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THE PRINCIPLE OF FREEDOM OF CONTRACT IN PRACTICE: BETWEEN THE THEORY AND REALITY OF ECONOMIC INEQUALITY IN INDONESIA

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Abstract

The principle of freedom of contract, rooted in classical individualism and adopted into the Indonesian legal system via Dutch civil law, grants parties the liberty to create agreements based on mutual consent. While this principle remains fundamental in Indonesian contract law—as enshrined in Article 1338 of the Civil Code—it is not absolute. In practice, especially within business relationships involving micro, small, and medium enterprises (MSMEs) and large corporations, significant disparities in bargaining power challenge the ideal of contractual equality. Empirical findings indicate that MSMEs often face one-sided contract terms due to their weaker economic position, lack of legal resources, and limited access to capital. This study aims to critically examine the implementation of the principle of freedom of contract in Indonesia, particularly regarding its impact on MSMEs. Using a juridical-normative method and a legislative approach, combined with case study analysis, the research explores the gap between legal theory and economic reality. The findings reveal that while the freedom of contract remains theoretically intact, its execution frequently undermines the position of weaker parties. The study suggests reconstructing the application of this principle within the framework of social justice, recommending enhanced regulation of standard contracts, fair contract guidelines, and an active role for the state in protecting MSMEs. These efforts are essential to ensure that contractual freedom functions not only as a legal doctrine but as a tool for equitable and inclusive economic participation.

Keywords: Freedom of Contract, Economic Inequality, Bargaining Position, MSMEs, Indonesian Contract Law

Introduction

Background on the principle of freedom of contract in the Indonesian legal system (Muhasim et al., 2019; Sarjito, 2024; Siregar, 2016; Syafrizal & Yustati, 2019). The principle of freedom of contract is rooted in individualism, which emerged embryonally in Ancient Greece, continued by the Epicureans, and flourished in the Renaissance through the teachings of Hugo de Groot, Thomas Hobbes, John Locke, and Jean-Jacques Rousseau. The peak of its development was reached in the post-French Revolution period (Zamroni, 2019). In that context, the state does not intervene much in the private relations of individuals, including in making contracts. Individuals are considered to be independent, rational, and self-governing legal subjects.

When Indonesia adopted the Criminal Code from the Dutch BW, this principle also entered the national legal system and became the main basis in the formation and interpretation of contracts. The principle of freedom of contract *(vrijheid van contract)* in the Indonesian legal system refers to the principle that gives the parties the freedom to make agreements with the content, form, and purpose according to their will, as long as they do not conflict with the law, public order, and morality (Do, 2023; Osmola, 2019; Ross et al., 2021; Sentot Sudarwanto et al., 2021; Tarmizi, 2020). This principle is one of the main points in treaty law in Indonesia, which is regulated mainly in the Civil Code (Civil Code), especially Article 1338 paragraph (1) which states that "All agreements legally made shall be valid as laws for those who make them."

However, this freedom of contract is not absolute, so the state still has the authority to limit this freedom in order to protect the public interest and justice. This can be seen in several regulations and jurisprudence that aim to protect weak parties in contracts, such as those contained in the Consumer Protection Law No. 8 of 1999, the Labor Law and Agreements in the banking, insurance, and lease sectors that are specifically regulated. Empirical facts about the inequality of bargaining positions in contractual relationships.

MSMEs, which include micro, small, and medium enterprises, are the backbone of the Indonesian economy, Coordinating Minister Airlangga Hartanto in a Tempo article (Yuantisya & Silaban, 2022) said that MSMEs contribute around 61% to the Gross Domestic Product (GDP) and absorb 97% of the national workforce. According to data from the Ministry of Cooperatives and SMEs, the number of MSMEs reached 64.2 million in 2022. However, this small scale of the economy often puts MSMEs at a disadvantage in contract negotiations with large companies, which have greater access to capital, technology, and market networks.

