LEGAL FRAMEWORK ANALYSIS

within the ICA-EU Partnership

National Report - Republic of Indonesia

ICA - Asia and Pacific (ICA-AP) is the voice of cooperative enterprises in the region, representing 107 member organizations from 34 countries (as on Sept 2019) across a variety of sectors. ICA-AP, as a regional office of the ICA, is also a co-signatory of a Framework Partnership Agreement signed between the International Cooperative Alliance and the European Commission in March 2016, which aims at strengthening the cooperative movement and its capacity to promote international development. This agreement underpins the 'Cooperatives in Development' program and includes knowledge building activities at the global (harmonized) and regional (decentralized) level.

The activities planned within the framework of the program include diverse research activities conducted at the global and regional level. The primary activities undertaken at the global level include a Legal Framework Analysis (A2.2), which is led in a coordinated way by all ICA offices. Within this framework, ICA-AP oversees implementing the research in the Asia and Pacific region.

The study on legal frameworks under the Legal Framework Analysis (A2.2) will evaluate jurisdictions and policy regulations according to their enablement of cooperative development. The document will present recommendations for the next steps in renewing the legal frameworks and helping to shape the policy agendas in a targeted way in the different regions and countries. It will evaluate the cooperative legal framework in place with common indicators, delivering on a scale of how 'cooperative-friendly' the legislation in a country is. In the same context, this report deals with the Legal Framework Analysis of Indonesia.

I. INTRODUCTION

Cooperative legislation is crucial and acts as a strategic function to create a conducive environment for cooperative development. The actual cooperative law in force influences the way cooperative members and communities behave, instigates formation of different types of cooperatives, but most importantly instils a paradigm as to how the society views cooperatives as an entity.

This Legal Framework Analysis is led by Mr. Untung Tri Basuki, a legal expert on cooperatives, and assisted by Messrs. Suroto and Ilham Nasai, with data and input from relevant sources. The focus of this analysis is on the legal basis of cooperatives in particular, and also in conjunction with other sectors associated with cooperatives.

The purpose of this Report is as follows:

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- To give a general knowledge about the National Co-operative Law, and in particular to show its content and characteristics in order to show the distinct difference between the Co-operative Identity and other types of businesses, especially those profit-making investor-driven firms.
- To analyse the extent to which the regulatory products are supportive or disruptive to co-operative development
- To recommend ways how the regulatory framework could be renewed and changed so it will be more conducive and friendlier to co-operatives, especially in appreciation of its true identity.

II: Outline of the national cooperative legislation

i. NATIONAL CO-OPERATIVE LAW: Sources and General Features

Ever since the amendment of the Constitution of 1945 - first in the 2000 and then the fourth and last one in the year 2002 - the Peoples' Congress of Indonesia deleted the special description of a cooperative in the Constitution.

The annotation of Article 33 in the original Constitution which stated "The appropriate enterprise (for mutual cooperation) is a Co-operative" was abolished, hence opening the door for a host of other interpretations.

Yet the 'weight of it's content' remains the same as regulated in Chapter XIV of the National Economy and Social Welfare, Article 33 Para 1-5. The Phrase 'weight of its content' means that the original Article 33 Para 1-3, was not changed at all, so the annotation could still be actively validated, because a new explanatory paragraph was added which highlighted that working of the economic system must be strictly regulated based on economic democracy. The explanation, which is not implicitly embodied in the main construction of the Constitution, resulted in a host of interpretations when it comes to the derivative laws and legal products, causing many deviations along with poor substances. This was highly apparent when Co-operative Law no 17/2012 was promulgated, but which was ultimately cancelled in its entirety by the Constitutional Court following a Judicial Review. Co-operative Law no. 25/1992 has been reinstated while awaiting the new Draft Co-operative Law that is still being discussed in parliament as this paper is being written.

