



**CHALLENGES OF RURAL CREDIT INSTITUTION TO ACCELERATE
RURAL ECONOMY: Case of Traditional Villages in Bali Province, Indonesia**

Dr. Gede Sedana
Dwijendra University, Denpasar, Indonesia

Abstract

Presently, rural economic development has still been an integral part of national economic development in Indonesia. The basic problem of rural people is usually limited access to finance, information, technology, and capability on economic management and development. To cope this, the local government in Bali province has a specific economic program to rural people through the traditional village. This program is under the regional regulations, Number 3/2017 about Rural Credit Institution or LPDs which is aimed at increasing the economic activities of rural people. The objectives of this study are to describe the economic activities of LPDs and identify the challenges of LPDs in rural economic development. The study was done within three traditional villages which were purposively selected. Techniques of survey, observation and focus group discussion were done to collect data and information. Data analysed by using descriptive method.

The results of study pointed out that several economic activities of LPDs consist of (i) saving and deposit from the rural people; (ii) lending money or credit service to rural people; (iii) managing loan from outsiders/financial institutions to enhance the working capital; (iv) saving and making deposit the excess fund to the bank; and (v) having services for payment of of electricity, domestic water, and phone. The challenges encountered by the LPDs toward the dynamic economic development are (i) competition among LPDs and the other finance institutions; (ii) limited access to information and technology; (iii) the need of investment for the increased working capital; (iv) lack of capability of human resources; and (v) the conditions of socioeconomic of rural people. LPDs should have social and economic innovation to cope with the challenges by providing attractive incentive/bonus and motivation to rural people, and involving in the training on the technology to the management boards.

Key Words: Rural people, economic activities, management, development, loan

INTRODUCTION

One of the main issues in the developing countries is poverty which is found in the rural and urban areas. This poverty contributes to the low growth of economic development in the countries. Economic development in the developing countries has been still focused on agricultural development (Sarris, 2001; Timmer, 2002; Omorogiuwa, et al., 2014). Development of agricultural sector is seemingly identic to rural development due to the natural resources and population are mostly situated within the rural areas (Otiman, 2008; Thurlow, et.al. 2006; Diao, et al, 2006). Agricultural sector has been significantly playing a great role in the economic development of Indonesia as happening in other developing countries. Food security, however,

has been becoming a big issue for the countries since the productivity and quality of rice could not meet the demand of population growth. Also, most of the rural people who cultivate the rice farming are relatively poor and more than one billion people worldwide suffer from food insecurity. Therefore, the country should be able to increase the low productivity through the application of technology, supporting policies and access to finance for the rural people (Ayodele, et.al, 2013). The main objectives of rural economic development based on agriculture as follows: (i) to provide food; (ii) to improve the welfare of people; (iii) to provide employment; (iv) to provide the materials for industries; (v) to consume the products produced by industries; and (vi) to enhance the foreign exchange to the state (Madhusudhan, 2015; Arjun, 2013; Jayasuriya, R. T., 2003). Rural economic development is an integral part of national economic development. The economic growth in rural areas is very slow compared to the economic growth in the urban areas. Some studies found that this is caused by the limited attractive business as occurred in the city, lack of job opportunities for the people, and insufficient education and skill (Kamar, *et al*, 2014; Surchev, 2010; Eteng, F.O. 2005). Rural people are always identified as a poor due to the limited access to information, technology, finance and transportation. Economic activities in rural area have still depended on their experiences. Poverty is one of the problems in the developing countries including Indonesia. It has being a complex problem since there are many inter-related factors contributing to poverty. Therefore, government at the national, provincial and district levels has increasingly promoted rural development program to eradicate rural poverty.

The increased production growth in the country is not directly making better improvement of people welfare, but it has made unequal distribution of income of the people in the urban area and rural area as well. Rural development should be given more priority within national economic development in order to support the increased economic growth and make more equal distribution of income. In case of Indonesia, several policies which had been implemented are follows: (i) stimulating regional economy, particularly within rural area; (ii) distributing infrastructures development into the village, relating to education, healthy, sanitation, domestic water, etc.; (iii) establishing and developing financial institution in the rural areas; (iv) supporting agricultural development program; and (v) integrated development program for promoting economic activities. In term of agriculture, the improvement of productivity and income of farmers could be achieved through farmers' co-operatives establishment. These cooperatives could encourage their members to engage in the joint farming cultivation for food and cash crops, in the provision of farm inputs with the subsidized price, and making better producers' price for their farm products (Poulton, *et al*, 2006). This means that farmers could solve their problem, particularly limited access to finance for their farms.

