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THE LOCAL WISDOM APPROACH IN RESOLVING NON-PERFORMING LOANS AT TRADITIONAL VILLAGE CREDIT INSTITUTION IN BALI: A CASE STUDY DURING THE COVID-19 PANDEMIC

This study explores the role of local wisdom in managing non-performing loans (NPLs) within Village Credit Institutions (VCDs) in Bali during the COVID-19 pandemic. Using a case study approach, the research examines the effectiveness of traditional mechanisms such as awig-awig (customary law) and pararem (community agreements) in maintaining social cohesion and addressing financial challenges. Through qualitative methods, including in-depth interviews with key stakeholders and document analysis, the study seeks to understand how these customary practices contribute to resolving NPLs. The findings indicate that local wisdom fosters community engagement and dialogue, offering temporary solutions to financial problems during crises. These traditional mechanisms promote a sense of collective responsibility and help maintain social harmony by facilitating discussions between debtors and VCDs. However, the research also highlights several limitations. While effective in the short term, local wisdom struggles to enforce sanctions and provide long-term resolutions, especially during severe economic downturns like the pandemic. This issue is compounded by external factors such as Bali's heavy reliance on tourism, which makes the local economy highly vulnerable to global disruptions. The lack of digital infrastructure and the absence of integrated government support further intensify the challenges faced by VCDs in managing NPLs.

The study concludes that while local wisdom remains a valuable tool for crisis management, its effectiveness is constrained in times of prolonged financial instability. For VCDs to achieve long-term sustainability and resilience in future crises, it is essential to integrate traditional practices with modern financial systems. Additionally, stronger government support, including digital infrastructure development and comprehensive financial regulations, is crucial to ensure the sustainability of VCDs. This combination of traditional and modern strategies can help VCDs navigate future economic challenges more effectively and safeguard their role in the local economy.

Key words: *Local wisdom, non-performing loans, Village Credit Institutions COVID-19, Bali, customary law, community agreements.*

Original article

INTRODUCTION. The COVID-19 pandemic has had a profound impact on the global economy. Various sectors have been affected, including the financial sector, which has experienced significant disruptions in operational systems and financial stability (Baldwin, 2020). In Indonesia, the effects of this pandemic are felt across all layers of society, particularly in terms of the inability of many to meet their financial obligations, both in the formal and informal sectors. One of the hardest hit sectors is traditional financial institutions like Village Credit Institution (VCD) in Bali, a community based entity established to support the economic wellbeing of Bali's customary villages (Datrini, Suwitra, Selamet, 2023, p. 56).

VCD plays a crucial role in maintaining the economic stability of customary villages, as it functions as a microfinance institution facilitating economic activities such as savings and loans, as well as managing village funds. The uniqueness of VCD lies in its operational base, which adopts principles of local wisdom, such as *awig* awig (customary laws) and *pararem* (community agreements), distinguishing it from conventional financial institutions. However, with the onset of the COVID-19 pandemic, many villagers have faced economic hardships, leading to an increase in non-performing loans at VCDs. This situation presents a significant challenge to the operational sustainability of these institutions (Ni Wayan Novi Budiasni, Darma, 2020, p. 19).

Globally, studies show that microfinance institutions face similar challenges regarding the reduced ability of debtors to meet their obligations during the pandemic (Brickell et al., 2020). This highlights the importance of local financial institutions that can integrate community-based approaches to address economic problems that arise during crises. In the context of Bali, the presence of VCDs, which are based on local wisdom, allows these institutions to adapt to crisis conditions, including developing mechanisms for resolving non-performing loans that take into account local cultural values.

Thus, the COVID-19 pandemic is not only challenging the financial stability of the WCDs, but also testing the resilience of these institutions in applying mechanisms based on local wisdom to overcome crisis situations. The economic impact experienced by customary villages and their communities serves as an important context for understanding how VCDs can remain relevant and survive amid unprecedented global challenges (Junaedi et al., 2020, p. 18).

The COVID-19 pandemic has triggered a significant economic crisis, which has directly affected the ability of the public to meet their financial obligations, particularly loan repayments. In Bali, Village Credit Institution (VCD) is one of the institutions most affected by this phenomenon. VCD, which has long been the economic driver in customary villages, has seen a drastic increase in non-performing loans during the pandemic. Communities that lost their livelihoods or experienced a decline in income due to restrictions on economic activities are no longer able to repay their loans on time (Diatmika, Putra, 2021, p. 305). These non-performing loans not only threaten the sustainability of VCDs as financial institutions but also pose serious risks to the overall economic stability of customary communities.