The first Government Regulation which specifically regulated the cooperatives is called "Verordening Op de Cooperatieve Vereenegingen" no. 431 in the year 1915. It was followed by the Regulation on the Co-operative Association Bumi Putera (Regeling Inlandsche Cooperatieve Vereenegingen) no. 91 in the year 1927. In 1933, the Dutch Colonial government issued another regulation for cooperative associations called the "Algemene Regeling op de Cooperatieve Verenigingen" no. 21/1933, which essentially regulates those people who adhered to the Staatsblad legal system of the Netherlands. With the issuance of the latter the Dutch Indies instituted two regulations, and the one of 1927 will apply only to Pribumi (Native) Indonesians.

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During the Japanese occupation when their troops landed in March 1942, there was a change of government. The Co-operative Law no. 91/1927 for native Indonesians (pribumi) continued to be in force, for so long as it did not contravene regulations of the Military Government of Japan.

In addition, the colonial government of Japan issued Law no. 23/1942, which regulated how organizations and assemblies ought to be established, including the establishment of a cooperative organization that had to gain permission from the Shuchokan (Regent).

The proclamation of Indonesian independence on 17th August 1945 marked the end of the Dutch and the Japanese government occupation, and celebrated the beginning of the government of the Republic of Indonesia. In 1949, the Co-operative Law no. 179/1949 was officially enacted by the Indonesian government, but the substance remained the same as in Law no. 91/1927 under the Dutch colony. Aware that this law was not suitable under the independence climate, cooperative leaders pursued legal changes since 1950 and Coop Law no. 179/1949 as well as regulations no. 21/1933 were eventually withdrawn and replaced with Co-operative Law no. 79 in the year 1958. This law was enacted during the liberal government when the role of communities was very active and the guidance of the government was very conducive for reigning peoples' economy, a clear translation of the Temporary Constitution, especially Article 38 which resonated Article 33 of the 1945 Constitution.

A Presidential Decree was issued on July 5, 1959, which commanded the return to the 1945 Constitution following which a Government Regulation no. 60 in the year 1959 was enacted to bring co-operative law no 79/1958 in conformity with the new government's direction of Guided Democracy and Guided Economy. This new regulation erased the autonomy of cooperatives and instead top-down government initiatives were imposed on cooperatives, so much so that cooperatives became political toolsof the government. Government Regulation no. 60/1959 was subsequently changed with a new Law no 14 on Co-operatives in the year 1965, but contents of the latter were basically the same because it had to abide by the Political Manifesto (known as MANIPOL) of the Republic of Indonesia of 17 August 1959. The Manipol was geared towards the NASAKOM, i.e. Nationalism, Communism, Religiosity, and the cooperative fundamentals were a part and parcel aligned to the revolutionary doctrine. In 1965 the position of the Communist Party was very strong and Co-operative Law no. 14/1965 was heavily influenced by the creed of Communism.
This law lasted only less than two months when the abortive coup of G-30-S by the Communist Party occurred on 30 September, and the New Order emerged as a result.

With the change of government in 1965, there was a two-year legal vacuum for cooperatives. It was only in 1967 when Co-operative Law no. 12/1967 was enacted. This new Law came about because of the politically-motivated Co-op Law no. 14/1965 which was administratively imposed from the top-down. The new Co-op Law no. 12/1967 was more member-driven and enacted upon the implementation of Annual General Assemblies of participating cooperatives.

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There were various attempts to renew and refine the cooperative Law, but many distortions occurred in the process because of the bureaucratic rigidity on the one hand, and influence of the liberal economic policies coupled with dogged insistence of the government on the other. When Co-operative Law no. 25/1992 was promulgated, de-bureaucratization and deregulations were being actively pursued due to the drive of the free market economy.

It was only after the reform movement in 1998 when serious efforts were made to renew the cooperative law. However, the reform process itself was not significant enough to generate a viable cooperative law, and thus Co-operative Law no. 17 in the year 2012 was a mere reproduction of Co-operative Law no. 25/1992 in terms of substance. A host of co-operative leaders were determined that the new Co-operative Law no. 17/2012 deviated from the universal cooperative values and principles, and diverged from the Constitution. These leaders then staged a Judicial Review at the Constitutional Court, after which the Law was abolished in its entirety as it was deemed unconstitutional by the Court. Up until now the new draft Cooperative Law is still being debated in Parliament, thus cooperatives are left in a wait and watch position by conforming only to Co-operative Law no. 25/1992 which has several shortcomings.