Lacking of access to finance of rural people including farmers has brought about the difficulty in the achievement of rice productivity and income. The roots of limited access to finance at the farmer level are caused by internal factor, such as low income, asset as collateral; and external factors, i.e. lack of existence of local finance institution, lack of access to information about finance. In case of Bali province, government has financial development program at the village level, particularly in the traditional village, called *desa pakraman*. This village is the unity of customary law community in Bali Province which has one unity of tradition and manners of social interaction of Hindu community from generation to generation which has certain territory and own property and has autonomy. Local government firstly issued a Governor Decree Number 972/1984 about The Establishment of Rural Credit Institution, locally called *Lembaga Perkreditan Desa (LPD)*. This regulation had been revised three times till 2017. The new revised

one is Number 03/2017 about The Village Credit Institution. By this regulation, the people within the traditional village have opportunity to establish the finance institution. Presently, there are 1,488 units of LPDs in Bali province scattered within 9 (nine) districts. Similar to cooperative, this institution is expected to support villagers to increase their productivity and income and income distribution as well (Kumar, et. al. 2015). Farmers' cooperative has been acknowledged to provide share profits for the farmers in rural area (Sedana and Astawa, 2016). Similar to agricultural cooperatives in the village, the *LPD* might expect to have significant role in the economic development of rural areas and in the poverty alleviation (Golmohammadi, *et al*, 2013). However, it is still found that some cooperatives and other rural finance institutions could not run well to provide services for their members. One of the reasons is poor participation and perception of members to the finance institutions. The objectives of this study are to describe the economic activities development in rural area through the village credit institution; to understand the participation of rural people in the *LPDs*' activities; and to portrait the challenges of *LPDs* in the rural economy development.

METHODS

Several *LPDs* were purposively selected as objects of this study, namely *LPD* of Kedonganan in Badung district, *LPD* of Batuaji Kawan in Tabanan district, and *LPD* of Sukawati in Gianyar district. Locations of the three districts are shown in the Figure 1. The considerations of this selection are (i) the three *LPDs* have good performance in running economic activities in each village; and (ii) government in each district has economic program for the traditional village. The population of this study is all of the household heads within each *LPD*. Samples were selected by using non-proportional random sampling within the three *LPDs*. It was taken 30 samples consisted of 10 households within each *LPD*, respectively. Besides, key respondents were also interviewed to get more information about the management of *LPDs*. They are the management boards of each *LPD*, such as the head, secretary, treasurer, and the head of traditional village and his staff.

Data collected were primary and secondary data by using survey, observation and focus group discussion techniques. Questionnaire was prepared to get information and data needed in line with the objectives of this study. Aside from this, it was also used the interview guide for having qualitative data and description of *LPD* management within each *LPD* and the traditional village where the *LPDs* located. Data were fully analysed by employing descriptive method.

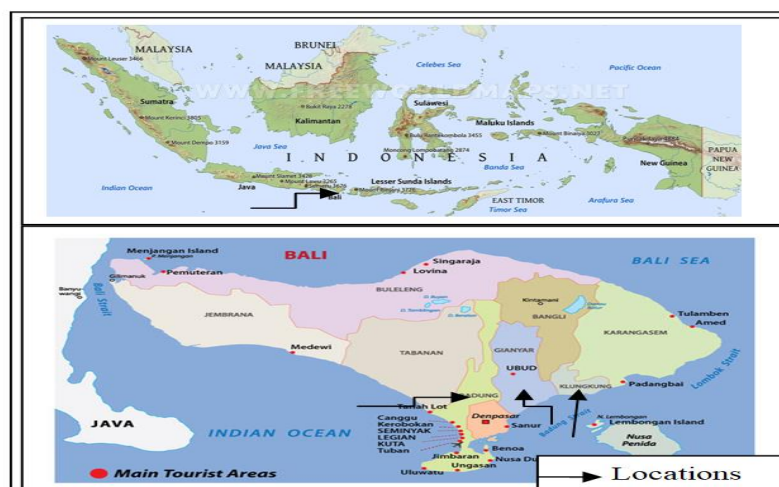


Figure 1

RESULT AND DISCUSSION

3.1 Economic activities development of *LPD*

As a part of traditional village, management of the three *LPDs* is addressed to improve the welfare of villagers within each village. In the study, the management board of traditional village take a control of *LPD*'s management, is not directly under the government. Traditional management employed is based on the customary law of each traditional village. The traditional village has autonomy in managing the activities of villagers. Based on the interview of management boards of *LPDs*, it was found that *LPDs* have several economic or business activities, which have been acknowledged and agreed by the villagers through the assembly meeting of villagers. These activities are as follows:

- (i) To collect fund from the villagers as a saving and deposit;
- (ii) To lend money in term of micro credit to villagers;
- (iii) To gain a loan from other finance institutions, such as a bank in order to enhance the working capital ;
- (iv) To save or deposit the excess funds to the finance institution; and
- (v) To establish other economic activities in order to provide services for villagers, such as payment of electricity, domestic water, phone services.

