

# THE DYNAMIC OF LOCAL INSTITUTION IN POVERTY REDUCTION: CASE STUDY ON MANAGEMENT OF “KREDIT MIKRO NAGARI” IN WEST SUMATERA, INDONESIA

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**Abstract:** *Sustainable poverty reduction considers local institution as a main factor in determine, guarantee, and contest people's entitlements. From social constructivist view, poverty reduction effort should bring local people into decision making process. In this paper, we analyze political process at Nagari level in managing microcredit, a program for poverty reduction, in West Sumatra. Nagari is the lowest-level political unit in the Minangkabau ethnic group, to which almost all of people in the study site belong. We applied Institutional Analysis and Development (IAD) framework to study the access of poor household to microcredit which is disbursed by West Sumatra Provincial Government. Based on the study at eight Nagaris, it is concluded that different political process and action arena have different effect on access of poor household to credit. There is likely strong correlation between social homogeneity and sustainability of microcredit management.*

**Key words:** *institution , sustainability of microcredit, Sumatera Barat*

## INTRODUCTION

Indonesia is facing new challenges in poverty reduction since it experienced huge changes in social and political system during last decade. Democratization and decentralization do not changes the political process at elite level only but also open the chance to bring grass root people into decision making process. Democratic decentralized policy guides policy makers in deciding the appropriate measures in most developing countries (Agrawal and Gupta, 2005; Andersson *et al.*, 2006; Ribot, 2002). However, decentralization may not work in the absence

of clear and specific institutions (Andersson, 2004; Ostrom, 1990). Strong and dynamic local institutions are the prerequisite for successful and good performance of decentralization (Ostrom, 1990; Uphoff, 1986).

Poverty reduction is a local institutional process (Bastiaensen *et al.*, 2005), when all actors interact in action arena within the sociopolitical and cultural situation. We need strong and dynamic local institutions for successful and sustainable poverty reduction because local institutions are main factors in determine, guarantee, and contest people's entitlements. Poverty is not the problem of low income only.

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Rather, there are inter-actions of complex factors that trap the poor into difficult social, economic, political and cultural situation. So, poverty reduction is not the business how to increase income only but also the process, both socially and politically, to empower poor household to capable them taking opportunities and accessing resources (Sen, 1998). Otherwise, poverty reduction would not be sustainable.

Within the context of decentralized political system, West Sumatra Provincial Government launched microcredit, then called Kredit Mikro *Nagari* (KMN), in the late of 2007 as the main program in poverty reduction. The main objective of KMN program is to improve access of micro enterprises, which mostly owned and managed by poor families, to credit that conventional banking system failed to reach for. Microcredit is an innovative and powerful instrument in war against poverty for last two decades (Helms, 2006). The credit is managed by *Nagari*. As the new re-emerging institution, *Nagari* has to set up internal regulation on how to distribute and manage the credit, in accordance with general guidelines provided by provincial and district/municipality government. There might be dynamic political processes among actors within the *Nagari* during formulation internal regulation. Those political processes either could bring positive outcome, sustainable microcredit management; or could result in negative one, unsustainable.

In this paper, we analyze the dynamic of political process at *Nagari* level in distributing and managing KMN by applying Institutional Analysis and Development (IAD) framework.

Before we reach the case study results, we, explain IAD framework and Indonesia poverty reduction status.

## **IAD FRAMEWORK**

IAD framework, developed by scholars at the Workshop in Political Theory and Policy Analysis, Indiana University (Ostrom, 1990; Ostrom *et al.*, 1994), is a tool in public policy and managing common pool resources analysis at all levels with multidiscipline approach. The framework is developed to facilitate analysis in specific policy and organization by identifying general problem which should be considered. The framework at the beginning was used in study on urban public services, then applied in several fields such as institutional arrangement, donor driven project, international policy analysis and widely applied in managing common pool resources (Clement and Amezaga, 2008; Meinzen-Dick *et al.*, 2006; Rudd, 2004).