As already mentioned above, cooperatives in Indonesia are regulated under a lex-generalis make up, whereas the sectoral segments are subjected to other general laws.Co-operatives in Indonesia are not regulated as a special entity *(lex specialis)* but as a general one *(les generalis)* in its current Law no 25/1992 on Co-operatives.

There are no special laws on particular types of cooperatives (like worker cooperatives, youth cooperatives. But different types of cooperative do exist.Different types of cooperatives are regulated under the general provisions of the Sectoral Laws such as the Civil Code, the Tax Law, the State Enterprise Law, Hospital Law, Food Security Law, Housing Law, Fisheries Law, etc., including its derivative legal products, namely the Government Regulation, the Presidential Regulation, the Ministerial Regulation, and the Regional Regulation.

All seven principles of co-operatives are not fully enshrined in the law. Many Articles in Law no. 25/1992, are actually contrary to the cooperative principles, and there are no sanctions attached to any misconduct of the cooperative principles.

ii. Special Elements of Cooperative Legislation

a) Definition and objectives of Co-operatives

Cooperative Law no 25/1992 on Co-operatives, which is still in effect, emphasises the co-operative character as a Corporate Body, hence not in accordance with the universal definition enshrined in the ICA Co-operative Identity Statement adopted at the ICA Congress of 1995 in Manchester. Co-operative Law no 25/1992, therefore, has its limitations

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to effectively develop genuine co-operatives as hoped for by Article 33 of the Indonesian Constitution, including its clarification (before the latter was amended).

Co-operative Law no 25/1992 was formulated during a period when structural adjustment and deregulations were taking place to formally reduce the role of government.

Paradoxically, however, preamble of the Law states that 'Co-operative Development is the duty and responsibility of the government and the people'. Implementation of the law was consequently left in the powerful hands of the government and political authorities, thus making co-operatives dependent on government facilities and control. The lack of autonomy among these government-sponsored co-operatives made them weak, and repeated failures has left a bad image of co-operatives in the eyes of the public. Government policies, as well as mismanagement of co-operatives themselves, rendered many of these co-operatives ineffectual as they deviated from the co-operative values and principles during the New Order government. It was in the year 1999 when the Reform Era government tried to rebuild genuine co-operatives by drafting a new co-operative law. Article 3 and 4 of the Co-operative Law 25/1992 are quite idealistic as much as they are normative, as cooperatives are meant to create welfare of the community and participate in building a just and prosperous society based on the Pancasila Ideology and the 1945 Constitution. Normative because cooperatives are positioned to help nation building rather than creating its own strong institution to improve members' welfare. The cooperative law provides ample space for membership promotion, but on the other hand the broad objective to help build the nation is hampering as the internal institutional capacity building because of external stimulation. Cooperative members cannot be expected to participate actively as they view cooperatives as mere instruments to obtain outside resources rather than build their cooperative based on self-help through mutual collaborative efforts.

Based on the cooperative Law, cooperatives in Indonesia are not prohibited to transact with non-members. The exception is only among the savings and loan cooperatives, since government Regulation no 9/1995 restrict these cooperatives from transacting with non-members, with a proviso that co-ops can still transact with non-members if the latter agree to become a would-be member within a specific period to then become a member. This proviso is being (mis)used by a number of large savings & loan co-operatives to transact with non-members; these non-members will be called would-be members without a limited timeframe, thus mimicking a micro-finance approach which is basically debt-based.