One of the main issues faced by VCDs during the pandemic is the lack of liquidity due to the high number of non-performing loans. Decreased liquidity limits VCDs' ability to provide new loans or fund other economic initiatives in the village. This situation is exacerbated by the fact that VCDs operate in an environment heavily dependent on tourism activities, the sector most affected by the pandemic in Bali (Sujana, Utama, 2023, p. 99). The drastic drop in income from the tourism sector has left many villagers unable to repay their debts. This has caused the level of non-performing loans at VCDs to surge to over 30 % in some areas, creating economic instability that affects the entire ecosystem of Bali's customary villages.

PURPOSE AND OBJECTIVES OF THE RESEARCH. This research aims to explore how local wisdom, such as *awig awig* and *pararem*, is applied by VCDs in Bali in dealing with non-performing loans during the COVID-19 pandemic. The focus is on identifying resolution strategies based on local cultural values that have proven effective in maintaining economic and social balance amid the crisis. The relevance of this research lies in showcasing the role of local wisdom in supporting the economic resilience of customary villages and strengthening community solidarity. The COVID-19 pandemic was selected as a case study due to its wide ranging impact on the global economy and the ability of traditional financial institutions, such as VCDs in Bali, to survive, particularly concerning the challenges of non-performing loan disputes during the pandemic. This situation provides a unique opportunity to study how local wisdom is utilized in an unprecedented crisis. The findings of this research are expected to offer practical contributions to designing adaptive, community based models for resolving non-performing loans.

METHODOLOGY. This study uses normative legal research methods with a case study approach. Normative legal research aims to examine and analyze the applicable legal norms and their application in resolving non-performing loans at Village Credit Institution (VCD) in Bali during the COVID-19 pandemic. The case study approach is used to study and evaluate non-performing loan cases handled by VCD, focusing on the application of local wisdom such as *awig awig* and *pararem* as part of the dispute resolution mechanism (Marzuki, 2021, p. 12). The case study approach in this research involves the analysis of specific cases occurring at VCDs in Bali's customary villages. Each selected case will be reviewed from a juridical and customary law perspective, with attention to how the applicable legal rules and local wisdom are applied in resolving non-performing loans. This case study explores practices of resolving non-performing loans that combine formal legal norms with local customary norms.

The legal materials used in this study consist of three types. Primary legal materials include laws and regulations related to financial institutions, credit, and customary law, including Law No. 1 of 2013 on Microfinance Institutions and regional regulations governing Village Credit Institution (VCD). Secondary legal materials include literature, journals, and previous research relevant to VCD, local wisdom, and the resolution of non-performing loans, providing a theoretical framework and empirical foundation for this research. Additionally, tertiary legal materials such as legal dictionaries and encyclopedias are used to provide clear and in-depth definitions of the legal concepts used, thus strengthening the analysis in this study.

The data is analyzed using qualitative analysis methods, involving the interpretation of applicable legal norms, and comparing them with their application in specific cases. This analysis aims to identify whether the resolution of non-performing loans by VCD complies with the applicable legal provisions, and whether local wisdom-based mechanisms are effective and aligned with principles of justice in customary law.

RESULTS AND DISCUSSION

Analysis of Non-Performing Loans at VCD During the COVID-19 Pandemic

The COVID-19 pandemic has had a significant impact on the global economy, including Bali, which heavily relies on the tourism sector. International travel restrictions and the closure of tourist destinations have led to a drastic decline in the number of tourists, directly affecting the income of the local population. As a result of this sharp decline in economic activity, many individuals and business owners in Bali have faced financial difficulties, including the inability to repay their loans from financial institutions such as Village Credit Institution (VCD). VCD, which operates as a community-based microfinance institution in Bali's customary villages, experienced a significant spike in non-performing loans during the pandemic. This situation occurred primarily because many of its borrowers in the tourism sector lost their primary income, leaving them unable to meet financial obligations such as loan repayments (Kurniasari, 2022).

In normal circumstances, VCD plays a crucial role in providing financial access to the people of the customary villages, such as loans for small business capital, agricultural financing, and household needs. However, during the pandemic, borrowers' inability to repay loans caused a drastic increase in non-performing loans (NPLs) at VCDs. NPLs in several VCDs in Bali reportedly increased by 30–40 % at the peak of the pandemic (Sari et al., 2024, p. 2200). This situation has not only caused financial losses for the VCDs but also created instability within the community, as many VCDs serve as the economic backbone of the customary villages.