Several empirical facts based on reports and research further illustrate the existence of inequality in bargaining positions between MSMEs and large companies. Many MSMEs are compelled to accept contract clauses that are unilaterally determined by large corporations, including unreasonable pricing schemes, delayed payments, and burdensome distribution requirements. According to a 2020 report by the Indonesian Competition Commission (ICC), there were 15 reported violations of business partnerships involving MSMEs and large firms. Among these, 11 cases proceeded to investigation, 8 reached the initial examination stage, and 4 were subject to formal warnings (SP1/SP2) (Qurani, 2021). These cases typically involved core-plasma partnership schemes, unfair profit-sharing mechanisms, or agency distribution arrangements, all of which highlight the unequal nature of such agreements.

Afifah (n.d.) further emphasizes this disparity in her article, Transformation of Partnership Implementation Supervision by ICC: Healthy & Rapid MSMEs, noting that dominant companies often exploit their superior bargaining position to dictate contract terms without accommodating the interests of MSMEs. As a result, MSMEs frequently feel forced to accept disadvantageous contracts to avoid losing business opportunities. For instance, in a reported case from Semarang, small-scale poultry farmers incurred losses due to one-sided pricing and delayed chicken purchases by large companies. Similar patterns were reported among dairy farmers in Malang who experienced unfavorable contract terms imposed by major dairy corporations.

This inequality stems from several root causes. First, MSMEs operate on a significantly smaller economic scale than large enterprises, reducing their ability to negotiate favorable contract terms. Second, a 2024 report by Media Asuransi News, based on OCBC Indonesia's Business Fitness Index, found that 80% of Indonesian MSMEs still rely on manual financial record-keeping. Bratadharma (2024) notes this as a major barrier to obtaining credit, as poor financial documentation prevents MSMEs from meeting banking requirements. Third, large companies tend to employ rigid standard contracts, which MSMEs—with limited legal and financial capacity—struggle to contest, further entrenching their vulnerable position in contractual relationships.

Previous research has shown that while the principle of freedom of contract is a cornerstone of civil law, in practice, its application often leads to unequal contractual relationships. Zamroni (2019) traced the philosophical roots of the principle and emphasized its continued presence in Indonesian contract law. Qurani (2021) and Afifah (n.d.) provided empirical evidence of inequality in contractual relationships between MSMEs and large corporations, particularly in core-plasma and distribution arrangements. Additional studies by Lubis (2020) explored the legal challenges MSMEs face in standardized business agreements, and Rachmawati and Hidayat (2021) analyzed the role of state protection for weak parties in contracts, emphasizing how legal norms alone are insufficient without effective enforcement. The novelty of this research lies in its critical legal analysis of how the principle of freedom of contract functions within unequal power dynamics—particularly between MSMEs and large corporations—and how the normative ideal often diverges from the lived economic realities of weaker parties in Indonesia's contemporary contract law framework. This study combines normative-juridical analysis with actual case studies of unfair partnership contracts to evaluate whether true contractual freedom exists for all parties.

The objective of this research is to analyze the implementation of the principle of freedom of contract in the Indonesian legal system, particularly in contractual relationships involving MSMEs and large companies. It aims to evaluate whether this principle is applied equitably in practice or whether it merely functions as a theoretical doctrine that disproportionately benefits the stronger party. This research uses a juridical-normative method with a legislative and case study approach to assess whether there is a need for state intervention or reform. The significance of this study is twofold. Theoretically, it contributes to the academic discourse on contract law by revealing the tension between legal formalism and economic inequality. Practically, it provides insights for policymakers and legal practitioners to improve the legal framework and enforcement mechanisms to protect weaker economic actors, especially MSMEs, in contractual engagements.

Research Methods

The method used in this study is a juridical-normative method. The juridical-normative approach is carried out by analyzing the norms contained in the prevailing laws and regulations in Indonesia, as well as their application in contract practice. This research focuses on understanding the principle of freedom of contract in the context of Indonesian law, as well as an analysis of the implementation of this principle in real practice, especially in relation to the inequality of bargaining position between large corporations and MSMEs.