Attention have to be paid on three sets of contextual factors in applying IAD (Ostrom, 1999), as shown in Figure 1. Action arena is the primary interest where actors made any action within action situation constrain, including physical and material world within which the actors interact, the attributes of community and institution or 'rules-in-use' that govern behavior. Institutions guide actors' behavior to increase predict-ability and provide order in uncertain environments, thus provide incentives or disincentives for people to cooperate or not. Institutions could be formal rules and/or informal pre-scriptions (e.g., norms, taboos) that allow, prohibit or require certain

actions or outcomes while specifying explicit material or implicit social sanctions for breaking rules (Crawford and Ostrom, 1995). Before any action taken, actors calculate cost and benefit depending on available incentives (Ostrom, 2005). Rudd, (2004) emphasizes that incentives are based on their underlying values and preferences, the information they have about the state of the world and the intentions of other actors (which may be incomplete and/or imperfect), and the threat of material or social sanctions.

Outcome is the respond to “action arena” and to higher level of

institution. While IAD can also be used to analyze decision making at higher level, such as collective and constitutional choice, as shown in Figure 2 (Rudd, 2004). Constitutional choice guides who have right and authority to set the rule for lower level regarding access to resources and assets. It provides general guidance for actors to take any actions. Collective choice refers common understanding on operational rules. While, operational choice focuses on day-to-day norm and regulation or procedures to manage resources.

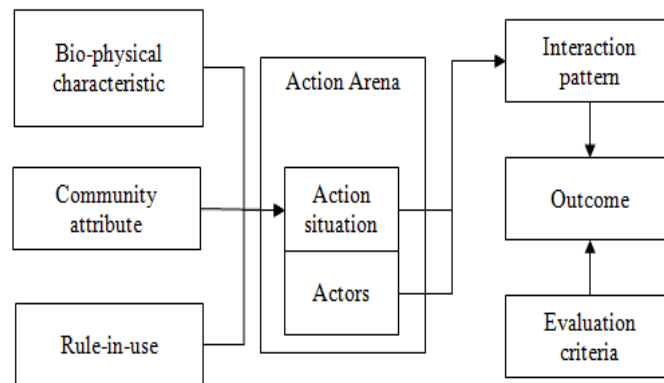


Figure 1. Institutional Analysis and Development (IAD) framework (Adapted from Ostrom *et al*, 1994).

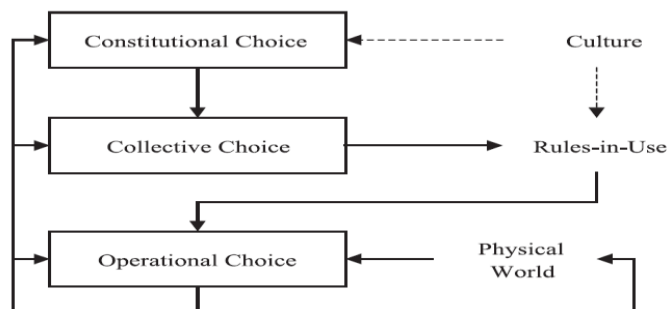


Figure 2. Multiple levels of institutional analysis (adapted from Rudd, 2004)

This framework is applied to learn the action of actors in distributing and managing KMN. The action, then, effects to sustainability of KMN management, the outcome of interaction pattern, as well as poverty reduction program.

## INDONESIA'S ECONOMIC DEVELOPMENT AND POVERTY REDUCTION

Poverty is main issue in Indonesian economic development. Its economic performance was always correlated to poverty indicators. Between 1970 and 1997, Indonesia achieved an average economic growth of 7 percent. During this period, it put parallel a broad-based and very strong program in order to promote investment and accelerate growth; an agricultural support program to stabilize food prices and subsidies to ensure food security; and a large scale construction program for basic services (the "inpres" programs) such as primary schools, markets, access roads, and so on. The result was the fastest drop in poverty that experienced by any country during the same period. Poverty reduced sharply from 40 percent of the population in 1970 to

about 11 percent in 1996. After enjoying stable and high economic growth for almost three decades, financial crisis by the end of 1997 hugely affected Indonesian economic growth and poverty reduction. After GDP fell 13 percent during 1996-1999, poverty level jumped to almost quarter of Indonesians at 23.4 percent (Table 1).