The COVID-19 pandemic caused a significant spike in non-performing loans at various Village Credit Institution (VCD) in Bali. According to reports from the Financial Services Authority (OJK) and local research, the increase in non-performing loans at VCDs during the pandemic reached alarming levels. Before the pandemic, the average non-performing loan (NPL) rate at VCDs was below 5 %, in line with healthy banking standards. However, from mid 2020 to early 2021, several VCDs reported NPL increases of more than 30 %, especially in villages whose economies rely on the tourism sector (Kurniasari, 2022, p. 5).

As an example, VCDs in the Ubud and Kuta areas, which usually benefit from the tourism sector, experienced a spike in NPLs from 3 % before the pandemic to 35–40 % by the end of 2020. These VCDs are heavily reliant on small business operators in the tourism sector, such as guesthouses, restaurants, and other tourism services. When the pandemic halted nearly all tourism activities, many VCD customers lost their income and were unable to continue making loan payments. A similar impact was felt by VCDs in other customary villages that rely on local economic activities and small-scale trade.

The decline in customers' ability to repay loans directly affected the liquidity of VCDs, limiting their ability to provide new loans. In fact, several VCDs were forced to temporarily halt lending as they struggled to maintain financial stability amid the surge in NPLs (Putri, Ratnawati, I.B.Gde Upadana, 2023, p. 13). One of the most prominent examples is the case of VCD Ubud, where the majority of customers work in the tourism sector, either as villa operators, tourism workers, or souvenir traders. With the drastic decline in the number of tourists during the pandemic, customers' incomes dropped by up to 90 %, leaving them unable to continue repaying their loans. Many Ubud customers had difficulty repaying the business loans they took before the pandemic, which were initially used to expand their tourism businesses (Damayanthi, Arisena, Suamba, 2022).

A specific case in Ubud involved a customer running a local guesthouse business. Before the pandemic, this customer had taken a loan of IDR 150 million to expand the business. However, with international travel restrictions and the closure of the tourism sector, the guesthouse no longer received any visitors, and the customer struggled to make monthly loan payments. In response, VCD Ubud offered a solution by restructuring the loan, extending the repayment period, and reducing the interest rate. However, this restructuring only provided temporary relief as income from tourism remained nonexistent for several months (Muttaqin, Kosim, Devi, 2020, p. 111).

A similar case occurred at VCD Kuta, where many small business owners, such as souvenir vendors and tourism service providers, experienced a sharp decline in income. In response, VCD Kuta also rescheduled payments and offered temporary loan deferrals to the most severely affected borrowers. However, the liquidity issues at VCD worsened as the number of customers applying for loan restructuring continued to increase. VCD had to find ways to keep their operations running while ensuring that affected borrowers had additional time to recover their financial condition (Hagawe et al., 2023).

The decline in liquidity forced VCDs to reduce lending activities and tighten credit requirements, which in turn affected their competitiveness in the local market. Additionally, public trust in VCDs began to waver due to the inability of these institutions to provide long term solutions to non-performing loans, especially for those most affected by the economic crisis resulting from the pandemic. This impact was also felt in the economic life of customary communities. Since VCDs serve as one of the main sources of financing for small businesses and economic activities in customary villages, many small business owners lost access to capital. This hindered the local economic recovery and exacerbated poverty in customary villages, which heavily depend on VCDs for financial stability (Zheng, Zhang, 2021, p. 408).

Bali's reliance on the tourism sector exacerbated the situation. Many VCDs, whose borrowers mainly work in tourism such as villa owners, restaurant operators, and souvenir traders were directly impacted when tourism came to a halt due to the pandemic. With lost income, these borrowers were unable to repay their loans. This created a domino effect on the liquidity and operations of VCDs. Dependence on a single economic sector made VCDs vulnerable to major economic shocks, such as the pandemic, which caused a substantial decline in borrowers' ability to repay loans.

The Application of Local Wisdom in Resolving Non-Performing Loans

Local wisdom in Bali plays an important role in the social and economic regulation of customary communities, including in the context of resolving non-performing loans at Village Credit Institution (VCD). Two main elements of local wisdom that form the foundation for managing life in customary villages are *awig awig* and *pararem*. *Awig awig* is a set of customary laws passed down through generations, serving as unwritten laws that govern all aspects of life in Bali's customary villages, including social, economic, and cultural relations (Susiani et al., 2021, p. 176).

