

ANALYSIS OF THE INSTITUTIONAL CAPACITY AS A PART OF THE INSTITUTIONAL ECONOMICS: EVIDENCE FROM THE ORGANIZATIONAL CAPACITY OF SURAKARTA CITY LOCAL GOVERNMENT

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Abstract

The institutional capacity is a part of the institutional economics. There are two standards of the institutional capacity. The first standard is the optimality capacity of micro, mezzo, and macro levels. The second standard is the criteria of expertise, specificity, and incentives. However, analysis on the concept of institutional capacity is limited. Therefore, this study aimed to analyze the application of the institutional capacity in Surakarta city local government and to obtain empirical facts of the optimal capacity of micro, mezzo and macro levels and its correlation with the institutional criteria. Descriptive method was applied to measure the capacity optimization in the micro, mezzo, and macro levels and to describe its correlation with the institutional criteria, namely expertise, specificity, and incentives. To examine the level of the capacity optimization, the percentage of the expected and prevailed was analyzed, whereas the dynamics of each criterion since 2005 to 2011 was analyzed to illustrate the correlation with the institutional criteria. The study indicated the overall capacity of Surakarta city government has not been optimal, due to their suboptimal mezzo and macro levels capacity. In addition, the capacity of micro, mezzo and macro level of Surakarta government turns to have correlation with the institutional criteria. The micro level correlates with the expertise criterion, the mezzo level with the specificity in authority and incentives criteria, and the macro level with the specificity in responsiveness criteria.

Keywords: Organizational capacity, institutional economics, institution, Surakarta government.

1. Introduction

Human behaves as a response to surrounding institution. The choices and the articulated of human behavior are mostly affected by the surrounding environment. For instance, some Muslims are inconvenient with the usury of conventional bank, consequently, Islamic financial organizations emerge widely in Indonesia (Muttaqien, 2008). Schramm and Taube (2003) also figure out the relation between corruption among the government officials and the surrounding institution in China. It turns out that corruption among the officers in the traditional values institution is higher compared to those in the anti-corruption modern institution.

Various studies have conducted regarding with the issue. Wardhono (2009), for example, analyzed the institutional factors such as the land law and its relevance with the transformation of land ownership in Klompangan village, Jember. Baksh and Ahmad (2008) analyzed the relation between credit institution and sugar cane farmers. Ngumar and Budi (2003) analyzed the integrated-investment institution in East Java. Maflahah (2010) analyzed the institutional factors that are important in reducing disorder in the supply chain of taro industry. Those studies analyzed institutions and human behavior as the response to institutions around them. Meanwhile, capacity is essential for an institution as it causes various related parties to behave and respond appropriately to the institution. Anantanyu (2011) reaffirms the importance of capacity as shown by the increase of farmer living standard as the result of proper institutional capacity of agriculture.

Despite its significance, studies on institutional capacity of local government are rarely conducted. This study aimed to analyze the organizational capacity as an institution in Surakarta City Local Government. Analysis on organizational capacity would be based on the studies conducted by Sragen Local Government (*Pemerintah Daerah Sragen*) in 2011 and Riyardi *et al.* in 2013. In addition, analysis on institution consisted of examination on expertise, specificity, and incentive. It is expected that the research will encourage further study regarding with institutional capacity at local government level to enrich understanding on the institutional capacity and institutional economics.

2. Literature Review

Economic Capacity

The economic capacity can be defined theoretically and technically. The theoretical definition of the economic capacity is related to the equilibrium condition. Equilibrium condition refers to the state of economic full capacity, while non-equilibrium conditions may indicate economic under or over capacity. These various states are mainly caused by the balance of supply and demand. High supply without demand suitability would result in over-capacity and conversely, supply is less than demand will lead to under capacity.