Government of Indonesia worked hard to re-energize the effort for poverty reduction. Some programs were launched, under supporting international societies, to re-reduce the number of its poor household after economic crises. Measures that were taken to alleviate poverty during 2003-till present have reduced the absolute number of the poor from 47.9 million in 1999 to 32.5 million in 2009, or 14.2 percent of the population. Most Indonesians poor live in rural areas, with agriculture as the main source of income. When using a global indicator, per capita income of US\$1 a day, the percentage of the poor in Indonesia was estimated to be 7.2 percent of the total population in 2009. Should the benchmark be raised to US\$2 a day, more than half of the Indonesian population (about 52.0%) is considered poor.

Table 1. Indonesia's rural-urban poverty level

Year	Rural (million people)	Urban (million people)	Rural and urban (million People)	% of total population
1990	9.4	17.8	27.2	15.1
1996	7.2	15.3	22.5	11.3
1999	15.6	32.3	47.9	23.4
2003	25.1	12.2	37.3	17.4
2007	23.6	13.6	37.2	16.6
2009	20.6	11.9	32.5	14.2

Source: BPS, 2010

In 2004, Indonesia launched its Poverty Reduction Strategy Paper (PRSP), internationally known as country-level operational framework for progressing toward the Millennium Development Goals (MDGs) that backed up by international powerful donors such as World Bank, IMF and OECD. The paper was drafted by Committee for Poverty Alleviation (*Komite Penanggulangan Kemiskinan*), formed through a presidential decree. The key strategies of poverty reduction are: (i) creating opportunities (creating job and business opportunity for the poor), (ii) community empowerment (to empower the poor so that they can attain their economic, social, and politic rights; can be in control for decisions that concerns their needs; can express their aspiration; can identify their own problems and needs), (iii) capacity building (to improve capacity or ability to fight for their needs), (iv) social protection/safety (to provide social protection of the poor). Basic principles of these strategies are: equality, justice, participation, democracy, market mechanism, legal order, mutual trust and sense of security (The Government of Republic of Indonesia, 2003).

The strategy was brought into national development plan (Propenas) and downed to both direct program, such as *program nasional pemberdayaan masyarakat* (PNPM) or national program for community empowerment, social protection (*Jamkesmas*), and etc, and indirect program, such as agricultural and industrial development, in order to shoot the root of poverty problem. In addition, provincial and district government formulated some programs, in accordance with

national policy framework. KMN, for example, is a program for poverty reduction that was proposed by West Sumatra provincial government to create opportunities (creating job and business opportunity for the poor) and empower the community, first and second national poverty reduction strategy.

### **KREDIT MIKRO NAGARI (KMN)**

Microcredit is the significant innovation in development policy during last twenty five years (Ahlin and Jiang, 2008). Main objective of microcredit is to improve access of poor borrowers to credit. It typically facilitates income generation and open up self-employment. It provides incentives for subsistence reduction and improved technology application in small scale business. Therefore, microcredit effects significantly to long run poverty reduction.

Providing and improving access of poor households to credit are weapons in poverty reduction (Meyer, 2001). Financial services, is belief, has double roles in development. On the one hand, microcredit opens up the chance to raise income and, on the other, it increases social status of the poor. It indirectly increases education of children from poor households, food security and nutrition. Providing credit for women is a strong instrument to bring women into economy and social activities (Premchander, 2003). In addition, credit facilitate poor households to health and life insurance (Zeller and Sharma, 2000).

For above reasons, West Sumatra Provincial Government launched KMN. It is carried out in two

principles. First, the program targets the small scale business that owned and managed by poor households. Second, the money, that allocated from both provincial and district/municipality budget, was transferred directly to *Nagari*. *Nagari* is given the authority to manage the money in accordance to the guidelines provided.

