responsibilities
R05	Written procedures
R06	Segregation of Duties
R07	Safeguards Over Assets
R08	Procurement process
R09	Other safeguards
R10	Flow of funds
R11	Work planning,
R12	Budgeting and financial performance reporting
R13	Reliable accounting system & Sub-grantees
R14	Relevance
R15	Effectiveness
R16	Efficiency
R17	Quality of Management
R18	Sustainability
R19	Communication
R20	Knowledge and learning
R21	Other Staffing issues (such as recruitment and retention)
R22	Project-Operational Challenges
R23	Political instability
R24	Other project environmental risks
R25	Project Design, Business start-up, etc.
R26	Project Design Fiduciary risk

## Appendix 2: Breakdown of risk categories for US projects

Theme	Risk indicator	Percentage
a) Skill and competence	R03	37,50%
	R04	29,17%
b) Procedures and Processes	R05	33,33%
	R08	33,33%
	R10	37,50%
	R11	45,83%
	R12	58,33%
	R21	66,67%
c) Performance	R14	50,00%
	R15	45,83%
	R16	58,33%
	R17	45,83%
	R18	54,17%
d) Risk and Uncertainty	R01	33,33%
	R02	58,33%
	R06	58,33%
	R07	25,00%
	R09	50,00%
	R22	45,83%
	R23	41,67%
	R24	33,33%
e) Innovation and Learning	R20	70,83%
	R25	75,00%
	R26	20,83%
f) Stories	R19	58,33%

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