



Full Length Research Paper

An Analysis of the relationship between capacity building and fiscal capacity in Uganda Local Government

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Abstract

Decentralization has been adopted by many economies as a tool to achieve objectives of better service delivery, attraction of more donor support necessary for capacity building all of which are important for increased revenue mobilization. The purpose of the study was to establish the relationship between Capacity Building and Fiscal Capacity in Mbale district local government. A cross sectional correlation approach was used to undertake the study. Stratified, purposive, convenience and simple random sampling involving a sample of 143 was used to obtain data about the study variables. The findings reveal that there was a significant positive relationship between Capacity Building Fiscal Capacity. It is recommended that more fiscal powers should be devolved to local levels and the central government remains committed to its decisions; both central and local governments should negotiate with donors to accept local government priorities and more Capacity Building programs based on local government needs should be undertaken.

Keywords: Capacity building, Fiscal capacity, Decentralization, Local Government, Uganda.

INTRODUCTION

Capacity building is the process whereby a community equips itself to undertake the necessary functions of governance and service provision in a sustainable fashion. The process of capacity building must be aimed at both increasing access to resources and to changing the power relationships between the parties involved. Capacity building is not only constrained to officials and technicians but must also include the general awareness of the local population regarding their services and development in general (Len, 1996). Capacity building is the need for adjusting policies and regulations, institutional reforms, modification of work procedures and mechanism of coordination, improvement of human resources, skills and qualifications, change of the value system and attitudes, so that the needs of regional

autonomy as a new approach towards governance, administration, and participatory mechanisms of development can be fulfilled in order to meet the demands for a more democratic system (Jakarta, 2001).

Fundamental to the development of a system of intergovernmental transfers is an understanding of the concepts of fiscal capacity and fiscal effort. The Fiscal Capacity of a region is the ability of the governments in the region to raise revenues from their own sources in order to pay for a standardized basket of public goods and services. On the other hand, fiscal effort is the degree to which a government or a sub national region utilizes the revenue bases available to it. As such, the level of fiscal effort is affected by the level of the tax rates applied, the level of exemptions granted and the tax

enforcement effort exerted by the tax administration authorities (Martinez-Vazquez and Boex, 1997).

Ability to Pay and Ability to collect are broad methodologies for fiscal capacity. Ability to pay methods emphasizes the definition of fiscal capacity as the ability of individuals in a certain jurisdiction to pay taxes, relative to other similar jurisdictions. Ability to pay methodologies is pegged to some type of economic measure such as total income, total product, or a combination of the two (Bollinger et al., 1990). Ability to collect methods defines fiscal capacity as a government's ability to collect revenues, relative to other similar governmental units (Martinez-Vazquez and Boex, 1997; Bollinger et al., 1990). In this study, we set out to examine the relationship between capacity building and fiscal capacity in Ugandan local government, with the aim of finding ways through which local governments can improve their capacity.

Literature review

Ability to Pay Approaches

While the level of revenue collection can intuitively be considered as a good proxy of fiscal capacity, the amount of revenue collection is not a good measure of fiscal capacity in actuality. There are several elements that create a gap between the amount of revenue raised by a region and the potential ability of a region to raise revenue. Two regions with the same fiscal capacity may collect different amounts of revenue as a result of applying different tax rates, due to variances in the enforcement effort and different levels of taxpayer compliance (Parker, 1995).

The most obvious source of revenue of a regional government is the income of its taxpaying residents. This is one of the most widely used measures of fiscal capacity. In theory this approach is advantageous in that it's clear, simple, and transparent. However, in general terms, its major problem is failure to measure the tax bases available to a region. While the data on the levels of per capita income may be available, its accuracy may be questionable. Besides, the existence of the underground economy, accurate measurement will be difficult mostly in large countries (Tanzi and Vito, 1996; Martinez-Vazquez and Boex, 1997).

Gross Regional Product is the regional equivalent of domestic gross product. It's defined as the total value of goods and services produced by regions economic resources (land, labour, capital) over a given period of time. Since the total value of goods and services produced in a region is equal to the income received by the owners of the employed economic resources, GRP reflects the total amount of income potentially subject to taxation by regional governments. GRP is a more comprehensive measure of fiscal capacity because it includes the income generated within a region

irrespective of the location or residence of the worker or producer. It also includes a substantial share of the personal income of the residents in a region (World Bank, 1998; Wolfensoh, 1998).