The credit has been disbursed to 300 *nagaris* till 2009 and will be for 800 *nagaris* till the end of 2010. Each *nagari* gets Rp. 300 millions (around 32.000 US\$). The *nagaris* have to set up their owned organization, called *Kelompok Kerja* (Pokja). *Pokja* is formed collaboratively between *Wali Nagari*, *Nagari* formal leader, and *Nagari* Council. Then, *Pokja* has shown its internal management regulation (regarding credit administration system, credit distribution and repayment system) and human resources capabilities before money transferred to its account.

## RESEARCH METHOD

To capture different biophysical characteristic, *Nagaris*, for research location, were chosen from four different biophysical setting; upland, lowland, coastal and urban areas. Then, data and information were collected, within selected *Nagaris*, in following three techniques. First is desk study. Its purpose is to learn KMN from annual report of committee for poverty reduction of provincial and district/municipality government, *Pokja Nagari* and other sources of data. Second is in-depth interview. It was carried out to get deeper information from key informants regarding KMN distribution and management. Key informants were

government officers, local leaders and *Pokja* managers, as well as some borrowers. *Third* was observation. It was done to study the characteristic of *nagari*. Collected data and information were analyzed qualitatively by using IAD framework in selecting issue and object that should be considered in the analysis.

## **NAGARI: Local Institution for Managing Kredit Mikro Nagari**

### **Return to Nagari**

The *Minangkabau* people adhere to the matrilineal lineage system (Kato, 1982). It has a unique sociopolitical system. The formation of most sociopolitical units in West Sumatra occurred as a result of interactions among families and clans. The *Mamak rumah*, representative of his extended family, along with other *mamak rumahs* within a lineage chose a leader called *Mamak Barih*. A *Datuk* was then voted among the *Mamak Barihs* within a clan. Many clans thereafter formed hamlets and many hamlets formed *Nagari*, the lowest level of political institution. *Nagari* is led by *Wali Nagari*, while *Nagari* council acts like a parliament (Naim, 1984).

This political system was relatively stable until 1983 (Dendi, 2003; Yonariza, 2006), when Indonesian central government imposed homogeneity and declared that the *Desa* should be the lowest level of government administration throughout country. Consequently in West Sumatra, *Nagari* was changed to *Desa* with the adoption of the latter's system. *Desa* was led by *Kepala Desa*, most of whom were appointed by those in the upper

political power hierarchy. Eventually, the West Sumatra provincial government launched a provincial government regulation (*Peraturan Daerah*) that pushed the *Datuks*' power from political executor to control the *Adat*, to local and traditional rule only. However, after the Indonesian military authoritarian government collapsed, decentralization was launched in 1999 and the power of administration was returned to the *Minangkabau* people. With the shift of the local power of administration from *Desa* to *Nagari*, the *Datuk* was able to reclaim their political role in the society again (Benda-Beckmann and Benda-Beckmann, 2001). The change was for

all *Nagaris* of West Sumatera except Kelurahan in municipality.

### Managing Kredit Mikro Nagari

In analyzing *nagari* institution in managing KMN, Figure 3 depicts how multilevel institutional analysis of IAD framework applied. Action arena is the frame where actors, government officers, *Nagari* leaders and borrowers, took any action within action situation. Rule-in-use, community attribute and biophysical characteristic are differ from a *Nagari* to others. Therefore, we differs our analysis from biophysical characteristic.