Meanwhile, *pararem* is a collective agreement made by the customary community to adjust *awig awig* in response to specific situations or challenges that arise within the community. If *awig awig* serves as the basic law, *pararem* acts as a more flexible adjustment or supplementary rule that can be modified as needed by the customary community at a given time. For instance, in response to the COVID-19 pandemic, *many* customary villages in Bali issued new *pararem* to adapt existing rules to the challenging economic conditions. *Pararem* is often used to address new issues not explicitly regulated in *awig awig*, including in the context of resolving non-performing loans at VCDs during the pandemic.

The role of *awig awig* and *pararem* is crucial in maintaining social harmony within customary villages. Through these mechanisms, dispute resolution is conducted in a way that emphasizes dialogue, deliberation, and solutions that minimize conflict. VCDs, as financial institutions based in customary villages, often use *awig awig* and *pararem* based approaches to resolve non-performing loans. This provides flexibility not found in formal legal systems, as the customary approach better understands the local context and social norms that apply within the community.

When non-performing loans occur, VCD often employs customary deliberation based on *awig awig* to resolve disputes peacefully. This deliberation process emphasizes open dialogue between the debtor, VCD administrators, and local customary leaders to reach a mutual agreement that considers not only economic aspects but also social harmony (Risey Junia, 2023).

Pararem is often used to adjust customary rules to dynamic economic conditions, especially during the COVID-19 pandemic. In several cases, customary villages in Bali issued special pararem that provided relief to debtors directly affected by the pandemic. For example, some VCDs implemented temporary payment deferrals for customers involved in the tourism sector, which experienced a drastic decline in income during the pandemic. By using this pararem, VCDs and customary communities demonstrated flexibility in handling non-performing loans while maintaining a balance between the institution's financial interests and the livelihood of affected customers.

Through customary deliberation mechanisms, non-performing loans are resolved peacefully by involving various stakeholders, such as debtors, VCD administrators, and customary leaders. This ensures that the resolution does not only focus on economic aspects but also considers the social and cultural relationships essential in the life of Bali's customary villages. By emphasizing dialogue, this approach avoids the conflicts that often arise in formal legal processes, where disputes are usually more confrontational.

The flexibility offered by *pararem* allows VCDs and customary communities to adjust rules to accommodate changing economic needs during the pandemic. For instance, by implementing temporary payment deferral policies for debtors directly impacted by the crisis, VCDs were able to prevent mass bankruptcies among their customers. This reflects the ability of customary approaches to adapt to difficult circumstances, where formal legal processes may require longer and less responsive procedures to emergency situations. Thus, these customary mechanisms provide a quicker and more locally appropriate solution.

Local wisdom-based approaches to resolving non-performing loans, such as *awig awig* and *pararem*, have significant differences compared to dispute resolution mechanisms through formal legal channels. One of the main strengths of local wisdom is its ability to maintain social harmony within customary communities. Local wisdom has limitations in terms of enforcement power. If a debtor does not comply with the outcome of customary deliberations, there is no enforcement mechanism as stringent as in the formal legal system. Additionally, in cases involving external parties or large loans, the customary approach may not be effective due to the limited sanctions that can be imposed. In such situations, formal legal channels provide clearer and more definite provisions for both parties. A combination of local wisdom and formal law can offer a more comprehensive solution. Local wisdom excels in resolving issues while maintaining social cohesion, whereas formal law provides a stronger structure for enforcing agreements in more complex contexts:

Comparison of Local Wisdom and Formal Law Approaches		
Aspect	*Strengths*	*Weakness*
	Maintaining social harmony: Customary deliberations encourage resolutions that prioritize peaceful agreements	There is no formal enforcement mechanism: If the debtor does not comply with the costumary deliberation decision, there is no strong legal route to enforce it
	Fast resolution: Does not involve formal bureaucracy, so it is more flexible in handling problems	Limited to local context: Effective only in indigenous community environments, difficult to apply in more complex cases or outside the community
	Local context: This approach considers local customary and socio-cultural values, providing solutions that are more relevant to indigenous communities	Mild sanctions: The customary approach tends to use social sanctions rather than strict legal sanctions
Formal Legal Approach	Execution power: Settlements made through formal legal channels have legal certainty and can be legally enforced	Bureaucratic processes: Formal legal pathways are often slow and involve complex administrative procedures
	Formal structure: There are clear and standardized procedures for completing credit settlements	More confrontational: Formal legal resolutions often lead to conflict between parties, focusing on contractual agreements
	Enforcement of sanctions: Formal legal channels allow creditors to take legal action to collect bad debts, making them safer from a legal perspective	Less responsive to local situations: Formal legal approaches are less flexible in taking into account local norms or customs