Despite the comprehensive nature of GRP, it still suffers from a one dimensionality as a measure of fiscal capacity. While in reality different tax bases may be subject to different levels of taxation, GRP simply aggregates the value added by all economic resources. At the same time computation of GRP is data intensive (Martinez-Vazquez and Boex, 1997).

Total Taxable Resources is closely related to GRP. TTR recognizes that while GRP is a good measure of the total economic activity that takes place in a region, it doesn't include the effects of certain federal taxes and transfers on the fiscal capacity of sub national regions. As such several adjustments are made to GRP to arrive at TTR. Certain federal taxes are subtracted from GRP because these funds are unavailable to regional and local governments as a source of revenue. Each region's GRP should be augmented with the amount of direct federal transfers to firms and individuals, including federal pensions and unemployment benefits. These transfers increase the wealth of regions producers and households, which in turn increases the ability of the region to raise revenues (Martinez-Vazquez and Boex, 1997). The advantage with this method is that it provides an accurate reflection of a regions actual fiscal capacity. It shares disadvantages with the GRP but its computation is more data intensive (Musgrave, 1983).

Ability to Collect Approaches

As a measure of fiscal capacity of a region, the fundamental concept underlying the Representative Tax System is to calculate the amount of revenue that a region would collect if it were to exert average fiscal effort. This is done by collecting data on revenue collections and (proxies for) tax bases for each of the taxes under consideration for every local government. Based upon information about tax bases for each region as well the national average fiscal effort for each of the taxes, the amount of revenues that every region would collect under average fiscal effort can be computed. This amount is then accurately quantified to represent the fiscal capacity of a region. The main benefit of the RTS is that computations are made at a disaggregated level and based on detailed knowledge of (proxies for) the statutory tax bases (Golola, 2001). The RTS consists of five elements; determination of revenue coverage, classification of revenues into sources, definition of standard tax bases, determination of average tax rates, estimation of fiscal capacity (Martinez-Vazquez and Boex, 1997).

The main benefit of the RTS as a measure of fiscal capacity is its accuracy. However, the methods intensive data requirements may prevent its implementation in

other countries. An alternative solution that would maintain much of the accuracy while reducing its data requirements is by introducing regression analysis to the RTS method. The use of regression analysis in the RTS dramatically reduces the requirements for the measurement process. Rather than collect data on the actual collections and tax bases for every tax component, the RTS regression method only requires information on the total amount of revenues collected for each region and data on a series of proxies for the tax bases for region. While the integrity of the data needs to be guarded, the requirements on the proxies for the tax bases are less strict. Most importantly there is no need to group revenue items into tax components and to specifically match each tax component with a standard tax base (Bird et al., 2000).

Alternately the RTS regression method can be expanded to include disaggregated information on the main revenue sources, their proxies and proxies for the remainder of revenues. Incorporating more explanatory variables in the regression model increases the accuracy of the method, albeit at the cost of more intense data requirements and more data analysis. Once a variety of these tax bases is selected, and data on their respective sizes gathered, we use regression analysis to estimate the fiscal capacity of a region (Martinez-Vazquez and Boex, 1997).

The regression method has several advantages over the computational method of the RTS. Use of regression avoids the necessity of having exactly to define components, define standard tax bases and compute representative tax rates. It can also provide information on the relationship between revenue collections and the tax base as part of the statistical procedure. Computationally, the procedure is much simpler. In addition other selection of proxies for each the tax base, little manipulation of results is possible (Martinez-Vazquez and Boex, 1997).

However even the regression approach has shortcomings. Computationally, the number of tax bases that can be included in the regression equation is limited by the available number of regions. Most importantly the RTS with regression analysis is relatively complex and not as transparent as other measures of fiscal capacity. The average policy maker is not likely to be familiar with the statistical technique involve and therefore he may view them with suspicion. Since transparency and simplicity are desired features of any measure used for the purpose of determining public policy, the shortcomings should be taken into account in the decision of what measure of fiscal capacity should be used (Martinez-Vazquez and Boex, 1997; Manor, 1995).

Focus on Government

One of the early theories about development assistance is a focus on governments as the most effective means of

instituting positive change in developing countries. Proponents of this theory believed that markets in developing countries were both nonexistent and incapable of growth. The Keynesian economic worldview was that governments were expected to regulate and direct economic activity (Linbaek et al., 1999). On the international scale, markets were viewed as tainted goods in the world of development because of their close ties with colonialism. Also the collapse of markets for commodities and credit during the Great Depression eroded confidence in market mechanisms as a means of achieving development (World Bank Group, 1999b).