The capital of *LPDs* within the study sites is firstly from (i) the contribution of traditional village members; (ii) the grant of government or other finance institutions; and (iii) some profit. Previously, all of the members were obliged to contribute their money in the form of saving in the *LPDs*. The amount of contribution was different among the *LPDs*. The management boards and villagers had a particular meeting to discuss about the amount of contribution. Each *LPD* had defined the minimum amount of saving from the members. According to the government regulations, the profit of *LPDs* should be distributed for: (i) the reserved capital as much as 60 %; (ii) village development up to 20 %; (iii) management fee about 10 %; (iv) cost for controlling, strengthening and protection about 5 %; and (v) social activities cost in the village about 5 %. This regulation has been implemented well by the *LPDs*, and the management board of each *LPD* always reported the finance status every year.

Local government started to have initiative to motivate villagers within traditional village to establish *LPD* within each study sites, after the Governor Decree regional Number 972/1984 issued. At the beginning, government provided socialization about the *LPD* establishment and its benefits. After the villagers understood and had good commitment to establish *LPD*, the government encouraged to form *LPD* and the management board. The government further conducted extension and training to management board of *LPD* regarding some aspects, namely organization and management, accountancy, business development, leadership aside from the government policies in terms of micro and macro economy influencing the economic growth at the national level and district level and village level as well. The village members were also provided information about the existence of *LPD* and its economic activities that might support rural development and improve the villagers' welfare.

In order to create an employment at the village level as a part of poverty alleviation program, government endeavored to empower villagers and develop productive economy business. For this effort, government provides facilitation on working capital strengthening through the

government local bank. *LPDs* are fully expected to be able to support this program through its economic activities for the villagers. Besides, the government through the Regulation of Governor No 34/2006 has made policy at the provincial level regarding capital strengthening for *LPD*. This policy is addressed to support poverty reduction efforts and the expansion of employment opportunities at the village level. By this, *LPDs* supported the villagers to develop productive economic enterprises through the micro credit services. The empowerment and development of economic business could be effective in supporting the rural economic development. In other words, the government's support on strengthening working capital to *LPDs* is fully useful for the villagers of within the study sites. Government local banks at the provincial and district levels have conducted channeling of this working capital strengthening to *LPDs*. These banks provided credit to *LPDs* within each traditional village, which functioned as a micro finance institution to channel loan either to the poor or to micro and small entrepreneurs within the villages.

LPD in Bali is unlike other finance institution in Indonesia due to its specific characteristic, which is based on the traditional or customary law of the village. *LPD* has philosophy called *tri hita karana* (three causes of happiness) consisting of three elements. Firstly, it is *parhyangan* (harmonious relationship between people and God). Secondly, it is *pawongan* (harmonious relationship among the people). Another one is *palemahan* as a harmonious relationship between people and environment (Roth, and Sedana. 2015; Sedana, *et al*, 2014). This philosophy is being a main principle of Bali's culture, too. All traditional organizations of Balinese community have this philosophy since it could be a glue of the social interaction within the society. In macro theory, this constitutes as a social capital for the people, which has significant role in achieving the common objective of them (Irvani, 2010; Jordan, 2010).