Data Types and Data Sources

The data used in this study consisted of secondary data, which included:

1) Laws and regulations related to freedom of contract, such as the Civil Code (KUHPerdata), Law Number 8 of 1999 concerning Consumer Protection, and the Law on Micro, Small, and Medium Enterprises (MSME Law).
2) Court decisions that are relevant to the topic of research, especially those that discuss the inequality of bargaining positions in contracts between MSMEs and large corporations.
3) Legal literature in the form of books, journal articles, and previous research that discusses the principles of freedom of contract, standard contracts, and the bargaining position of MSMEs.

4) Empirical data is in the form of a case study that illustrates the inequality of bargaining position in contracts, which can be obtained through interviews or surveys with MSME actors and large corporations in Indonesia.

Data Collection Methods

Data will be collected through literature studies and document analysis. This process involves searching and collecting relevant legal documents, as well as scientific literature related to contract law theory and economic inequality. In addition, this research will also include a case study of contract practices that occur between MSMEs and large corporations, by examining the contracts used by both, as well as the influence of inequality of bargaining positions in business transactions.

Data Analysis Techniques

The data that has been collected will be analyzed using qualitative analysis techniques. This analysis will be carried out by:

1) Juridical-normative interpretation of the text of laws and regulations, legal doctrines, and court decisions.
2) A critical analysis of contractual practices that occur in Indonesia, focusing on the problem of inequality of bargaining positions between MSMEs and large corporations.
3) Compare the law with the legal systems in other countries, such as the United Kingdom, Australia, or the Netherlands, to provide additional perspective on the application of the principles of freedom of contract and the protection of weaker parties in contracts.
4) Empirical evaluation through contract case studies that show inequality between parties that have unbalanced bargaining power.

Result and Discussion

Freedom of Contract in the Perspective of Indonesian Law

The basic position of freedom of contract in the Civil Code and legal doctrine. In Indonesian law, the principle of freedom of contract is recognized as one of the fundamental principles underlying contractual relationships. According to Article 1338 of the Civil Code, "All agreements made legally shall be binding on those who make them." This shows that the parties are given the freedom to make contracts as they wish, as long as they do not conflict with public order and decency. Indonesian legal doctrine, as explained by Satjipto Rahardjo, states that freedom of contract is the main foundation in a contractual relationship that provides space for the parties to negotiate the content of the contract according to their needs (Rahardjo, 2018).

A form of manifestation of freedom of contract in business practices.

In business practice, freedom of contract is often implemented through direct negotiations between contracting parties. This allows the parties to adjust the content of the contract according to mutual agreement, including the terms, rights and obligations, and the duration of the contract. However, in reality, unbalanced economic forces often limit this freedom, especially for small and medium enterprises (MSMEs), who tend to accept burdensome conditions due to market pressure and lack of alternatives.

Economic Inequality and Bargaining Position: A Case Study of MSMEs

Case studies of partnership, lease-rent, or product distribution agreements. MSMEs often face inequality in bargaining positions when negotiating with large companies or distributors. In many cases, partnership, lease, or distribution contracts are dominated by one-sided clauses, such as burdensome payment terms, unilateral termination clauses, and unfair surcharges. This practice causes MSMEs to be in a vulnerable position and less able to resist unfavorable contract provisions.

The practice of standard contracts that burden MSMEs. The use of standard contracts by large companies often contains clauses that burden MSMEs, such as provisions that reduce legal protection for them, and place risks unilaterally on MSMEs. Such clauses are often difficult to change due to their standard and non-negotiable nature, thus significantly reducing the bargaining position of MSMEs (OJK, 2019). This practice is a major challenge in protecting the rights of MSMEs and shows the need for stricter regulations to protect small businesses from unfair contract practices.