The absence of good supervision by the government resulted in many savings and loan co-operatives becoming pseudo co-operatives, and even becoming loan-sharks, hence damaging the image of the co-operative movement as a whole. The credit union movement is the exception because credit unions in Indonesia are run democratically based on self-help and self-reliance. There is no particular type of cooperative specifically designed in the law for the pursuit of social interest like social cooperatives, social initiative cooperatives, etc. but the cooperatives are free to pursue such objectives. The Cooperatives in Indonesia can carry out any economic activity that any enterprise can. They are not specifically excluded from any particular sector. In a more specific legislative context, regulations have made it hard for cooperatives to achieve the aims for public

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good, because many legislative products are contradicting the main objective of cooperatives to increase public welfare. Sectoral laws in Indonesia, such as the Hospital Law, ignored the role cooperatives can play in the health sector, and the law stated that only private corporations could establish hospitals. At a more grassroots level, regulation of the Ministry of Rural development intensifies the development of Village-Owned Public Enterprises and provides no legal option for the development of cooperatives. On the one hand, co-operatives are being glorified as an important sector, but ignored when it comes to the 'modus operandi'.

Mistrust among regulators to acknowledge co-operatives as a strategic option for economic democracy has led to a host of other sectoral legislative products neglecting co-operatives, hence creating a legal environment that is not conducive for co-operative development. Cooperatives are often misinterpreted in the making of economic and community regulations and thus outplayed in the crossroads of modern business activities. There is a sense of discrimination, sub-ordination and even elimination in the making of many regulations such as seen in the Laws on Banking and Public Enterprises. Cooperatives are regarded as mere recipients of mercy and compassion, as recipients of what corporate social responsibility can allocate. In the modern business regulations, including their products, cooperatives are seen as a burdensome entity and thus do not deserve a special place other than being subordinate to the private capitalistic enterprises.

b) Establishment, cooperative membership and governance

According to Co-op Law no. 25/1992, a co-operative could be registered and incorporated as a legal body upon fulfilment of all administrative requirements. The Ministry of Co-ops & SMEs at the national level has the authority to grant the legal permit, and the application could be submitted online via a public notary.

Legal administrative requirements are, among others, Minutes of the meeting of founding members alongside their signatures, copies of Citizenship Cards of these founders, By-Laws, Workplan, and initial Balance Sheet.

Since the Law requires a minimum of 20 members to incorporate, it is often difficult for co-operatives to fulfil this requirement, with the exception of savings and loan co-ops. Founding members of say, a Worker Co-op, are forced to add names of 'reluctant or ignorant' individuals as members to the list in order to get incorporated. For this very reason, most cooperatives in Indonesia are composed of savings and loan co-ops because the law emphasizes the economies of scale rather than scope. This provision hampers the emergence and growth of real sector co-operatives.

The lack of knowledge among regulators that co-operatives are 'people-based associations' and opposed to 'capital-based associations', as well as their narrow interpretation of the democratic 'check and balance' mechanism, have made it difficult for sincere individual founders to form genuine co-operatives in Indonesia.

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The Law imposed a full-fledge structure with at least 3 board members, 3 supervisory board members, and a number of other individual members to form a co-operative is considered very burdensome.

When it comes to forming secondary level co-operatives, the law requires three primary co-operatives to form one secondary level co-operative. This requirement is quite logical for savings and loan co-operatives that could then form their secondary structure. However, the imposition of the same requirement for other types of co-operatives by the existing law, only adds to forming weak secondary structures by weak pseudo primary co-operatives, and it also defies the subsidiary principle at the same time. Secondary structures are for the most part created from the top-down by the government to fulfil their national agenda rather than to fulfil members' needs, and their roles are often conflicting and duplicative, defying the subsidiary principle. Admission of new cooperatives is open and voluntary, hence with no discrimination, based on co-op Law 25/1992. This is recognized in article 5 para 1 and point a, based on the first cooperative principle. However, in Article 18 and 19 on membership, this first principle could be interpreted differently inasmuch as membership could be limited according to their respective By-Laws.

These limitations, especially if based on race or ethnic group, could contravene the cooperative principle. Furthermore, limitation of members could also be based on economic or political expediencies, hence slowing the growth and development of cooperatives.

The law stipulates "one member one vote", yet this democratic principle is often seen by self-serving elites as a mere cooperative slogan. While the law guarantees this democratic principle, the "managerialism" attitude of elites (i.e., Board members) often motivates them to take financial advantage of members they are serving, hence reducing the quality of democratic policymaking of the co-operative. The cooperative Law 25/1995 provides firm recognition of the supreme power of membership assembly within the democratic cooperative structure, where members must at least elect a Board of Directors (BOD) and a Supervisory Board at their general assembly. This basic right of members is guaranteed by the existing law. These two elected entities are accountable to members at their AGM.