Given the pervasive nature of politics in the realm of development, it is not surprising that a counter-argument to the bilateral emphasis of ODA also emerged. This theory points to the lack of transparency and control as the norm in dealings between two governments. The multilateral approach to ODA is viewed as means to minimize the influence of one countries' political agenda as a factor in allocating development assistance (Williams, 1999).

The multilateral system has some inherent flaws. One problem with the World Bank, for example, is that when it was established, it was discovered that borrowers oftentimes did not have well-prepared proposals for development assistance. In response, the Bank decided to prepare projects themselves. This resulted in the need for increased staff. It also resulted in no effective separation between preparation and appraisal, because these functions were combined in the same staff. World Bank became both 'prosecutor and judge' in this situation (Burnell and Peter, 1997).

Whether coming from multilateral or bilateral sources, one of the most pervasive ODA theories has been the emphasis on economics as the road to sustainable growth and poverty alleviation. The Marshall Plan had an early emphasis on grants and loans to help recipient countries engage in international commerce. This was also the focus behind the creation of the World Bank and the IMF. The World Bank was originally set up to facilitate European borrowing in international markets, while the primary focus of the

IMF was to assist in the flow of repayments (Engberg and Poul, 1998). Supporters of this theory argued that developing countries have low savings because of their absolute poverty. In this situation they cannot afford to save and need a boost from ODA in order to become more competitive in the global marketplace. This increased competitiveness will then translate into increased GDP and poverty alleviation in the recipient country (Gentry and Bradford, 1999).

Critics of this theory argue that poverty and the lack of economic development are not driven by capital shortages. Looking back in retrospect, critics of this theory argue that "although aid programs have transferred large capital flows to developing countries, investment has not risen significantly in response and

consumption has increased instead (Grant and Nijman, 1998). Critics also claim that there is more to success in development than just the accumulation of capital. The argument is that our emphasis is misplaced. In some instances, countries have had high, (sometimes forced) savings rates and have not been able to achieve comparable increases in per capita income. The problem is that capital has to be put to good use (Stiglitz, 1997).

The reverberations of the end of the Cold War has shaken the foreign aid regime and spurred a reevaluation of ODA theory. Donors have had to address not only a smaller ODA budget but also the methodology for allocating ODA. The effects have been quite dramatic and in many cases have led donor agencies to redefine their role in development. Many new theories about how to apply foreign aid are emerging in response to the changes in the global political and economic environments that are so closely linked to foreign aid (Williams, 1999).

Levels and Dimensions of Capacity Building

The highest level within which capacity initiatives may be considered is the system or enabling environment level. For development initiatives that are national in context, the system would cover the entire country or society and all subcomponents that are involved. For initiatives at a sectoral level, the system would include only those components that are relevant. The dimensions of capacity at a systems level may include areas such as policies, legal/regulatory framework, management and accountability perspectives, and the resources available (UNDP, 1998).

The institutional level may include a formal organization such as government or one of its departments or agencies, a private sector operation, or an informal organization such as a community based or volunteer organization. At this level, successful approaches to capacity building include the role of the entity within the system, and the interaction with other entities, stakeholders, and clients. The dimensions of capacity at the entity level may include areas such as mission and strategy, culture and competencies, processes, resources (human, financial and information resources), and infrastructure (Williamson et al., 2003).

The individual level addresses the need for individuals to function efficiently and effectively within the entity and within the broader system. Human Resource Development is about assessing the capacity needs of people and addressing the gaps through adequate measures of education and training. Capacity assessment and development at this third level is considered the most critical. The dimension of capacity at the individual level should include the design of educational and training programs and courses to meet the identified gaps within the skills base and to provide the appropriate number of number of qualified staff to

operate the systems (Groot and van der Molen, 2000).

Capacity Assessment and Development

Capacity is two-dimensional: capacity assessment and capacity development (Williamson et al., 2003). Capacity Assessment is an essential basis for the formulation of coherent strategies for capacity development. This is a structured and analytical process whereby the various dimensions of capacity are assessed within a broader systems context, as well as being evaluated for specific entities and individuals within the system (UNDP, 1998). Capacity Development is a concept that is broader than institutional development since it includes an emphasis on the overall system, environment and context within which individuals, organizations and societies operate and interact. Even if the focus of concern is a specific capacity of an organization to perform a particular function, there must nevertheless always be a consideration of the overall policy environment and the coherence of specific actions with macro-level conditions (Rajabifard, 2002).