Based on the study, the existence of *LPDs* is very strong in the traditional village due to the village customary law is also prevailed in the management of *LPD*. As known that the customary law of the villages where the *LPDs* located has strict sanctions for the people who break the rules of the *LPDs* and traditional village. Therefore, in the economic activities of *LPDs* and the rural people who seize the services of *LPDs* must follow the regulations or rules in each village. These regulations were also being social norm which governs behaviour of the rural people, particularly in the economic activities of *LPDs*. The management board of traditional village made a meeting with management board of *LPDs* to discuss about the mechanism of money borrowing and returning the money, rate of interest and other conditions. This decision was being a basis of the *LPDs* rule to manage the micro credit service to the members. In the three *LPDs*, there were different interest rates of credit provided to rural people because they have different consensus on defining the interest. The mechanism of micro credit looks similar among the three *LPDs*. Each traditional village has autonomy to manage the *LPD*. According to the management boards of *LPDs*, providing credit to members is addressed to support the acceleration of economic growth in the village including agricultural growth. This is being a viable means of poverty reduction as found in Africa, too (Dorosh & Mellor, 2013). The common organizational structure of *LPD* s is shown in Figure 2. Referring to Figure 2, the chairman of traditional village plays great role in the management of *LPD*. He is also being a chairman of internal control assisted by two members. *LPD* has accountant who has responsible to finance management aspect. This is very important to make accountable reports of *LPD*. Other sections also support the *LPD*'s activities, such as credit services, general affairs and collector sections.

Government and traditional village as locations of the three *LPDs*, have relatively similar missions in order to improve the welfare of rural people. These are as follows: (i) to increase the *LPD*' performances by making better growth, best services for the rural people, empowering organization and human resources; (ii) to increase competitiveness through the improvement of product innovation and increase efficiency to provide good services and competitive prices; (iii) to empower rural people economy, such as micro enterprises for the improved income of rural people; (iv) to increase the concern of *LPD* toward village social environment, especially social, cultural and religious necessities; (v) to achieve the equal distribution on employment for the rural people; and (vi) to develop small enterprises of rural people.

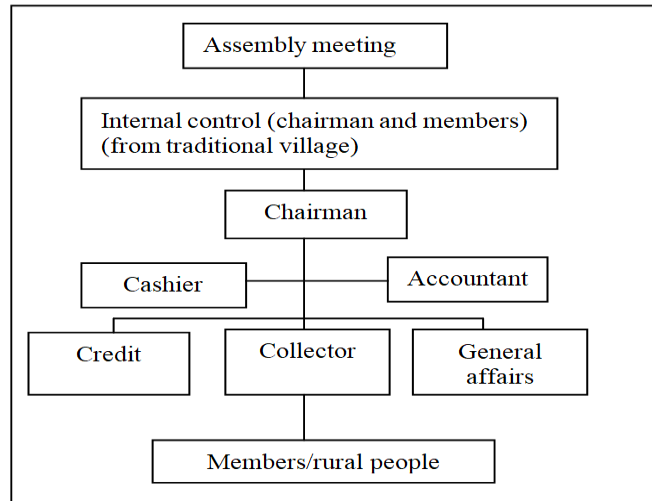


Figure 2 Organizational structure of *LPD*

Based on the interview, it was known that management of *LPDs* within the three districts had a strong social capital (trust, norms and networking) based on common social life in the village. Mutual trust among the people and among members and management board of *LPDs* and traditional village has significant influence towards the good performance of *LPDs*. Members of each *LPD* had good trust to the management board of *LPD* in running economic activities. Management board always inform the general activities of *LPD* before the members in the monthly meeting (one month equals to 35 days, based on Balinese calendar). Finance management is regarded accountable in line with the rules/regulation of *LPD* and traditional village. Every six month, traditional village invites *LPD* to present the progress report of activities through the meeting. Local government was also invited and attended the meeting. He gave direction and guidance to each *LPD* and traditional village concerning the management of *LPD*.

Aside from economic activities, the three *LPDs* were obliged to share the profits for social activities in the traditional village, such as ritual ceremony and others. The share percentage was agreed between the *LPD* and traditional village. By this profit share, the rural people gained lower burden for the social activities in the village. Aside from this, *LPDs* also had obligation to share the profits for the construction or rehabilitation of temples, community hall within the village. It means that *LPDs* give contribution to traditional village. Having *parhyangan* element, *LPDs* always supported the activities related to finance to ritual ceremonies, temples rehabilitation and construction and others. Before *LPDs* gave contribution, the rural people must

contribute a big number of money for those activities. *LPDs'* contribution is being an economic benefit of rural people.

In term of social norm, the customary law of traditional village is being a guidance and control of management board and rural people in involving the economic and non-economic activities of *LPDs*. The contents of customary law are fully based on the traditions which had been practiced since long time ago and also based on the Hindu religion. This has been well acknowledged and understood by the rural people. Therefore, they must follow the regulations since the sanctions are very strict. Concerning the management of *LPDs* within three districts, the management board ensure the rural people could support and develop the *LPDs*. In other hand, rural people also trusted to management board to run the *LPDs'* activities. High mutual trusted among the rural people as members of *LPDs* and traditional village is happened due to the strict sanction of social norms within the traditional village. In other words, social norm of traditional village which is prevailed into *LPDs* has function as social control due its strong sanction.

