Legal Strengthening of Village Credit Institutions to Drive Bali's Economy through Tri Hita Karana

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Abstract. This study aims to analyze the institutional strengthening system of Village Credit Institution (*Lembaga Perkreditan Desa*-LPD) based on the philosophical values of *Tri Hita Karana*. One of the findings in this article is that the LPD service mechanism in Bali Province, which is based on the local wisdom of Tri Hita Karana, has become a key indicator in spurring economic growth. The method used in this study is normative legal research using primary, secondary, and tertiary legal materials. This study aims to address the normative gap in the position of LPDs as legal subjects. A clear legal position will lead to legal discovery. The legal position of LPDs is examined using the legal construction reasoning method to strengthen the position of LPDs as institutions under traditional villages, by utilizing primary legal sources. The expected output is that an understanding of this legal construction can serve as a reference for traditional actors and law enforcement, enabling them to formulate solutions to the normative gap that defines LPDs as legal entities within the legal framework but operates like other financial institutions; and unclear LPD supervision, which results in various problems and even cases of corruption. For the government, the legal findings from this research are expected to facilitate the preparation of regulations related to authority, supervision, and applicable laws and regulations.
Keywords: Bali; Legal Construction; Strengthenin; *Tri Hita Karana*; Village Credit Institution.

1 INTRODUCTION

The existence of LPD (Village Credit Institutions) in traditional village communities has experienced rapid development, but unfortunately this has also been accompanied by allegations of increasing legal violations due to weak authority and supervision [1]. In addition to weak supervision, other factors suspected to be the cause include the lack of knowledge of LPD members in reading balance sheets, the lack of clarity or absence of a legal basis underlying their formation, the lack of knowledge of law enforcement officers in distinguishing customary law from national law, and the minimal active role of customary officials in resolving cases involving LPDs.

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Bali is known as an island rich in culture and local wisdom. Balinese culture is not merely tradition, but also serves as the foundation for various aspects of life, including social and economic activities. One of the local wisdom values that deeply rooted in Balinese life is the philosophy of *Tri Hita Karana* [2]. This concept emphasizes the importance of maintaining harmony with God (*parahyangan*), fellow humans (*pawongan*), and the environment (*palemahan*). These three elements are believed to be the source of happiness and well-being.

The implementation of *Tri Hita Karana* values is reflected in the traditional village governance system in Bali, which regulates community life through customary regulations (*awig-awig*). These regulations are then further elaborated into regulations to govern more specific aspects of life, including the management of the traditional village financial institution, the Village Credit Institution (LPD). The LPD is a unique entity located in the traditional village, with villagers as members called *krama desa*. The existence and operationalization of LPDs are based on customary regulations which form the basis of village governance.

Bali Governor Regulation No. 44 of 2017, stipulates that LPDs are required to manage four main types of risk: loan risk, liquidity risk, operational risk, and capital risk. One approach that can be used is Enterprise Risk Management (ERM) based on the COSO 2013 framework, which consists of five main components: governance, strategy, performance management, reporting, and monitoring [3]. This integrated risk management system supports sustainability-oriented and accountability-oriented governance.

The existence of LPDs as financial institutions is regulated in Bali Provincial Regulation No. 03 of 2017, which, in Article 1, point 9, states: "Village Credit Institutions, hereinafter referred to as LPDs, are financial institutions owned by Traditional Villages and domiciled within the jurisdiction of Traditional Villages. "The background to this regulation is to see the rapid development of financial institutions, necessitating the need to accommodate LPDs as village-owned financial institutions so they can make economic, social, and cultural contributions to Traditional Village Communities and improve their governance as Traditional Village-owned financial institutions. To date, the most obvious difference between banking financial institutions and LPDs (LKBB) is that banking financial institutions are supervised by the Financial Services Authority (OJK) in accordance with statutory regulations, while LPDs cannot yet be said to have a robust supervisory system.

Regional Regulation No. 3 of 2017 concerning Village Credit Institutions is needed to clarify the position of LPDs (Village Credit Institutions) as village-owned institutions, as stipulated in Article 3 [4]: "LPDs carry out operational business activities within the village environment and for the village community." This article states that LPDs can engage in financial institution activities aimed at helping village communities. However, the legitimacy of LPDs to carry out these activities is almost non-existent because LPDs, as defined in Regional Regulation No. 3 of 2017, are not mentioned in other laws and regulations. There needs to be a master regulation that states that LPDs are LKBBs and regulates who supervises them and the scope of their activities.