It is customary that the BOD recruits a fulltime General Manager or CEO in well-established cooperatives with large membership and complex business undertakings, and the GM/CEO is accountable to the BOD. It is also customary in the cooperative law that rights and responsibilities of every unit in the structure are well spelled out. Notwithstanding, there is an apparent weakness in the legal authority when it comes to enforcing legal actions against misappropriation by the cooperative elites or in the case of co-operative mismanagement. The supervisory function is still very weak because of inadequate regulations to enforce intensive supervision, thus opening loopholes for the misappropriation of co-operative resources for self-serving ends.

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c) Co-operative Financial Structure

As a legal body, the Law made it obligatory for cooperatives to draw up their capital structure composed of fixed and voluntary savings, allocation for reserves, any external grants, which amount is not limited, except for financial (savings & loan) cooperatives which has a limited amount as determined by a Ministerial Regulation. For the build-up of capital, every member has to fulfil payment of the fixed saving and will only be deemed full member after filling its name in the member registry and completing its fixed saving.

Members are urged and encouraged to raise the co-op capital by paying their obligatory savings. The amount of the latter is not limited, and members are also encouraged to build their savings deposit which bears an interest.

The term used for the capital build-up in the Law is just "savings", giving the impression that it is a risk-free savings of members as their equity. This terminology creates the perception among members that a co-operative does not have a permanent capital structure so they can withdraw their 'equity/shares' at will, making it vulnerable for the financial liquidity of the co-operative. Article 45 stipulates that the surplus of the cooperative, after deduction of the reserve, education and social funds, will be distributed to members in the form of dividends based on members' patronage. The amount set aside for reserves and other funds will be decided by the General Assembly. There is no stipulation for the distribution of surplus to non-members. It creates opportunism on part of some cooperative leaders to enlarge transactions with non-members. Law no 25/1992 gives permission to co-operatives to enlarge their capital structure with loans from members, other cooperatives, banks, financial institutions, and other legitimate sources. Cooperatives can issue bonds and other debentures. Other capital instruments include equity participation from other sources, including the government, which are specifically regulated under Government Regulation no 33/1998.

Cooperatives are still restricted by Law and by other sectoral regulations from having a deposit and/or loan guarantee system like those set up by the government for the banking sector. Financial cooperatives are thus excluded from modern financial business streams such as using chequebooks, debit cards, and in clearing transactions. Low commitment of the government in providing equity participation to accelerate cooperative business also adds to the weakness of the co-operative capital structure.

In the event of dissolution, every member is liable to forfeit their equity shares, but priority should first be given to reimburse the creditors and any balance left would then be redistributed to members.

The regulatory provision does not specifically deal with conversion, but only deals with mergers and amalgamations (split off).

d) Co-operative external control.

External control is quite prevalent in the cooperative system. The regulatory regime is giving more emphasis on directing the operations of the cooperatives than on supervising

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it. The supervisory function is actually more important in order to protect the public interest. Lack of supervision could also trigger moral hazards whereas the lack of firm sanctions could cause further deviation from the values and principles of co-operatives.

There is no provision for the supervision of secondary cooperatives. After all, most secondary cooperatives were created from the top-down, on account of the fact that the legislation overlooked the subsidiary principle as a condition to set up secondary cooperatives. Without such a mandate from the law, coupled with weak supervision, secondary structures remain feeble. This gave rise to the proliferation of 'co-operatives in name only'.

e) Co-operation among Co-operatives

The law promotes the sixth principle of cooperation amongst cooperatives. It specifically recognized this principle as secondary structures are established and need to cooperate amongst themselves. However, the law does not spell out the subsidiary principle and thus secondary cooperatives are not necessarily cooperating on behalf of the needs of primary cooperatives but mostly to promote business dealings amongst themselves. This weakens the organic nature of cooperation.

f) Co-operative Taxation

Cooperatives are subject to the general taxation regime for business enterprises. There is no distinction given to cooperatives in provisions of the Tax Law. Cooperatives ought to gain the moral right to receive distinct treatment because of the nature of their business with members only, and also because of their distributive justice. The tax situation is a double burden for co-operatives because co-operatives are taxed as legal bodies, and patronage refunds to members are also taxed.