Figure 1.1. Comparison of Local Wisdom and Formal Law Approaches Challenges in Resolving Non-Performing Loan Disputes During the COVID-19 Pandemic at VCD in Bali

The COVID-19 pandemic has brought significant challenges to many microfinance institutions, including Village Credit Institution (VCD) in Bali. During the pandemic, there was a drastic increase in non-performing loans due to the inability of borrowers to meet their payment obligations. In addressing this issue, VCDs faced a number of internal and external obstacles that slowed the resolution of loan disputes. These challenges are related to various aspects, such as liquidity, dependence on the tourism sector, and limitations in the application of local wisdom.

To understand how local wisdom, formal financial systems, and government policy support interact in the context of resolving non-performing loans in Village Credit Institutions (LPD), it is important to map the relationship between these three elements. Local wisdom, such as *awig-awig* and *pararem*, has functioned as a community-based dispute resolution mechanism that respects local social and cultural values. On the other hand, formal financial systems offer a more structured legal and regulatory framework to ensure the stability and sustainability of financial institutions. Meanwhile, government policy support provides liquidity assistance, credit restructuring, and digital infrastructure, which are crucial for strengthening the resilience of traditional financial institutions like LPD during crises.

The following Venn diagram illustrates the relationship between these three components, showing the areas of synergy where local wisdom, formal financial systems, and government policy can work together to offer more comprehensive solutions.

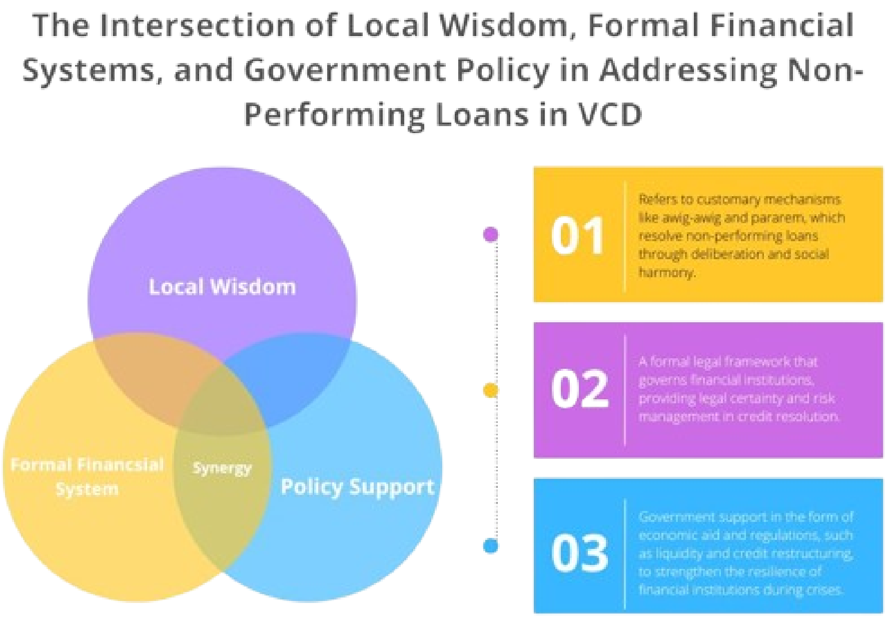

Figure 2. The Intersection of Local Wisdom, Formal Finansial Systems, and Goverment Policy in Addressing Non-Performing Loans in VCD

From the diagram above, we can see that each component has a unique role in building adaptive solutions to economic challenges. Local wisdom focuses on problem-solving through community dialogue and maintaining social harmony. Formal financial systems provide legal and regulatory frameworks that strengthen legal certainty and risk management. Meanwhile, government policy supports the sustainability of financial institutions through economic assistance and regulations that are responsive to crisis situations.

The area of synergy, where these three components intersect, creates a stronger and more inclusive framework for addressing non-performing loans in LPD. This synergy promotes community-based financial solutions, supported by formal legal structures and driven by adaptive government policies, resulting in more sustainable and resilient economic growth.