This regulation can be seen as an attempt to bring LPDs into the realm of Balinese customary law, as evidenced by the formation, membership, and supervisory board drawn from the village community. However, problems that have emerged recently are precisely because customary law is dynamic, does not need to be written down, is believed to fulfill the sense of justice of indigenous communities, and has a strong pragmatic value of truth. This has led some LPD members, and perhaps even village officials and officials, to trivialize the various problems that arise within the LPD, which are actually related to property and crime. The purpose of this study is to understand the current Criminal and Civil Law in traditional villages, which lack a strong foundation for resolving or implementing appropriate sanctions for various violations that arise within the LPD.

2 Methods

The type of research used in this study is Normative Legal Research, namely research conducted on legal norms themselves [5]. This study analyzes the existence of ambiguities or gaps in legal norms within laws and regulations. The methods used in this study include a legislative approach, a comparative approach, an analytical approach, and legal concepts [6]. The legislative approach is used to broadly understand the regulatory basis for LPDs and legal concepts derived from theories, principles, and thinking to find the best solution in this study. Meanwhile, the comparative method is used to compare the regulatory concept of Financial Institutions in national law with the regulatory concept of village-owned Financial Institutions, namely LPDs. The legal sources used here are primary legal sources such as laws and regulations, and secondary legal sources such as books, literature, theses, dissertations, journals, and others.

3 Results and discussion

3.1 Regional Regulations as the Legal Basis for LPDs

Over time, many parties continue to debate the legal status of LPDs as financial institutions owned by traditional villages. This is suspected to be the root of various problems, such as:

1) The legal status of LPDs remains unclear because it is not explicitly explained in legislation;
2) Various cases of misappropriation of funds have emerged, for which the law has not provided adequate solutions for the victims (customers);
3) The weakness of the organizational structure, particularly regarding the designated supervisory and auditing institutions, is due to the lack of a clear legal basis for their formation.

This problem arises because the implementation of the law is considered hasty, solely for the sake of law enforcement. If violations occur, action must be taken to ensure legal certainty, but not based on justice for the community. To further examine the legal structure of LPDs and provide recommendations for possible solutions, the author uses legal systems theory [1], which describes a consistent correlation between: 1. Legal structure; 2. Legal substance; and 3. Legal culture. Regarding legal structure, Friedman explains: "First of all, a legal system has a legal structure consisting of elements such as the number and size of courts; their jurisdiction... Structure also refers to how the legislature is organized... what procedures the police follow, and so on. Structure, in a sense, is a kind of cross-section of the legal system... a kind of still photograph, with pauses in the action."

LPDs are sui generis financial institutions. Sui generis means special, something that is very unique, unique in its kind, or very different from other institutions in its environment [7]. As institutions established specifically for the welfare of traditional village communities, LPDs only serve those in traditional villages. They do not serve communities outside the traditional villages where they operate. Therefore, LPDs are considered special financial institutions. The uniqueness of LPDs lies not only in the type of activities they carry out, but also in their nature and method of formation. This differs from other legal entities because LPDs are established solely to improve the welfare of the traditional villages in which they are located [8].

The formation of LPDs is regulated by Regional Regulation Number 5 of Law Number 3 of 2017 [9], which requires the creation of regional regulations, a socio-economic study of village potential, and a recommendation from the Regent/Mayor, which will then be ratified by the Governor of Bali Province. Compared to the requirements for establishing other legal entities, LPDs are not considered legal entities because they do not have a deed of establishment.

However, legal entities are not only assessed based on their requirements and formation process. A legal entity can be considered and recognized as such if it meets the following requirements: it has received legal recognition and approval, is recognized as a legal subject by the community, possesses assets, has a specific purpose, and has a will through its organs or bodies. This legal recognition and approval arise from the Governor's Decree on the establishment of the LPD. This is because the Governor's Decree itself is a product of the government/authority, containing policies that can regulate the lives of various elements of society and provide recognition for what the policy aims to regulate. Meanwhile, other elements, such as specific objectives, intent, sources of assets, and organs, are regulated in Regional Regulation Number 3 of 2017.