Technically, the economic capacity is defined as the capacity utilization. It is assumed that economic capacity cannot easily utilize resources and produce goods to meet the demand. The utilization can be higher or lower than the demand. As a consequence, a lag between the actual and potential output occurs. The economic capacity describes the level of the capacity utilization in the economy.

The organizational capacity can be used as an approach to the economic capacity. It is because the organization is more easily observed than the economy. For instance, the organization of seller and buyer is more easily observed than the overall economy that includes seller and buyer. Therefore, determining the economic capacity and utilization can be approached through the organizational capacity and utilization.

Various studies have analyzed organizational capacity and utilization. The studies can be divided into three groups. The first group mainly concerns on organizational capacity and utilization by using qualitative approach, the second group on the public sector analysis using engineering approach, while the third on analyzed capacity utilization in the profit oriented sector. Figure 1 describes these groups classification.

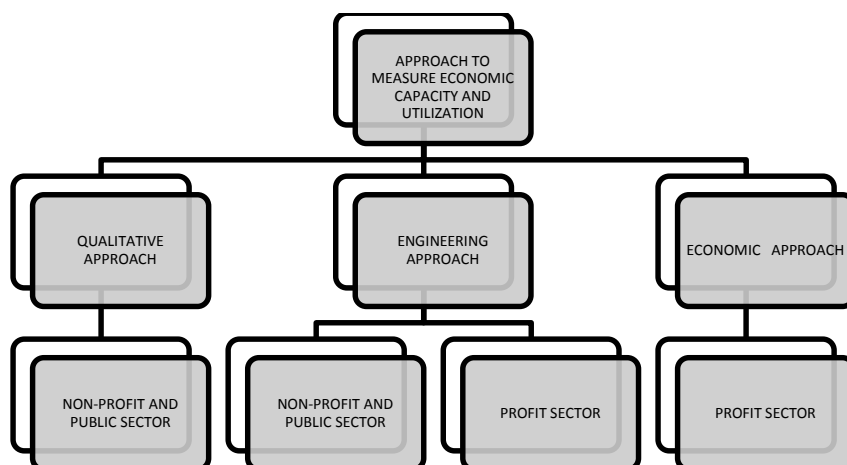


Fig. 1 Classification of Groups Studying Economic Capacity and Utilization

Sato *et al.* (2000), Plescovic *et al.* (2002) and Yuswijaya (2008) are included in the first group. Sato examined organizational capacity of projects under ODA authority in Bangladesh, Thailand and Indonesi, which were the rural electrification development project and the backward village infrastructure development project. Three criteria were used to assess organizational capacity, namely, expertise, specificity, and incentives. Those studied figured out the role of organizational capacity in increasing the project’s performance. Plescovic *et al.* (2002) who used the perception of the various groups that are considered having competence in the matter as an analysis technique argued that indigenous capacity was needed in the field of education and research in the transition economies. Yuswijaya (2008) who used perception of the employees as a technique to measure the organizational capacity analyzed that the organizational capacity of Civil Service Police Unit in Lahat municipality at individual, organization and system level is optimal.

The second group is represented by Riyardi *et al.* (2013). The engineering technique used to analyze the organizational capacity was comparing the percentage between the expected capacity and the existing capacity. It is found that the organizational capacity at all levels in Sragen municipality local government was inoptimal.

The second group includes the studies of Johanson (1968) and Berndt and Morrison (1981). Johanson (1968) is the first proponent who used engineering approach, whereas Berndt and Morrison (1981) used the economic approach. Based on their approaches, the engineering and economic approaches are developed. They are the second and third group of economic capacity and utilization approach for profit sector.

Institutional Economics

Institutional Economics discusses the relation between economic agents and institution around them. Figure 2, as stated by Hodgson (1998) shows the relation that occurs in institutional economics. As shown in Figure 1, on the right side the institution forms and send information, whereas on the bottom and right sides, it is shown that the agents will make a decision and do a behavior based on the information signed by the institution. Furthermore, as shown in the right-top side, the cyclical and dynamic adjustment happens. The behavior will be responded by the institution.