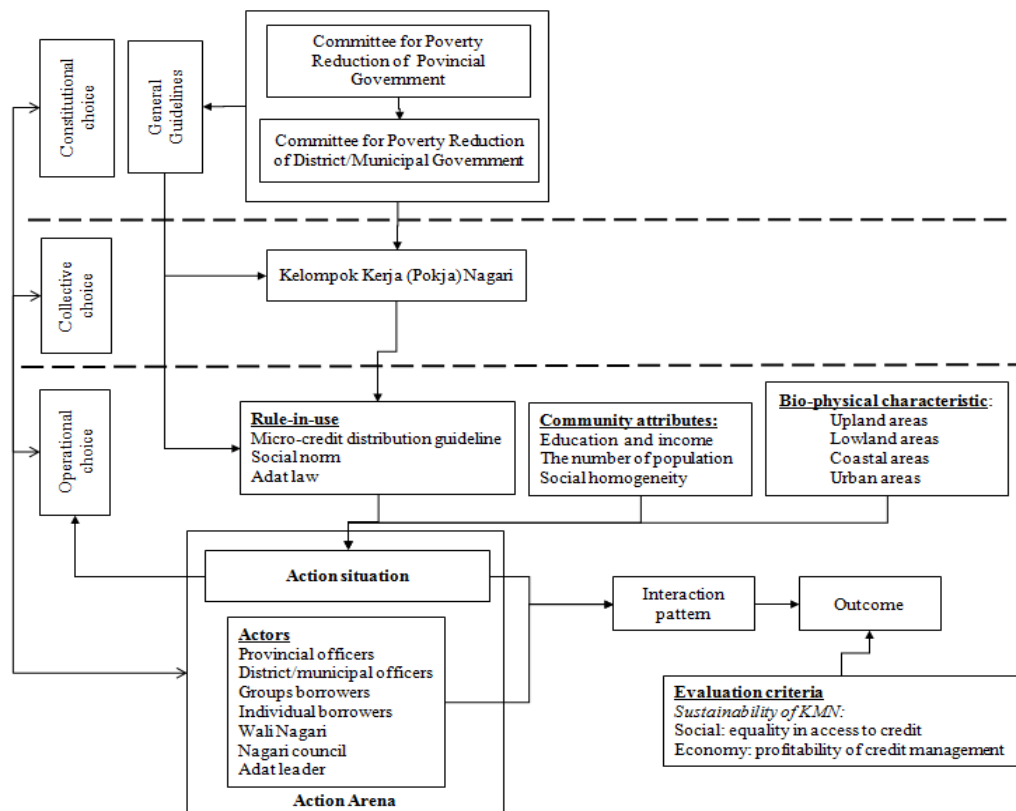


Figure 3. IAD framework for analyzing *Nagari* institution in managing Kredit Mikro Nagari

Our attention is focused on two phases. First is political process during setting up *Pokja* and formulating its internal regulation. Each leaders, both in *Nagari* Government and *Nagari* Council as well as *Adat* leaders as the main actors in this step brought up their vested interest. As the representative of their extended family, each *adat* leader brought his extended family interest, especially for *kemenakan* who extremely need external financial support for livelihood improvement. *Wali Nagari* and *Nagari* Council members used the event to save their political position by promoting their crony to fill strategic position within *Pokja*. However, they brought all within the action situation, rule-in-use, community attributes and biophysical characteristic. Each *Nagari* has different action situation that effect different outcome on sustainable microcredit management.

Second is the process distributing and managing microcredit. All actors reacted to regulation and its implementation. The main problem in microcredit management is the problem of default. As mention by (Tedeschi, 2006), there are two reason for borrowers default-strategic default or the default as the result of economic shock. In institutional analysis, attention should be paid on the strategic default, when borrowers would not like to repaid their loan due to weak of rule and/or its implementation.

### **Action Arena**

#### **Action Situation**

##### **Rule-in use**

Although general guideline, that provided by provincial and district/municipality government, is the main

sources of rules in distributing and managing the credit, different *Nagari* absolutely has different rule in use. *Nagari* in lowland areas with heterogenic society faces difficulties in formulating the internal regulation especially in establishment of *Pokja*, credit distribution and repayment system. Mostly borrowers do not fully entrusted *Pokja* in managing the credit. *Adat* rule is remaining followed, but the formal leaders of *Nagari*, that called *Wali Nagari*, is more powerful. Therefore, decision making is likely on his hand.