PART III: Degree of "cooperative friendliness" of the national legislation

Co-operatives are basically subordinated, discriminated and even eliminated in most legislation dealing with economic and societal affairs in the country. This also pertains to national policies dealing with economic and social issues. In many legislative and policy frameworks, co-operatives are considered legal bodies which need direction from the government and become instruments of government programs. One of the most obvious legislation which discriminates and trivializes cooperatives is namely the National Law on Capital Investment, which only permits Investment Oriented Firms (or private enterprises) to partake. Subordination of co-operatives could also be seen in the Hospital Law and the Law on Public Enterprises. It is difficult to cite the best practices of cooperative legislation in Indonesia because Co-op Law no 25/1992 was passed before the ICA Congress in Manchester in 1995, hence the co-operative definition, values and principles in the Co-op Law are not congruent with the Universal Co-op Identity. Then a new Co-op Law no 17/2012 was introduced and passed in 2012, but its contents are deviating even further from the co-operative definition, values and principles, and hence contested at the Constitutional Court, and ultimately abolished in 2014. The promotion of co-operatives as a public

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function is much to be desired. There is systemic misinterpretation in Indonesia of what a genuine co-operative actually is. The image of co-operatives has deteriorated due to practices of moneylenders using co-operatives as their legal shield. Since many of these loan-shark businesses - using co-operatives as their legal entity - have been captured and penalized, the public in general have little trust in co-operatives because they equate co-ops as illegal moneylending businesses.

In conclusion, the degree of "cooperative friendliness" of the legislative framework in Indonesia is essentially "*more cooperative unfriendly than friendly*".

Comparing the national legislation in Indonesia with a foreign legislation, the Framework Act in Korea is a source of inspiration, but also a combination of the legislation in Japan and Singapore could be a positive reference.

Sectoral, rather than omnibus, Law seems to generate more support from the respective government sector, and hence greater potential for growth and development. However, since law making has been historically a very arduous process in Indonesia due to political squabbling and upheavals in the process, an omnibus law such as the one in the Philippines could be a conducive reference. The Republic Act on co-operatives in the Philippines provides a clear distinction of co-operatives based on the ICA Co-op Identity Statement, and there exist a special tax formulation for co-operatives. The development of a special agency, which in this case is the CDA (Cooperative Development Authority), in the Philippines is also more conducive for cooperative development as compared to a full-fledged Ministry like in Indonesia. The fact that cooperative constituents are represented in the board of the CDA, the voice of the cooperative movement is also better heard and acknowledged.

Part IV. Recommendations for the improvement of the national legal framework

Changes that are necessary to make the cooperative law in Indonesia more adequate for the development of cooperatives are:

(a) The philosophical underpinning is important, and must be supported by an epistemological, ontological, and axiological overview that serves as the preamble of the Law.

(b) The ICA cooperative Identity Statement must be incorporated as a recognition of the universal definition, values and principles of a Co-operative.

(c) The Law must contain a theoretical analysis that clearly shows the distinct nature of a cooperative as compared to capitalistic forms of enterprises.

(d) Cooperatives being a manifestation of an economic democracy system, the law must in the first place recognize practices of successful cooperatives, such that the Law must be designed together with representatives of the successful cooperative enterprises and not just a "top-down" mechanism dictated by government representatives. General

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modifications and/or specific changes in the national law must meet the criteria in the above recommendations as mentioned above, hence, to make it more cooperative friendly. Since most co-operatives in Indonesia are related to Savings & Loans, there must be a special Law designed mainly for Savings & Loan/Credit Unions, and a separate law for other types of cooperatives. The number of member-founders for the latter could be as low as 2 or 3 members, giving room for the development of workers' co-ops, health co-ops etc. Changes are thus necessary regarding specific sectors or types of co-operatives.

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