1. Liquidity Constraints

The primary obstacle faced by VCDs during the pandemic was liquidity constraints. As non-performing loans increased, VCDs lost their main source of income, namely from installments paid by borrowers. This resulted in VCDs struggling to provide sufficient liquidity to meet their obligations, both to offer new loans to other borrowers and to maintain their financial stability. This situation was exacerbated by the ongoing economic uncertainty during the pandemic, where key economic sectors such as tourism came to a complete halt (Muna, Ardani, Putri, 2022, p. 22). Without adequate liquidity, VCDs lacked the flexibility to negotiate with borrowers or offer effective loan restructuring.

Liquidity refers to the ability of an institution to meet its short term financial obligations, such as covering operational costs, providing new loans, and fulfilling customers' requests for fund withdrawals. When non-performing loans skyrocketed due to the pandemic, many borrowers were unable to make their loan payments. This led to a reduction in the inflow of funds to VCDs, which in turn diminished the available liquidity.

The absence of income from loan installments resulted in VCDs losing one of their main sources of revenue. These installments are typically used to cover operational expenses such as employee salaries, office operating costs, and other expenses related to the management of the institution. When this source of income was disrupted, VCDs were forced to use their reserve funds or even temporarily stop issuing new loans to other borrowers.

2. Dependence on the Tourism Sector

Bali's dependence on the tourism sector created significant challenges for VCDs during the pandemic. Most of the VCD borrowers came from the tourism industry, including guesthouse owners, restaurant operators, and tourism service providers. When tourism came to a halt, many borrowers lost their main source of income, rendering them unable to pay their loan installments. This dependence on a single economic sector made VCDs vulnerable to external shocks beyond their control, such as a global pandemic (Rosado, Kurniati, Peck, 2022, p. 138).

The heavy reliance on the tourism sector became a significant barrier for VCDs in Bali during the COVID-19 pandemic because tourism is the backbone of Bali's local economy. When tourism halted, the main source of income for the majority of VCD borrowers, such as guesthouse owners, restaurant operators, souvenir shop owners, and tourism service providers, also disappeared.

The high dependence on a single economic sector makes VCDs highly vulnerable to external shocks beyond their control, such as a global pandemic. Under normal circumstances, borrowers in the tourism sector could rely on stable income from local and international tourists to run their businesses and pay off their loan obligations. However, the pandemic triggered travel restrictions and the closure of tourist destinations, causing tourism activities in Bali to come to a complete halt.

The lack of economic diversification further worsened the situation. VCDs, which are heavily reliant on borrowers from the tourism sector, did not have a backup base of clients from other economic sectors that may have been less affected by the pandemic. For example, financial institutions that serve clients from the agricultural, manufacturing, or technology sectors may still receive income from borrowers working in these fields, even though these sectors also face challenges. However, VCDs in Bali predominantly serve communities working in the tourism industry. When this sector experienced a drastic downturn, it created a domino effect on the financial stability of VCDs due to the loss of loan payments from their borrowers.

The absence of income diversification from borrowers in other sectors also makes VCDs unable to survive the crisis effectively. VCDs face significant challenges, such as a simultaneous increase in non-performing loans from nearly all of their borrowers. Without income from other sectors, VCDs lose the flexibility to manage risks and maintain liquidity. This makes VCDs more vulnerable to financial losses and further complicates their ability to restructure loans or provide new loans to clients still operating in other sectors.

3. Limitations in the Application of Local Wisdom

Although local wisdom based mechanisms such as *awig awig* and *pararem* have been applied to resolve non-performing loan disputes, there are limitations in the implementation of these mechanisms during the pandemic. Local wisdom is indeed effective in maintaining social harmony through deliberation and peaceful agreements. However, in a severe economic crisis like the pandemic, the social sanctions used in customary mechanisms are often not strong enough to compel debtors to meet their obligations (Praptika, Yusuf, Heslinga, 2024). Additionally, in some cases, the flexibility offered by *pararem* has caused delays in resolving disputes, as debtors feel less pressured by the absence of more formal legal sanctions.

During the COVID-19 pandemic, local wisdom based mechanisms like *awig awig* and *pararem* have a greater emphasis on deliberation and social harmony. While this approach is effective in normal situations where financial issues and loan disputes can be resolved through peaceful agreements among community members, the weaknesses in this approach have become more apparent during a severe economic crisis such as the pandemic.