Strategies for capacity assessment and development can be focused on any level, but it is crucial that strategies are formulated on the basis of a sound analysis of all relevant dimensions. Often capacity issues are first addressed at the organizational level. Organisational capacity is, however, influenced by not only the internal structures, systems and procedures, but also by the collective capabilities of its staff on the one hand, as well as by external factors in the wider institutional environment – such as the policy framework, and other political, economic and cultural factors – on the other hand.

These may constrain or support performance and influence issues of organisational credibility, efficiency, and legitimacy. By taking this approach, capacity building measures can be addressed in a more comprehensive societal context (Georgiadou, 2001).

It should be noted that the entry point for capacity analysis and development may vary according to the major focus of the project. However, it is important to understand that capacity building is not a linear process. Whatever is the entry point and whatever is the issue currently in focus, there may be a need to zoom in or zoom out in order to look at the conditions and consequences at the upper or lower level (s). Capacity Building should be seen as a comprehensive methodology aiming to provide a sustainable outcome through assessing and addressing a whole range of relevant issues and their interrelationships (Rajabifard et al., 2003).

The relationship between Capacity Building and Fiscal Capacity

Local Governments need capacity to analyze and

formulate tax policy. There's need for people who understand the technical aspects of policies in their respective areas and can use technical information. Administrative capacity to implement policy decisions and programs is also necessary (Hilderbrand, 2002). Revenue planning, budgeting, and collections can only be effective with appropriate financial management skills and procedures (LGFC, 2003).

The design of the Decentralization Program should be based on the premise that certain service delivery and development needs of the population can be addressed more effectively by empowering local governments with a strong capacity to manage participatory development planning and implementation with accountability. The key outcomes would be having in place the institutional capacities at central and local levels to mobilize and effectively utilize resources to meet core local government responsibilities, all with transparency and with upward and downward accountabilities (Len, 1996).

Urban Local Bodies need to be strengthened and their capabilities enhanced so that they are able to discharge their functions. The concept of e-governance of municipalities is prevalent in some cities, where computerization of municipal functions can tremendously improve the service delivery level to the citizens and dramatically enhance the revenue of the local authority. The objective is to build capacities of the Urban Local Governments towards a more efficient revenue collection; administrative, financial and service delivery management with a state of the art computerized Management Information System, as well as trains the municipal personnel in the proper use and maintenance of the systems(s) (Jarkata, 2001).

Research design

This study adopted a quantitative research design whereby quantitative research methods were used. Data were collected from 82 Local Council III Councilors, 45 Local Council V Councilors, 28 Sub County Chiefs and 5 Heads of Department at Mbale district Head Quarters. Mbale district was chosen it was one of the most successful decentralized local governments in Uganda.

After collection, the data was edited to ensure accuracy and analyzed using the Statistical Package for Social Scientists (SPSS). Descriptive and Inferential Statistics were used to compute the relative frequency distributions of all variables and Pearson's Correlation Coefficient was used to determine the degree of relationship between the variables. Factor Analysis was used in data reduction to identify a number of factors that explain the variance observed in the study variable. The variables with factor loadings less than 0.5 were considered low and therefore deleted. Factor loadings explain how closely the variables are related to each of the factors discovered. Further, multiple regression

analysis was used to predict the impact of fiscal decentralization, donor aid and capacity building.

Measurement of variables

Fiscal capacity was measured using Revenue Collections (Martinez-Vazquez & Boer, 1997) and a five point likert scale ranging from strongly agree as response 5 to strongly disagree as response 1. On the other hand, Capacity Building was measured using a five point likert scale ranging from strongly agree as response 5 to strongly disagree as response 1.

FINDINGS

This section presents study findings from primary data.

Descriptive Statistics

This section presents the general characteristics of the respondents specifically highlighting age distribution, gender, highest level of qualification, occupation, period in service and institutional level. Cross tabulations and frequency distributions were used to indicate variations in the respondents' characteristics. The findings are presented in tables 1-5.

Age Distribution

Data were collected to determine the age distribution of respondents. Table 1 presents the results.

The results in Table 1 show that a majority of the respondents were in the 36-45 age bracket (38%). The least respondents fall in the 18-25 age bracket (8%).

Gender Distribution

Data were also collected to analyze the gender of respondents that participated in the study. Table 2 shows the results on gender.

Results in Table 2 indicate that the majority of the respondents were male (66%). Female respondents were only 39 (34%).

Capacity Building Rotated Component Matrix

Factors analysis was done using a component matrix to examine the factors for capacity building. Table 3 presents the results.