Networking of *LPDs* was developed to improve the performance of *LPDs*. They have good partnership with the finance institution, such government local bank and non-government bank. This partnership has made mutual benefits between the two sides. *LPDs* got additional capital from the bank, and *LPDs* deposit and save the excess fund in the bank. Relationship with the local government has also developed to enhance the capacities of human resources through the training and technical guidance/assistances relating to organization, administration, management, finance management and others.

For the rural people, they gained economic benefits from the *LPDs*. They sent proposal to get credit/loan from *LPD*. The chairman of traditional village has a role to give recommendation whether the proposal should be approved or not. The use of credit is addressed to productive economy activity, such as home industry, small shop. In particular case, *LPDs* also provided credit for social activities uses, such as schooling and ritual activities, etc. In managing credit, *LPDs* have specific requirement when the rural people must put the collateral or not. Kinds of collaterals needed by the *LPDs* are land title and vehicles ownership document. Besides, those who applied a credit must also oblige to have recommendation from the head of traditional village. The chairman of *LPD* would firstly talk with the head of traditional village after receiving the application of credit from the rural people. Based on their consideration, *LPDs* could give approval of credit application.

Concerning the *tri hita karana*, *LPDs* have shown activities in *parhyangan*, *pawongan* and *palemahan*. In term of *parhyangan*, all selected *LPDs* have contributed to rehabilitation of the temples within the villages. Besides, *LPD* also contributed to the expenditures of ritual ceremonies within the temples. In term of *pawongan*, *LPDs* could maintain the social interaction of rural people through the credit or loan service in order that they could be more productive in economic activities. Improvement of social networking was already created by *LPDs*, including with government at the provincial and district levels. *LPDs* also provided the extension to rural people about the roles of *LPDs* in rural economic development. Thus, the villagers' awareness to develop *LPDs* should be increased through the empowerment program. The environment of villages where the *LPDs* are located could be maintain by the rural people under the contribution of *LPDs*, especially in supporting the materials and equipment for keep clean of environment from the garbage.

3.2 Participation of rural people in the LPDs' Activities

Participation is one of the social capital elements which support to the achievement of organization's objectives (Khalili, et al., 2013). In term of social participation, it can be seen as a process wherein the members of community to involve on the basis of their consciousness and voluntary to share for having collective objectives. In this study, participation of rural people in the *LPD* management and activities comprised three aspects, namely planning, implementation and monitoring and evaluation. In general, the average rate of participation of rural people is high with the score 78.67 % out of maximum score with the interval of 72.33 % to 88.67 %. The distribution of samples based on their participation is shown in Table 1.

Table 1

Distribution of samples based on their participation

No	Category	Frequency (person)	Percentage (%)
1	Very high	7	23.33
2	High	21	70.00
3	Moderate	2	2.67
4	Low	0	0.00
5	Very low	0	0.00
Total		30	100

Source: Primary data

Looking at the Table 2, it is known that most of samples have high participation in the activities run by the *LPDs*. This indicates that the members of traditional village within the three sites feel satisfaction to the management of *LPDs*. This members' involvement has significant contribution to the good performance of *LPDs* in providing services to them. Similar to other development programs, the high participation of people could ensure the successful program and its sustainability (Widianingsih and Morrel, 2007). The important participation of rural people was in the monitoring and controlling process of the *LPDs*' activities, particularly the finance management. This monitoring had made the transparency of management run by the management board of *LPDs*.

3.3 Challenges and efforts of *LPDs*

The positive growth of *LPDs* had significant contribution to rural people in the aspect of economy. Rural people increased their economic activities supported by the micro credit from *LPDs*. However, the more dynamic development at the national, provincial, district levels had made higher competition among the finance institutions. They endeavoured to persuade the rural people by offering credit or loan, too. Based on the study, it was found that several challenges encountered by *LPDs* in running economic activities within the village. These are (i) strong competition among the finance institutions; (ii) access to information and technology; (iii) investment; (iv) capability of human resources; and (v) socioeconomic condition of rural people.

These challenges have interrelated in the LPDs' development for making more productive and better improvement of rural people livelihood.