4. Limitations in Digital Infrastructure and Monitoring

During the pandemic, many formal financial institutions began adopting digital technology to streamline administrative processes, payments, and monitoring. However, VCDs in Bali still face limitations in terms of digital infrastructure. The largely manual administrative processes slow down VCD's ability to review, monitor, and adjust customer payment schemes during the pandemic (Suryani, 2024, p. 109). The lack of digital technology also complicates the monitoring of debtors who fail to repay their loans, further delaying responses to non-performing loans.

The manual processes still used in VCDs slow down administrative procedures and data management. In normal situations, manual processes may not pose a significant problem due to a lower workload. However, during the pandemic, when there was a surge in non-performing loans and customers requiring loan restructuring, these manual processes hindered VCD's ability to respond quickly. Reviewing customer data, verifying eligibility for loan restructuring, and adjusting payment schemes became much slower. Without an efficient digital system, VCD staff had to manually check each customer, which was not only time consuming but also increased the risk of human error in data management.

5. Lack of Integrated Government Support

Although several government policies provided support to the financial sector during the pandemic, such as credit restructuring for formal banks, VCDs as traditional financial institutions did not always benefit from these policies. The lack of integrated support for VCDs added to their burden in dealing with non-performing loans. VCDs often had to rely on internal mechanisms and community resources to address issues without significant external assistance (Putri, Widyari, Sari, 2024, p. 409).

One of the main reasons this lack of support becomes a barrier is that VCDs are not fully integrated into the national formal financial system. As traditional financial institutions, VCDs operate under different rules and mechanisms, which are largely governed by customary law (*awig awig*) and local community norms. Their community based operational nature makes VCDs incompatible with national policies designed for conventional financial institutions. As a result, VCDs often do not have the same access to government assistance programs, such as liquidity support or credit guarantees.

This mismatch is also evident in the credit restructuring programs introduced to help the formal banking sector. These programs are usually designed for large banks or financial institutions with more advanced accounting and risk management systems. Meanwhile, VCDs, which operate under a traditional framework, do not have comparable financial infrastructure or systems, making it difficult for them to utilize credit restructuring policies in the same way as other financial institutions. In practice, VCDs rely more on internal mechanisms such as customary deliberation or local wisdom adjustments, which are limited in terms of flexibility and structural support.

The challenges faced by VCDs during the COVID-19 pandemic reveal inherent vulnerabilities in microfinance systems that rely on specific sectors and have limitations in infrastructure and policy support. The liquidity constraints experienced by VCDs expose a fundamental issue within microfinance structures, where dependence on loan repayments serves as the primary source of operations. Without diversification of income sources and adequate liquidity guarantee mechanisms, VCDs were unable to withstand major economic shocks like the pandemic, resulting in an inability to respond quickly and effectively to the rise in non-performing loans. This situation was exacerbated by the reliance on the tourism sector, highlighting that VCDs were not prepared to handle systemic risks when the dominant sector came to a complete halt.

While the application of local wisdom, such as *awig awig* and *pararem*, provided temporary solutions by maintaining social cohesion through customary deliberations, the limitations of these mechanisms became evident during a deeper economic crisis. The customary approach, which relies on social sanctions and peaceful mediation, proved less effective in situations requiring stronger legal enforcement, especially when debtors faced ongoing economic uncertainty. The flexibility of *pararem* provided relief, but it also prolonged dispute resolution without offering adequate long term solutions.

Another challenge, such as the limitations in digital infrastructure, demonstrates that although VCDs are traditional financial institutions, they need to adapt to modern technology to enhance efficiency and transparency in monitoring and administration. The lack of digital technology adoption caused delays in responding to non-performing loans, slowing down the process of handling and restructuring loans, and exacerbating existing problems.

Additionally, the lack of integrated government support for VCDs created a significant policy gap. As traditional financial institutions, VCDs are often not accommodated within national financial policies, which tend to focus more on the formal banking sector. To ensure the continuity and resilience of VCDs in the future, stronger synergy between government policies and traditional financial mechanisms is required. Support in the form of liquidity assistance, broader credit restructuring programs, and improved technological infrastructure could help VCDs survive future crises.

In the long term, VCDs need to strengthen their financial systems through income diversification, digital technology adoption, and expanding relationships with sectors outside of tourism. Furthermore, the government needs to play a more active role in providing integrated policy support tailored to the needs of traditional microfinance institutions like VCDs. Without these measures, the challenges faced by VCDs during the pandemic may set a precedent for future crises, ultimately threatening the sustainability of these institutions and the economic stability of Bali's customary communities.