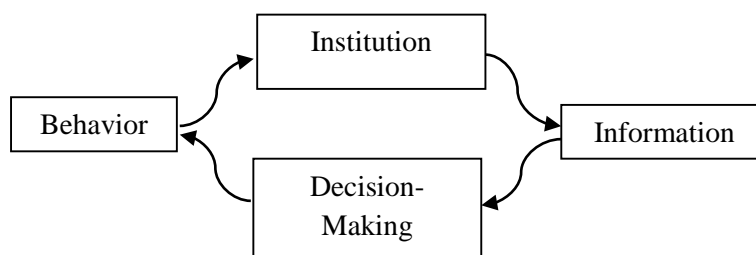


Fig. 2 Iteration in Institutional Economics

Petrović and Stefanovic (2009) explain two theories of Institutional Economics, namely, Old Institutional Economics Theory and the New Institutional Economics Theory. Old Institutional Economics assumed that the institution is not easy to be trusted by agents and the theory seeks and discusses sociological, psychological, technological and laws factors which determine un-trusted behaviors to the failed institution done by agents. The theory analyzed the reasons of a non-maximization based behavior.

Old Institutional Economics Theory is known as an opposition to the Neo-classical Economic Theory. The reason is the contradiction values. The Old Institutional Economics Theory assumed the probability of a non-maximization based behavior, whereas the Neo-classical Economic Theory assumed agents always have a profit maximization orientation.

Some exponents after exponents of Old Institutional Economics Theory tried to continue the economic concept of Old Institutional Economics Theory with an emphasis on the efforts to give an answer to the failure of the assumption of the Neo-classical Economic Theory. J. Schumpeter, G. Myrdal and K. Galbraith are among those exponents. Santosa (2008) classified their concepts into Institutional Quasi Economics that are different from the Old and New Institutional Economics.

The New Institutional Economics Theory puts more emphasis on the conceptualization of various things that accompany the relationship between institution, information, and decision-making. Various conceptualizations include the concept of transaction costs, property rights, public choice and game theory. The decision-making may or may not be based on profit maximization. The choices in the decision-making emerge because there is an information from institution. The information is analyzed and processed based on one or more concept of transaction costs, property rights, public choice and game theory.

Santosa (2008) analyzed that the conceptualization strengthened the position of Institutional Economics Theory as 'opponent' of Neo-classical Economics Theory, market economy or such. The conceptualization in Institutional Economics Theory can be divided into institutional environment and institutional arrangement. This conceptualization can lead to the understanding of the essence of holistic approach and the diversity of the economic education.

Institutional Economics considers that institution, either formal or informal, is different from organization. Institution, according to Rutherford (2001), is broader than organization. Institution includes organizations, various forms of laws and regulations, culture, technology and agents, whereas organization as mentioned by Sato et al. (2000) is groups bound by some common purpose. Institution provides strong sign for the agent behaviors.

3. Research Method

Research Design

The study was a descriptive research. There are two types of descriptive design. The first type is descriptive design to analyze the organizational capacity of Surakarta city government. The second type is descriptive design to analyze the readiness of the organization of Surakarta city government to be responded by surrounding parties.

There are four variables, namely the capacity variables of micro, mezzo, macro level and the whole level. The capacity variable of micro, mezzo and macro level has sub variables. Each sub-variable has assessment indicators. Table 1 shows the variables and the sub variables. The indicators are not shown. The data in this research were taken from the documents available. Those documents were taken from Statistics Central Bureau and various agencies in Surakarta city government.