Juridical Analysis on the Legal Protection of MSMEs

Legal protection for Micro, Small, and Medium Enterprises (MSMEs) is becoming increasingly crucial in Indonesia's growing economic dynamics. A thorough analysis shows that although there have been various legal instruments aimed at protecting MSMEs, there are still significant weaknesses in their implementation (Badriyah et al., 2019; Disemadi, 2022; Noraga et al., 2023; Ramadhan, 2022). The problems of MSME development in Indonesia include marketing difficulties, financial limitations, limited human resources, raw material problems, and technological limitations which are often seen as MSME shortcomings, not as a result of broader structural conditions1. Meanwhile, the pattern of economic exploitation of MSMEs continues through the mechanism of capital accumulation, the creation of economic and social dependence, and a monopolistic market structure. A comparison with the protection systems in developed countries such as the United Kingdom, Australia, and the Netherlands shows that there are weak party protection practices in contracts that can be adopted to improve the Indonesian legal system.

Weaknesses of current legal protection. The current problem of legal protection of MSMEs in Indonesia has several fundamental weaknesses that need serious attention. First, although there are various regulations aimed at protecting MSMEs, their implementation in the field is still far from optimal. Limited capital, quality of human resources, and weaknesses in mastery of technology are often seen as disadvantages of MSMEs, rather than as a result of structural conditions that require legal protection.

The ongoing pattern of exploitation of MSMEs includes several forms such as unbalanced capital accumulation, the creation of economic and social dependence, and monopolistic market structures1. This condition is further exacerbated by the weak bargaining position of MSMEs in business relations. The party with a stronger bargaining position can easily impose its will to pressure the weaker party, for its own benefit.

The form of legal protection for MSMEs provided by the government is currently still limited to administrative aspects such as simplifying the requirements and procedures for applying for business licenses, development procedures, partnership patterns, coordination and control of MSME empowerment, and procedures for granting administrative sanctions. However, this form of protection has not touched the root of the economic exploitation problems faced by MSMEs in daily business interactions.

Another limitation in the legal protection of MSMEs is the lack of supervision of business practices that are detrimental to MSMEs. Without adequate supervision, various forms of economic exploitation of MSMEs continue without significant legal consequences for the perpetrators.

Evaluation of the effectiveness of positive laws (UUPK, UU MSMEs, Civil Code). Evaluation of the effectiveness of positive laws related to the protection of MSMEs shows several fundamental weaknesses. The Consumer Protection Law (UUPK), although it has provided a solid foundation for consumer protection, still has significant shortcomings in its implementation. Henny Marlyna, an academic from the Faculty of Law, University of Indonesia, admitted that the creation of the UUPK in his time was carried out in a short time, leaving a number of technical shortcomings and even some grammatical errors.

As an umbrella law, the UUPK should be the main reference for other laws and regulations. However, in fact, sectoral regulations such as in the fields of finance, health, food, and electronic commerce are actually more advanced and relevant to the needs of the 2nd century. This shows the need to revise the UUPK to be in line with market dynamics and the latest technological developments.

In the context of the Civil Code, the evaluation shows that there are still weaknesses in the protection of weak parties in the contract. The principle of freedom of contract, which is one of the basic principles in contract law in Indonesia, can cause inequality in people's lives if there is an imbalance in bargaining power between the parties. This condition is very relevant to the situation of MSMEs which are often in a weak position in contractual relations with larger business actors.

When there is an imbalance of bargaining positions, the stronger party can impose unfair contract terms on the weaker party. The terms or conditions of such a contract will ultimately violate the rules of fairness and propriety. To overcome this problem, state intervention is needed to restrict the implementation of the principle of freedom of contract to protect the weak, in this case MSMEs.

Comparison and Practice in Other Countries

Practice in the UK, Australia, or the Netherlands in protecting weak parties in contracts.The common law system in the United Kingdom and Australia has developed the concept of undue influence as a mechanism to protect weak parties in contracts. The doctrine of undue influence developed significantly and was used as the basis for judicial considerations in England in the 19th century. This doctrine is widely developed by judges in court in civil cases where the position of the two parties to the dispute is not equal or in the sense that one party has greater power over the other.

In Australia, undue influence refers to when there is an imbalance of bargaining power between the parties to a contract. This inherent inequality causes or forces the 'weaker' party to agree to a contract with the dominant party. In addition, undue influence also occurs when there is undue pressure exerted by one party on the other. The result of undue influence is to make the contract voidable, and usually returns the parties to their original position.