In contrast, *Nagaris* in upland and coastal areas has different rule-in-use from above lowlanders'. In upland areas, *adat* law is remaining strong and efficiently enacted in *nagaris*' affair, including in managing KMN. The people, especially the borrowers, entrust the personnel who in KMN management. In coastal areas, although *Wali Nagari* is powerful, appointed personnel of *Pokja* are accepted and entrusted by borrowers.

Urban dwellers, that heterogenic in income, social status and origin, follow formal rule that provided general guidelines only. *Pokja* sets up operational rules, which are likely strong influence by *Lurah*. *Lurah* is administrator that has no cultural and social root in where he/she works. Because of less control from upper administration hierarchy, *Lurah* and his staff play importance role in operational rule decision by puts his/her cronies in *Pokja*'s position.

##### **Community attributes**

The communities in upland and coastal areas are more homogeny in income, social status and origin than



communities in lowland and urban areas. This situation affects the Pokja's performance, especially in accountability. Pokjas in upland and coastal areas are likely more accountable to other stakeholders than Pokjas in urban and lowland areas.

#### Bio-physical characteristic

Study is undertaken in four different bio-physical characteristic; upland, lowland, coastal and urban areas in purpose to capture various physical that determine livelihood of credit targeted poor household. In upland areas, most micro enterprises is quite related to common pool resources (CPRs) such as forest, non timber forest product or small holding for agro-forestry as well as vegetables agriculture. Lowlanders, including the poor,

mostly work in paddy cultivation and its related business because paddy field is its surrounding biophysical characteristic of these areas. While in coastal areas, the poor depends their livelihood on fisheries and coastal resources extraction. Providing credit in coastal should follow their routine live rhythm. Urban poor dwellers mostly work in informal sector small business, such as mobile tavern (well known as *kaki lima* in Indonesian terminology) and other related business. In addition, different biophysical setting would produce different sociocultural and political situation that affect indirectly rule-in-use. Table 2 recapitulates eight *Nagaris* that represent all four biophysical characteristic.

Table 2. Studied *Nagaris* by biophysical characteristic and interaction pattern among actors

Areas/ Nagari	District/ Municipality	Rule-in-use	Area (ha)	Number of population	Social homogeneity	Main source of income	Interaction pattern	Outcome	
								Equity in access to credit	Profitability of credit
Upland									
Pandai Sikek	Tanah Datar	Adat law	23,44 km <sup>2</sup>	5.339	Homogeny	Paddy, vegetable agriculture, Songket	Adat law is remain exist and followed by mostly community members. Within this context, people could control their leaders. Establishment of Pokja was acknowledged fair and commonly accepted. So, Pokja is trusted to develop and enact the rules in KMN management. Borrowers acknowledged that the credit distribution is fair.	Good	High
Alahan Paniang	Solok	Adat law	30,5 km <sup>2</sup>	9.600	Slightly heterogenic in income	Mostly vegetable agriculture		Good	Middle
Lowland									
Muaro Paneh	Solok	Adat law, Cronyisms	33,48 km <sup>2</sup>	12,400	Slightly heterogenic in income	Paddy, small trading	Formal Nagari leaders have big influence in decision making. Establishment of Pokja was not openly done that criticized by some stakeholders. Pokja is not fully entrusted in KMN management.	Fair	Middle
Lubuk Alung	Padang Pariaman	Less power of adat leaders. Formal elected leaders are very powerful	111,63 km <sup>2</sup>	40.952	Heterogenic in income and social status	Paddy Small trading		Bad	Low
Coastal									
Sunur	Padang Pariaman	Adat rule, but Wali Nagari has huge influent to control Pokja	110,00 km <sup>2</sup>	8,000	Homogeny	Paddy, Fishing	Adat law is remain exist and followed by mostly community members. Within this context, people could control their leaders. Establishment of Pokja was acknowledged fair and commonly accepted. So, Pokja is trusted to develop and enact the rules in KMN management. Borrowers acknowledged that the credit distribution is fair.	Good	Middle
Sungai Pisang	Pesisir Selatan	Adat rule, but Wali Nagari has huge influent to control Pokja	110,00 km <sup>2</sup>	8,000	Homogeny	Mostly fishing and		Fair	Low
Urban									
Tabing Banda Gadang	Kota Padang	Formal rule only. Lurah and his staff are powerful in decision making regarding credit	30,50 km <sup>2</sup>	12,334	Heterogenic in income, social status and origin	Mostly mobile tavern (kaki lima) and warung	Due to high heterogenic, only formal regulation could be applied. However, lack of control and human resources of Pokja, the rules could not be fully implemented. Lurah, the head of Kelurahan mostly determines the management of Pokja and KMN. Some potential credit borrowers even do not know about KMN.	Bad	Low
Tanah Garam	Kota Solok	Formal rule only. Lurah and his staff are powerful in decision making regarding credit	24,36 km <sup>2</sup>	11,554	Heterogenic in income, social status and origin	Mostly mobile tavern (kaki lima) and warung		Fair	Low