Tab. 1 Variables and Sub-variables

VARIABLES		SUB VARIABLES
Overall	Micro	The Number of Surakarta local government civil servant
		The quality of Surakarta local government civil servant
		Civil servant job understanding and commitment
	Mezzo	Adminstration capacity

		System capacity
		Local fiscal capacity
		Local fiscal sustainability
	Macro	Public service quality
	Public service accessibility	

Data Analysis Technique

This research employed two data analysis techniques. The first technique was used to describe the organizational capacity of Surakarta city government. The second technique was used to describe the form of the institutional economics in Surakarta city government. The first technique is executed following Riyardi, *et al.* (2013) with the following steps:

1. Calculated the percentage of the target variables and sub variables using tools of statistical linear trend.
2. Calculated the percentage of optimization capacity by comparing the percentage of the performance with the target that has been computed on the entire sub variable and variable.
3. Classified the level of capacity optimization of sub variables and variables into optimal, not yet optimal and not optimal based on certain criteria.

The second technique is executed by measuring the institutional dynamics at all sub variables and variables. There are three steps in this technique:

1. Classified variables and sub variables based on characteristics as proposed by Sato et al (2000) in the form of expertise, specificity and incentive.
2. Measured the dynamics of each characteristic based on the state of dynamic. It is called dynamic if a characteristic shows an increase from year to year. It is called not dynamic if a characteristic shows a decrease from year to year.
3. Concluded that one or whole characteristics correspond to responsiveness factor of institutional characteristics. A characteristic is responsive if it meets the dynamic criteria.

4. Results and Analysis

Organizational Capacity of Surakarta City Government

Overall, the organizational capacity of Surakarta city government is not optimal. The overall average indicates that the percentage of organizational capacity is 89,90% of the ideal capacity. The overall capacity, as can be seen in Table 2, is contributed by micro level capacity (99.73%), mezzo level capacity (83.62%), and macro level capacity (86.35%). Thus, the organizational capacity of Surakarta city government is not optimal

Tab. 2 Organizational Capacity of Surakarta City Government

LEVEL	CAPACITY (%)
Micro	99.73
Mezzo	83.62
Macro	86.35
Average	89.90

Note: The capacity value is a calculation result. The raw data is not presented but available in the research report.

The organizational capacity of micro level in Surakarta city government is in optimal condition, because the average capacity of all sub-variables is 99.73%. As illustrated in Table 3, the capacity of civil servants is 95.31% of the ideal capacity, while the capacity of the quality and commitment of civil servants is 100% of the ideal capacity. Therefore, the organizational capacity of micro level in Surakarta city government is in optimal condition.

Tab. 3 Organizational Capacity of Micro Level in Surakarta City Government

MICRO LEVEL	CAPACITY (%)
Number of civil servants	95.31
Quality of civil servants	100
Commitment of civil servants	100
Average	99.73

Note: The capacity value is a calculation result. The raw data is not presented but available in the research report.

The organizational capacity of mezzo level in Surakarta city government is not optimal. As illustrated in Table 4, this condition is caused by Administration Capacity and System Capacity sub variables. The Administration Capacity is above the ideal state (120%), while the System Capacity is 60% of the ideal capacity. The Administration Capacity which is above optimal is caused by the expenditure of goods and capital that reaches 145.40% of the ideal expenditure, while the System Capacity is not optimal because there are several units and SKPDs which have operated but did not have a renstra, SOP and SPM.

Tab. 4 Organizational Capacity of Mezzo Level in Surakarta City Government

MEZZO LEVEL	CAPACITY (%)
Administration Capacity	120.65
System Capacity	60.32
Local Fiscal Capacity	97.94
Fiscal Sustainability Capacity	92.59
Average	83.62

Note: The capacity value is a calculation result. The raw data is not presented but available in the research report.

The organizational capacity of macro level in Surakarta city government is not optimal. The definition of macro level in this case is the relationship between the local government and its environment in the form of public service. The focus of public service and its capacity is the capacity of quality in giving public service and the capacity of its accessibility. Table 5 shows that in Surakarta city government, the public service quality are not in an optimal state.