From Table 3, it was observed that system level, institutional level, and individual level explain up to 60% of Capacity Building at local governments. It was also noted that system level Capacity building was more dominant (22%), followed by institutional level capacity building (21%) and individual level capacity building

Table 1. Age Distribution of Respondents

Age		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	18-25	9	7.9	7.9	7.9
	26-35	40	35.1	35.1	43.0
	36-45	43	37.7	37.7	80.7
	above 45	22	19.3	19.3	100.0
	Total	114	100.0	100.0	

Table 2. Gender Distribution of Respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	75	65.8	65.8	65.8
	Female	39	34.2	34.2	100.0
	Total	114	100.0	100.0	

Table 3. Capacity Building Rotated Component Matrix

Statements	Capacity Building		
	System level	Institution level	Individual level
Recruitment is based on local government tasks	.613		
Through capacity building, we have recruited optimal staff		.714	
We always follow the policies on remuneration		.630	
We always follow the policies on promotion from lower to higher levels		.602	
We set and communicate performance measures		.502	
Capacity building has enabled our staff to attain the necessary skills to perform their tasks			.812
Capacity building has improved on the motivation of staff			.788
Capacity building has improved the attitude of our staff towards work			.766
Through capacity building, officials are sponsored to attain the necessary qualifications			.729
Workshops are organized with the aim of improving on the skills of our staff			.728
Capacity building has enabled our staff to meet the performance measures			.717
Capacity building has improved on the working ethics of our staff			.680
Capacity building has enabled our staff to use modern technology			.599
Eigen Values	5.623	5.317	4.696
Variance %	21.627	20.452	18.062
Cumulative %	21.627	42.079	60.141

(18%). This is because it's the regulations and guidelines at system level that are used for implementation and operation at institutional and individual levels.

Fiscal Capacity Rotated Component Matrix

Similarly, factors analysis was done using a component

matrix to examine the factors for fiscal capacity. Table 4 presents the results.

It was observed from the Table 4 that enumeration, collection effort, education and sensitization, ability to pay and assessment explain 70% of Fiscal Capacity. Further analysis showed that enumeration was more significant at (24%), followed by collection effort (17%), education

Table 4. Fiscal Capacity Rotated Component Matrix

Statements	Fiscal Capacity				
	Enumeration	Collection Effort	Education and Sensitization	Ability to pay	Assessment
Information on tax payers property/income is usually recorded through door to door visits	.783				
Enumeration and assessment exercises are well facilitated	.617				
We ensure that the local population complies to its tax obligations		.619			
LC's fully participate in the enumeration and assessment of taxes		.573			
We take all necessary steps to collect local revenue		.521			
The local population pay their user charges in time				.623	
We have enough and reliable information about our tax payers					.877
We always carry out tax assessment					.581
Eigen Values	4.769	3.412	2.098	1.989	1.745
Variance %	23.844	17.058	10.489	9.944	8.725
Cumulative %	23.844	40.903	51.392	61.336	70.061

Table 5. Correlation Coefficient Matrix

Zero Order (Bi-Variate) Correlations									
	1	2	3	4	5	6	7	8	9
Capacity Building (8)	.540**	.444**	.282**	.452**	.867**	.888**	.668**	1.000	
Fiscal Capacity (9)	.515**	.460**	.451**	.537**	.350**	.179	.422**	.387**	1.000
** Correlation is significant at the 0.01 level 2-tailed.									
* Correlation is significant at the 0.05 level 2-tailed.									

and sensitization (11%), ability to pay (10%) and the significant is assessment (9%).

Correlation results

Correlation analysis was done to examine the relationship between capacity building and fiscal capacity as seen in Table 5.

Results in Table 5 reveal that there was a significant positive relationship between Capacity Building and Fiscal Capacity ($r = 0.387^{**}$, $p \leq 0.01$). This implies that more and better Capacity Building programs at local levels and clear procedures from the central government will lead to an improvement in the Fiscal Capacity of local governments.

CONCLUSION AND RECOMMENDATIONS

The study findings revealed a significant positive relationship between Capacity Building and Fiscal Capacity. Therefore if the local governments follow the set procedures on capacity building and carry out more Capacity Building programs aimed at improving the skills and abilities of the work force, the Fiscal Capacity of local governments will also improve.

Since there was a significant positive relationship between Capacity Building and Fiscal Capacity, it's recommended that Capacity Building at the various levels; system level, institutional level and individual level should be improved. The central governments should encourage local governments to follow procedures on

recruitment, promotion, remuneration and the performance measures should also be clear. The relationship between the various local governments should also be made certain and their interaction enabled. The local communities should also be sensitized to make them appreciate the importance of their participation in the development of their communities.

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