The existence and development of other credit institutions in the village and the city nearby the village was being a competitor to *LPDs*. The competition was seen from the rate of interest offered by the other credit institutions (banks). They provided lower interest and sometimes gave other prizes or bonus. This situation might make rural people to gain credit from other credit institution. Apart from this, they might also save and deposit their money to those credit institutions. As a challenge, this competition should be anticipated by the *LPDs* in order that the rural people are still interested in saving and putting deposit and borrow money from *LPDs*. *LPDs* have tried to continuously improve better services for the rural people by preparing bonus and other interesting things, too. Aside from this, the rural people were intensively given motivation to keep participating in the *LPDs* due to benefits of *LPDs* would return to the people. Different to other finance institutions, the benefit and profit would go to the owners who are not from the village.

The *LPDs*' access to information and technology were more limited than the other finance institutions (private sector). This could influence the performance of *LPDs*. In the future, mastering of information and technologies should be done by *LPDs* since the dynamic development and dynamic economic in the country. Access to information, therefore, is being very important for the *LPDs* in order to have more knowledge about the financial and economic aspects. Less information might make late responses to the needs of customers, rural people. The *LPDs* have prepared to strengthen the capacities of management board relating to knowledge of economic and business development and other relevant knowledge. Improvement of management board's skills was also planned to conduct by *LPDs* by involving them to the training or workshop conducted by government and other institutions. Government at the level of province and district also intensively provide technical assistances and training to *LPDs* to anticipate the dynamic changes in the future. Training on technologies, such software, hardware and other programs have been planned by *LPDs* in order that the management board could follow the high technology uses.

Investment is one of the most important things for the *LPDs* as an economic institution. In the future, *LPDs* should have capacity to access to the finance from other sources. Presently, the main fund sources of *LPDs* are gained from the contribution of rural people and grant from the government. In anticipating the needs of customers which would be increased and more complex, the availability of more investment must be required by *LPDs*. At least, additional investment would function to develop the working capital for buying infrastructure and goods and increasing capital for micro credit service. Operational and maintenance might also increase in line with the larger scale-economic business of *LPDs*, including salary and other costs for developing *LPDs*.

Human resources in *LPDs* would be an important part for running *LPDs*' activities (economic and non-economic aspects). The management boards of *LPDs* and traditional villages (locations of *LPDs*) should be prepared to strengthen their capacities in terms of organization, management, administration, technologies, business and other relevant aspects. The abilities in developing social and economic networks are also needed to improve for making better performance of *LPDs*. Coordination between the *LPDs* and traditional village should be intensively conducted to discuss about the development and growth of *LPDs*. Trainings needed are not only from

government but also from the business institutions in order to meet the demand of people and other prospective partners relating to business development. Capability on financial matter is very important in the management of financial institution (Johnson and Sherraden, 2006).

Due to *LPDs* and traditional villages have specific organization, development and empowerment of *LPDs* must consider the existing social capital in the village, such as mutual trust, social norms and networking. These must be a main principle to strengthen the professionalism of *LPDs*. *Tri hita karana* philosophy should be more intensively grounded to the behaviour of management board and rural people as a filter of modernization and globalization.

Anticipating efforts of *LPDs* should be early prepared by the management board and traditional village's management board, too. This is addressed to maintain and develop economic functions of *LPDs*, such strengthening working capital for the rural people, thus support the acceleration of rural economic development. In term social aspect, *LPDs* should afford the rural people through their contributions to some activities in the village. Besides, the *LPDs* should also keep its function to cultural aspect of villagers, such as tradition sustainability, including support the implementation of ritual ceremonies which always need big amount of money. Therefore, the three elements of *tri hita karana* are still covered by the *LPDs* while running business development.

CONCLUSIONS

The local government at the Bali province and district have a particular program on the improved financial development for the rural people through the traditional village. Government has issued the regional regulations, Number 3/2017 about Rural Credit Institution or *LPDs* to increase the economic activities at the rural level. Economic activities of *LPDs* are based on the *tri hita karana* philosophy as a social capital within the village. These activities include: (i) saving and deposit from the rural people; (ii) lending money or credit service to rural people; (iii) managing loan from outsiders/financial institutions to enhance the working capital; (iv) saving and making deposit the excess fund to the bank; and (v) having services for payment of electricity, domestic water, and phone. *LPDs* have several challenges in the dynamic economic development in the country which might influence the performance of *LPDs*. These challenges are (i) strong competition with the other finance institutions; (ii) access to information and technology; (iii) investment for enhancing working capital; (iv) capability of human resources; and (v) socioeconomic condition of rural people. Social and economic innovation should be introduced to cope with the competition, by giving incentive/bonus and motivation to rural people. Besides, training on the technology should be done by *LPDs* to improve the capability of management boards.

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