Tab. 5 Organizational Capacity of Macro Level in Surakarta City Government

MACRO LEVEL	CAPACITY (%)
Capacity of Public Service Quality	72.7
Capacity of Public Service Accessibility	100
Average	86.35

Note: The capacity value is a calculation result. The raw data is not presented but available in the research report.

Institutionalism of Surakarta City Government

Surakarta city government is a responsive institution. It can be seen from the correspondence of every level of organizational capacity with expertise, specificity in responsibility and accountability and incentive characteristics. Micro level corresponds to expertise characteristic, mezzo level is in the form of sub-level administration on expenditure of goods and capital, macro level in the form of public service quality and accessibility corresponds to specificity characteristic: responsiveness, mezzo level in the form of system capacity corresponds to specificity characteristic: accountability, and mezzo level in the form of budget either from higher government or local government revenue

corresponds to incentives characteristic. Table 6 shows the correspondence between levels and sub-levels of organizational capacity and institutional characteristics.

Tab. 6 Correspondence Between Levels/Sub-levels of Organizational Capacity and Institutional characteristics

Level	Sub-Level	Institutional Characteristics
Micro level	Number of civil servants	<i>Expertise</i>
	Quality of civil servants	
	Commitment of civil servants	
Mezzo level	Administration of good and capital expenditure	<i>Specificity: Responsiveness</i>
	System capacity	<i>Specificity: Authority</i>
	Local government expenditure	<i>Incentives</i>
	Sustainability of local government expenditure	<i>Incentives</i>
Macro level	Quality of public service	<i>Specificity: Responsiveness</i>
	Public service accessibility	

Note: The institutional characteristics are based on the data provided in Table 7, 8, and 9

Micro level of Surakarta city government has an institutional characteristic, namely expertise because the three components of micro level had an increasing dynamics from 2006 to 2011. The three components of the micro level of Surakarta city government are the number of civil servants, the quality of civil servants and the commitment of civil servants. Table 7 describes the micro level of Surakarta city government and its dynamics.

The number of civil servants in Surakarta city government has decreased since 2009. The decrease in 2011 was higher than the decrease in 2009 and 2010. The number of civil servants in 2011 decreased by around 4% from the previous year, while the number of civil servants in 2010 and 2009 decreased by under 1, 5%. The decrease in the number of civil servants corresponds to a hope that civil servants should focus more on a term "poor in structure but rich in function" as stated by Pujiyono (2006) or Yustiono (2008).

Tab. 7 Micro Level Dynamics of Surakarta City Government

Years	Number of Civil Servants Based on Formal Education Level						Violation Settlement
	Total	<Junior high	Senior high	Senior high <civil servants<S1	Bachelor degree (S1)	Master degree (S2)	
2006	9182	519	1982	2173	3693	382	No data
2007	9642	468	1856	2092	3734	424	20
2008	10335	532	1537	1810	4080	512	11
2009	10397	602	2173	1992	5060	567	14
2010	10242	603	2004	1799	5213	655	19
2011	10156	591	1929	1781	5162	693	16
2012	9751	598	1911	1761	5181	674	12

Source: Regional Employment Board of Surakarta (*Badan Kepegawaian Daerah Kota Surakarta*)

The quality of Surakarta city government civil servants, using an approach to formal education background, also shows expertise characteristic. Table 7 shows two education levels of the civil servants which become the indicators of expertise characteristic. The first indication is an increase in the number of civil servants with formal higher education. Since 2009, the number of civil servants

with lower than bachelor degree education background (D3 diploma degree, D2 diploma degree, D1 diploma degree, high school degree, junior high school and elementary school degrees) decreased, while the number of civil servants with bachelor (S1) and master (S2) degree increased. The number of civil servants with S1 degree has decreased since 2009, but since 2006 the number of civil servants with S1 degree increased. The second indication is the domination in number of civil servants with higher education over civil servants with primary and secondary education. For example, in 2012, the number of civil servants with S1 and S2 degree reached approximately 60% of the total civil servants in Surakarta.