There are two main types of undue influence in the practice of law in common law countries:

1) Presumed - When there is an assumption that the relationship of the parties fundamentally affects the formation of the contract. This assumption applies when there is a relationship of trust between the two parties. Common examples where

assumptions arise are parent/child relationships when children are under 18 years of age, relationships between lawyers and their clients, and doctor/patient relationships.

2) Express or Actual - In these circumstances, undue influence must be proven by the party claiming to have experienced undue influence.

The Dutch legal system provides protection to the weaker parties in the contract through the concept of misbruik van omstandigheden (abuse of circumstances). The Netherlands in the Nieuw Burgelijk Wetboek (NBW) in Article 3:44 paragraph 1 explicitly includes the prohibition of abuse of circumstances in the formation of agreements.

The provisions of Article 3:44 paragraph 1 of the NBW state that: "Een rechtshandeling is vernietigbaar, bila zij door bedreiging, door bedrog or door misbruik van omstandigheden is totstandgekomen" which means that "an agreement (legal act) can be canceled if there is a threat, deception, and also abuse of circumstances".

The concept of misbruik van omstandigheden in the Dutch legal system provides more comprehensive protection for the weaker parties in the contract by explicitly acknowledging the abuse of circumstances as one of the grounds for cancelling the contract. This is different from the Indonesian legal system which has not explicitly regulated the abuse of circumstances in the Civil Code.

Based on a comparison of practices in other countries, there are several lessons that can be adopted into the Indonesian legal system to strengthen legal protection for MSMEs:

First, Indonesia can adopt the concept of undue influence from common law countries such as the United Kingdom and Australia. This concept provides protection to the weaker party in the contract by allowing the cancellation of the contract if it is proven that the contract was made under the undue influence of a stronger party. The application of this concept in the Indonesian legal system will provide stronger protection for MSMEs in contractual relationships with larger business actors.

Second, Indonesia can adopt the concept of misbruik van omstandigheden from the Netherlands by explicitly including the prohibition of abuse of circumstances in the Indonesian Civil Code. With explicit arrangements, MSMEs will have a stronger legal basis to request the cancellation of adverse contracts made under conditions of imbalance of bargaining power.

Third, Indonesia needs to strengthen supervision of economic exploitation practices against MSMEs. This can be done by giving greater authority to supervisory institutions to monitor and take action against business practices that are detrimental to MSMEs.

Fourth, Indonesia needs to revise the 25-year-old UUPK to be more adaptive to the times and the current consumer protection needs. This revision must take into account the latest market dynamics, technological developments, and new business practices that may not have been accommodated in the existing UUPK.

Fifth, Indonesia needs to strengthen the position of MSMEs in the value chain by providing greater incentives and support for increasing the capacity and competitiveness of MSMEs. This will reduce the dependence of MSMEs on larger business actors and increase their bargaining position in business relationships.

Through the adoption and adaptation of the concepts of protection of weak parties in contracts from developed countries, Indonesia can strengthen the legal framework to protect MSMEs from various forms of economic exploitation. This in turn will support the growth and sustainability of MSMEs as the backbone of the national economy.

Conclusion

This research concludes that while the principle of freedom of contract is a foundational aspect of Indonesian contract law—enshrined in Article 1338 of the Civil Code—it is not fully realized in practice, particularly in contractual relationships between large corporations and MSMEs. The analysis reveals a significant gap between the theoretical ideal of contractual freedom and the empirical realities faced by weaker parties, who often lack equal bargaining power. This disparity highlights the urgent need to reconstruct the application of the principle of freedom of contract within the framework of social justice, ensuring that it does not serve merely as a formal doctrine but as a mechanism for equitable and fair contracting practices. To address this, the study recommends the strengthening of standard contract regulations, the development of transparent and fair contractual guidelines, and an active regulatory role by the state to protect the interests of MSMEs. Future research should explore models of contract regulation that balance autonomy with fairness and examine comparative legal frameworks where the principle of contractual freedom is harmonized with protections for vulnerable economic actors.

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