### Actors

Provincial and district government officers, the presentation of their organization to regularly monitor distribution and management KMN. Due to lack of incentive, most officers do not fully meet their responsibility.

*Wali Nagari* and *Nagari Council*, are the political bodies of *Nagari* Government. They are elected for every five years. Their motive in KMN management is likely to maintain their political status, and even to scale up their position to district parliament for upcoming election.

Borrowers. They can be individual or groups. They are KMN target and considered micro entrepreneurs, who owned and managed micro enterprises. Providing credit to them would enhance their business scale. Therefore, they could increase household income, send their children to school and improve family health status. Unfortunately, most borrowers are marginalized socially and politically.

*Adat* leaders, are *Datuk* or *Mamak Barih* who sit in *Kerapatan Adat Nagari* (KAN) or adat council. They represent their respective extended family (clan). Their motive in KMN management is likely more to enhance their *kemenakan* in accessing credit. Unfortunately, they are still not strong enough to influence *Nagari's* politic because *Wali Nagari* is directly elected and authorized to represent *Nagari* to external organization especially to district government.

### Interaction pattern

Within different frame of rule-in-use, community attributes, and biophysical characteristic, actors took

different actions (Table 2). In upland and coastal areas *adat* law is remaining exist and followed by mostly community members. Within this context, people could control their leaders. Establishment of *Pokja* was acknowledged fair and commonly accepted. So, *Pokja* is trusted to develop and enact the rules in KMN management. Borrowers acknowledged that the credit distribution is fair.

In contrast, urban dwellers and lowlanders are facing different action situation that leads to different interaction pattern. In lowland, formal *Nagari* leaders have big influence in decision making. Establishment of *Pokja* was not openly done that criticized by some stakeholders. *Pokja* is not fully entrusted in KMN management. While in urban areas, due to high heterogenic, only formal regulation could be applied. However, lack of control and human resources of *Pokja*, the rules could not be fully implemented. *Lurah*, the head of *keurahan* mostly determines the management of *Pokja* and KMN. Some potential credit borrowers even do not know about KMN.

### Outcome

Although we measures two indicators to assess outcome of those above interaction pattern, equity in access to credit and profitability of credit management, till present, we can only show one indicator because the latter indicator is not yet fully calculated yet. Our field work, actually, is still going on. However, based on this measured indicator, we can see the outcome. There is likely strong correlation between social homogeneity and sustainable microcredit manage-

ment. The *nagari*, which homogeny, still follows *adat* rules, and less number of population show good and fair equity in accessing credit.

## CONCLUSION AND POLICY IMPLICATION

Above results show the importance of strong local institutions in successful managing sustainable microcredit. Political process within *Nagari* is quite dynamic and strongly affected by action situation which frame actors to make any actions. Weak institution would be taken over by strong and powerful person who would use organization to legitimize their wrong behavior.

Based on those above findings, we need to strengthen local institutions before any responsibilities are hand over to them. Local institutions strengthening could be facilitation for rules formulation, enhancement of human resources capabilities, and setting up organization administration.

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