From a constitutional perspective, the existence of LPDs has a strong constitutional foundation, both before and after the amendments to the 1945 Constitution [10], which coincides with the recognition and respect for the existence of indigenous legal communities. The difference is that while previously this recognition was granted implicitly by the Constitution, after the amendments to the 1945 Constitution [11], this recognition and respect were granted explicitly.Because the existence of LPDs stems from the state's recognition and respect for the unity of customary law communities, it is only right that the LKM Law excludes the LKM Law from its application to LPDs. Article 39 paragraph (3) of the LKM Law cannot be interpreted other than as expressly stated in its formulation. Every legal expert knows that the first rule in interpreting laws is that "clear provisions may not be interpreted." Legal interpretation is one way of discovering the law (rechtsvinding) [11].

3.2 The *Tri Hita Karana* Concept in Improving LPD Internal Control

Village Credit Institutions (LPD) are legal entities owned by customary villages, which have unique characteristics ranging from their formation and recognition to their activities. The existence of LPDs as regional financial institutions is not explicitly defined in national legislation. LPDs are only mentioned in Article 39 (3) of Law Number 1 of 2013 [12], which states: "Village Credit Institutions and Village Granaries, as well as similar institutions that existed before this Law came into effect, are recognized under customary law and are not subject to this Law." This article explains that the Microfinance Institutions Law does not have the authority to regulate financial institutions that existed before this regulation was enacted because it is not retroactive. Therefore, this regulation can only recognize pre-existing financial institutions.

The Tri Hita Karana concept is a Balinese Hindu cultural and religious concept that aligns with the Triple Bottom Line Accounting concept [13], which prioritizes not only profit but also people and the planet. Tri Hita Karana is embodied in parahyangan, a sacred place that serves as a means of building relationships between humans and God, pawongan, the relationship between humans and humans, and palemahan, the relationship between humans and nature and other living creatures.

Parahyangan (Relationship with God): Management focuses on instilling noble values by cultivating prayer before activities and performing tirta yatraguna (prayers) to strengthen relationships with God, thereby fostering social capital within each LPD employee. The values of honesty and kindness are expected to increase employee commitment, or satyakaryawan (employee loyalty), to the progress of the LPD. This fosters a sense of sincerity and devotion in carrying out their duties as LPD managers. Therefore, instilling values through spiritual concepts is expected to reduce fraudulent practices or embezzlement by LPD employees [14].

Pawongan (Relationship with Others): In implementing internal controls, the LPD always considers the impact on the village community. This is due to its inherent compassion and concern for the community. The concept of karma phala also underpins LPD management's efforts to serve the community. Consistent and wholehearted service improves economic standards by providing loan interest relief for communities in need of micro-enterprise funding and school scholarships. Panureksa's oversight also adheres to the principle of human relations, ensuring that the entire LPD management process is directed towards the traditional village community. Any issues encountered during the process are handled by LPD management and customers (village residents).

The Palemahan concept is implemented by maintaining environmental sustainability through the implementation of a decision support system aligned with green accounting technology [15]. In this regard, the Bualu Traditional Village LPD has adopted digital technology and systems. Reports based on this system serve as supporting documents for every decision made. Furthermore, the profit allocation concept stipulated in Governor Regulation Number 44 of 2017 requires 20% of funds for the village and 5% for social funds. This can be used as an indicator of internal control over LPD accountability for the progress and welfare of traditional villages.

4 Conclusion

The Regional Development Institution (LPD) functions as a legally recognized entity that mobilizes community funds to enhance the economic welfare of traditional villages in Bali. Its legitimacy is rooted in constitutional provisions and Bali's provincial regulations, while also being grounded in enduring cultural and customary practices protected by the state. Findings show that each traditional village (pakraman) retains autonomy in regulating and managing its LPD, provided these do not contradict state law. The study highlights that applying the Enterprise Risk Management framework within LPDs enriches the discourse on risk governance by integrating local values of Tri Hita Karana, thereby ensuring that customary-based financial institutions remain culturally sensitive and sustainable. The key insight is that provincial regulations play more of a legitimizing and affirming role rather than prescribing operational details, leaving governance largely within the customary legal framework of each village. Future research should further investigate how risk governance models can be adapted to diverse local cultural contexts, assess the long-term resilience of LPDs within evolving financial landscapes, and explore strategies for balancing local autonomy with broader state regulatory frameworks.

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