In addition, the commitment of Surakarta city government civil servants, using an approach to violation settlement, also shows expertise characteristic. General violations, not extra ordinary violations like corruption and terrorism, which could be solved have decreased since 2010. It shows that there were less violations committed by the civil servants. On the contrary, it shows that the civil servants have a great commitment to their job.

Mezzo level of Surakarta city government organization also demonstrates it as an institution because the mezzo level describes the system, administration, local fiscal and local fiscal sustainability which have similarity with institutional criteria, i.e. specificity and incentives. Table 8 shows the dynamics of mezzo level of Surakarta city government.

Tab. 8 Dynamics of Mezzo Level in Surakarta City Government: System and Administration

Years	Number of SKPD/Work Units in SKPD that have				Expenditure (IDR)	
	Renstra	SOP	SPM	Tupoksi	Goods and Services	Capital
2005	29	29	29	29	356646628715.00	297254826480.00
2006	29	29	29	29	470560732279.00	418266800630.00
2007	32	32	32	29	656247692000.00	311365824000.00
2008	26	26	26	32	854690395842.00	380975125502.00
2009	34	34	34	32	747265470803.00	190399019196.00
2010	36	36	36	32	110249182000.00	138197639000.00
2011	31	31	31	32	170669342000.00	142402558000.00
2012	32	32	32	32	235244723000.00	196087207000.00

Note: (1) Source: Surakarta City Agency of Development Planning and Surakarta Statistics, (2) Renstra is strategic planning, SOP is standard Operating and Procedure, SPM is Minimum Service Standard and Tupoksi is job description.

Mezzo level in the form of system can be measured from local government of work unit called SKPD (Satuan Kerja Perangkat Daerah) in Surakarta city government that already have a strategic planning called Renstra (Rencana Strategis), SOP (Standard Operating and Procedure), Minimum Service Standard called Standard Pelayanan Minimal (SPM) and job description called Tupoksi (Tugas Pokok dan Fungsi). Since 2012, all SKPDs Units have already had Renstra and Tupoksi. It shows that Surakarta city government has institutional characteristics, namely specificity in authority.

Mezzo level in the form of administration is analyzed using expenditure of goods and services approach. It is undertaken to describe administration that leads to public service because the expenditure of goods, services and capital produce goods, services and capital that are used to serve public. Since 2010, as shown in Table 8 the expenditure of goods, services and capital has increased. It shows that Surakarta city government has institutional characteristic, namely specificity in responsiveness.

Mezzo level of Surakarta city government in the form of fiscal and its sustainability, as described in Table 9 and 10, meets the institutional criteria, namely incentives. The local government own source revenue, PAD and the general allocation fund, DAU have always increased since 2006. Both are

incentives because they are used for Surakarta city government expenditure. The greater the revenue and fund, the greater the government expenditure.

Tab. 9 Dynamics of Mezzo Level in Surakarta City Government: Fiscal Sustainability 1

Years	Local Government Fiscal				
	PAD	DAU	DAK	DBH	Regional Loan
2005	66086575400	218045000000	5500000000	63197827116	1400000000
2006	78637865549	334287000000	16470000000	38242000000	0
2007	89430977982	374500999992	25900400000	50878370323	7500000000
2008	102909501970	420911721000	31007000000	61481691439	72402000000
2009	101972318682	435470810000	38765000000	74088717915	32913000000
2010	113946007542	499448133000	29118400000	74490132000	50000000
2011	181096816152	473888738000	34895100000	62541000000	0
2012	231672100429	681813458000	28972180000	44479389343	32441000000

Note: (1) Source: Surakarta Statistics, (2) PAD (Pendapatan Asli Daerah) is the local government own source revenue, DAU (Dana Alokasi Umum) is a general fund allocated by central government for Surakarta city, DAK (Dana Alokasi Khusus) is a special fund allocation by central government for Surakarta City, DBH (Dana Bagi Hasil) is revenue sharing fund between central government and Surakarta city government.