CONCLUSIONS. The COVID-19 pandemic has posed significant challenges for Village Credit Institutions (LPDs) in Bali, particularly in handling the surge of non-performing loans. This study utilizes a normative juridical approach, which is relevant for analyzing legal regulations and the application of local wisdom in resolving credit disputes during crises. By employing case studies, the research successfully explores the implementation of *awig-awig* and *pararem* as settlement mechanisms that maintain social harmony within the Balinese customary communities. Through this approach, it has been found that customary deliberations provided an effective solution in addressing credit issues by involving all parties and considering local social and cultural values.

However, this methodology also helped identify significant limitations in the local wisdom approach, especially during more severe crises like the pandemic. The main weaknesses lie in the lack of formal sanctions and the excessive flexibility in the use of *pararem*, which made LPDs less capable of handling large-scale credit problems. The study also revealed that limitations in digital infrastructure, reliance on the tourism sector, and the lack of integrated government support exacerbated the challenges faced by LPDs.

The primary benefit of the normative juridical methodology lies in its ability to evaluate the alignment between formal regulations and local practices, leading to the finding that while the local wisdom approach is relevant and effective for maintaining social stability, additional reinforcements are needed during complex crises. The research suggests integrating local wisdom with formal financial systems, adopting digital technologies, and providing more comprehensive government policy support to enhance LPD resilience. Therefore, a combination of tradition and innovation is key to the sustainability of LPDs in facing future crises, as revealed through the methodological approach used in this study.

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ВИКОРИСТАННЯ МІСЦЕВОЇ МУДРОСТІ У ВИРІШЕННІ ПИТАННЯ ПРОБЛЕМНИХ КРЕДИТІВ У ТРАДИЦІЙНІЙ СІЛЬСЬКІЙ КРЕДИТНІЙ УСТАНОВІ НА БАЛІ: ПРИКЛАДИ З ПРАКТИКИ ПІД ЧАС ПАНДЕМІЇ COVID-19

Вивчено роль місцевої мудрості в урегулюванні проблемних кредитів у сільських кредитних установах на Балі під час пандемії COVID-19. За допомогою підходу кейс-стаді проаналізовано ефективність традиційних механізмів, таких як *awig-awig* (звичаєве право) та *pararem* (домовленості між громадами), у підтримці соціальної згуртованості та вирішенні фінансових викликів. За допомогою методів якісного аналізу, враховуючи глибинні інтерв’ю з ключовими зацікавленими сторонами та аналіз документів, зроблено спробу зрозуміти, як ці звичаєві практики сприяють вирішенню проблемних кредитів. Результати дослідження свідчать, що місцева мудрість сприяє залученню громади та діалогу, пропонуючи тимчасові рішення фінансових проблем під час кризових ситуацій. Ці традиційні механізми сприяють формуванню почуття колективної відповідальності та допомагають підтримувати соціальну гармонію, сприяючи дискусіям між боржниками та сільськими кредитними установами. Однак існують деякі обмеження. Незважаючи на свою ефективність у короткостроковій перспективі, місцева мудрість намагається забезпечити дотримання санкцій та довгострокове вирішення проблем, особливо під час серйозних економічних спадів, таких як пандемія. Ця проблема ускладнюється зовнішніми факторами, такими як значна залежність Балі від туризму, що робить місцеву економіку дуже вразливою до глобальних потрясінь. Брак цифрової інфраструктури та відсутність комплексної державної підтримки ще більше посилюють виклики, з якими стикаються сільські кредитні установи в управлінні проблемними кредитами.

У ході дослідження було зроблено висновок, що хоча місцева мудрість залишається цінним інструментом антикризового управління, її ефективність обмежується в часи тривалої фінансової нестабільності. Для досягнення довгострокової сталості та стійкості до майбутніх криз необхідно інтегрувати традиційні практики із сучасними фінансовими системами. Крім того, для забезпечення стійкості сільських кредитних установ необхідна сильніша державна підтримка, зокрема розвиток цифрової інфраструктури та всеосяжне фінансове регулювання. Таке поєднання традиційних і сучасних стратегій може допомогти сільським кредитним установам ефективніше долати майбутні економічні виклики та зберегти свою роль у місцевій економіці.

Ключові слова: *місцева мудрість, проблемні кредити, сільські кредитні установи, COVID-19, Балі, звичаєве право, громадські угоди.*

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