The special allocation fund, DAK, fluctuated since 2010, while the revenue sharing Fund, DBH, and regional loan fluctuated since 2006. Even in 2006 and 2011 there was not a regional loan. Fluctuations of DAK, DBH and regional loan happens because they are allocated by central government based on the Surakarta specialty and the financing requirement. The amount however, still indicates that they are incentives.

Fiscal sustainability of Surakarta city local government ensure that the Surakarta local government fiscal is an incentive. The total revenue from PAD until local loan always increases year to year since 2005. At the same time the the Gross Regional Domestic Product (GRDP) on the basis of 2000 constant prices also continued to increase. It means that Surakarta city government fiscal causes economic increasing. However, since 2009 the domestic investment (PMDN) were less interested in fiscal incentives, so that their investment decreased.

Tab. 10 Dynamics of Mezzo Level in Surakarta City Government: Fiscal Sustainability 2

Local Government Fiscal Sustainability			
YEARS	REVENUE	GRDP AHK 2000	PMDN
2005	354229402516	3858171660000	No data
2006	467636865549	4067529940000	334434075840
2007	548210748297	4304287370000	532768516315
2008	688711914409	4549342950000	2266289750055
2009	683209846597	4817877630000	1145481636317
2010	717052672542	5103886250000	966065372477
2011	752421654152	5411912310000	Not yet available
2012	1019378127772	5742409960000	Not yet available

Note: (1) Source: Statistics Surakarta, GRDP is Gross Regional Domestic Product, AHK (Atas dasar Harga Konstan) is at constant price and PMDN (Penanaman Modal Dalam Negeri) is the Domestic Investment.

Macro level of Surakarta city government also corresponds to institutional criteria, namely specificity in responsiveness. It is because the macro level of Surakarta city government in the form of public service accessibility has been prepared two forms. The first form is the number of SKPD established. Since 2006, there were 33 units. The second form is the service provided that consists of education, health, civil administration, local business licensing and permission to use local government asset servicing. All of them show that the macro level has an institutional criterion, namely specificity in responsiveness.

5. Conclusion and Recommendation

The institutional capacity is a part of the Institutional Economics that focus on the importance of the institution. The institutional capacity can be approached by two standards, namely, the optimal organizational capacity and the institutional criteria. The institutional capacity encourages the institution to provide a good sign to all of the economic agents so that the agents can behave appropriately.

There are three levels of organizational capacity, namely micro, mezzo, and macro levels. The institution criteria capacity consists of expertise, specificity in authority and responsiveness, and incentives. Optimal organizational capacity which fulfills the institutional criteria indicates the institution has a good performance. Overallly, the organizational capacity of Surakarta city local government was inoptimal, yet it occupied various institutional criteria. The micro level fulfilled the expertise criterion, the mezzo level filled up the specificity in authority and incentives criteria, and the macro level met the specificity in responsiveness criterion.

Surakarta government should improve the capacity of mezzo and macro levels to optimize its capacity. In addition, strong incentives should be provided as one of the institutional criteria. The improvement is expected to increase not only the aggregate production but also the domestic investment.

The limitation of this research is laid on the using of the organizational level to analyze the institutional criteria and the well-responded institution. The organization level comprehends the organizational capacity but only focuses on the internal orientation. To be closer to the institution criteria and well-responded institution, it needs more comprehensive approach so that the organization is described as focusing on the internal and external orientation. If described comprehensively, then the organization is easy to be analyzed based on the institution criteria and the well-responded institution. Even, the support to the poor people can be analyzed. It is suggested for the future research to use the public sector balanced scorecard approach. The approach can bridge the organizational level to the institution criteria and the well-responded institution. Even, the customer and citizen perspective as one of the perspectives of balanced scorecard can be used to analyze the public sector as a pro-poor institution.

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