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Enforcing Contracts In Pre-Capitalist Economy: The Case Of Nattukottai Chettiars Of Tamilnadu

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Abstract

The execution of financial and banking agreements is frequently perceived to reside within the purview of governmental legal provisions. This study examines a particular instance of self-enforcing financial contracts within the banking framework of nineteenth-century South India. The Chettiars, a caste of merchant-bankers, depended on religious uniformity as well as a practice of endogamous marriage, wherein members exclusively united with others from the same community, to uphold banking contracts within their structure. Recognized as a significant source of credit both locally and across Southeast Asia, this paper delineates and scrutinizes the mechanisms of enforcement that were operational in the absence of governmental intervention. In addition to introducing a new case of self-enforced financial contracts, this paper also offers an innovative perspective on the interpretation of the social institution of caste, as analyzed through the lens of rational choice theory.

The implementation of regulatory measures pertaining to banking and financial agreements is predominantly perceived as residing within the purview of governmental legal frameworks. The principal rationale supporting this perspective is predicated on the assertion that individuals are incapable of surmounting prisoners' dilemmas in the absence of an external entity to ensure compliance with contractual obligations. This limitation consequently diminishes the frequency with which they engage in reciprocal trade, thereby inhibiting the potential for robust contractual commerce to either persist or thrive. Nonetheless, are there specific scenarios wherein it might become feasible for collectives to uphold banking and financial agreements independently of governmental enforcement mechanisms? Empirical historical instances offer illustrative examples of such self-enforcing systems that challenge the prevailing assumptions regarding the extent of governmental authority in the enforcement of contracts.

This manuscript conducts a comprehensive examination of a novel instance of self-enforcing contracts within a network of banking professionals. The banking infrastructure of the Chettiars, an esteemed Indian banking caste during the nineteenth century, proliferated across numerous nations within South-East Asia, furnishing critical credit services to emergent industries in those regions. Members of this caste established distinct banking institutions that were intricately interlinked in their commercial activities, serving as significant sources for each other's deposit liabilities and engaging in the discounting and re-discounting of each other's bills of exchange. This interconnection consequently generated a necessity for the enforcement of commercial contracts among bankers, the mechanisms of which are elaborated upon in this manuscript. Traditional economic evaluations of the caste system in India tend to implicitly characterize it as a societal construct that obstructs economic development and advancement. Does this perspective remain valid when assessed through the lens of a rational choice framework that centers around a profit-maximizing agent? The case study of the Chettiars indicates that this perspective is flawed. In their situation, it becomes evident that the ties and boundaries of their caste established the requisite environment for effective business operations. Therefore, in this context, caste assumed a crucial economic function, particularly in the absence of governmental enforcement of their contractual agreements. Prevailing economic analyses have failed to elucidate this economic role of caste due to their overarching aggregative perspective. Hence, this manuscript may also be regarded as a progressive contribution to the application of rational choice theory to the intricate social institution of caste, while concurrently engaging with the broader literature that applies rational choice to institutional analysis.

In the absence of a tertiary enforcement agent, it is a multitude of alternative mechanisms that must be activated to ultimately ensure the enforcement of contracts among individuals. Identifying the precise mechanisms in operation facilitates the hypothesis that such arrangements may exist even beyond the specific instance at hand. For the Chettiars, it was the religious homogeneity within the caste coupled with a rule of endogamous marriage that permitted matrimonial unions solely among caste members while prohibiting marriages with individuals outside the caste that upheld contract enforcement. In addition to challenging the extent of governmental enforcement of financial contracts, this also exemplifies the potential for analogous arrangements to exist within other castes in India, all of which adhere to endogamous practices and are typically characterized by religious homogeneity.

For the Chettiars, the establishment of common religious customs facilitated the enforcement of financial agreements through institutions such as temples and adjudication panels composed of esteemed business elders. Conversely, caste adjudicators employed the matrimonial regulation by threatening to impose restrictions on the marriage prospects of a guilty recalcitrant offender with other caste members. This mechanism consequently engendered a self-reinforcing system whereby the decisions rendered by the adjudication panels were highly likely to be acknowledged by the disputing parties. This phenomenon arose from the fact that a member jeopardized not only his social standing, as no other caste member would be permitted to unite in matrimony with him, but also, as a subsequent consequence, his professional reputation. This enforcement mechanism was effectively utilized by the Chettiars in their banking framework for numerous decades until the early twentieth century, when escalating governmental intervention and surging nationalist movements precipitated a comprehensive restructuring and decline of their enterprise.

Chettiar Banking System

The Chettiars are frequently designated as ‘indigenous bankers’ (Jain, 1929; Krishnan, 1959; MPBEC, 1930; Rudner, 1994; Thomas, 1941), a designation intended to reflect an intermediary role situated between that of a moneylender and a formal banking institution. Unlike conventional moneylenders who primarily extend credit from their personal savings or capital reserves, the Chettiars functioned as authentic financial intermediaries, engaging in both the acceptance of deposits and the provision of loans. Nonetheless, in contrast to banks formally recognized within the ‘formal’ sector, the Chettiars and similar entities developed and operated within an ‘informal’ context, devoid of any government charter or regulatory oversight. Consequently, the appellation ‘indigenous banker’ was employed to characterize them, denoting a spontaneous and self-sustaining characteristic. Jain (1929) in his examination of indigenous banking in India delineates a distinction between moneylenders and genuine bankers, including the Chettiars, Marwaris, and Jains, among other groups. He articulates that indigenous bankers “are not required to register themselves as such under any law of the realm” (Jain, 1929:1), tracing their historical evolution back several centuries when they served as significant sources of credit and money-changers within royal courts. The Chettiars are rooted in a rural region of the South Indian state of Tamil Nadu and emerged as the most prominent indigenous bankers in Southern India throughout the nineteenth century (Jain, 1929; Krishnan, 1959). Initially commencing as salt traders in the seventeenth century and subsequently diversifying into money lending, they established a comprehensive banking system by the nineteenth century (Mahadevan, 1978a; Rudner, 1994). The caste was estimated to comprise approximately 10,000 individuals in 1896, growing to 40,000 by 1920 (Rudner, 1994). As a social group, the Chettiars adhered to endogamous practices, marrying exclusively among fellow caste members. However, within the caste, they were segmented into nine exogamous clans or ‘gotras’, wherein marriages among individuals of the same clan were expressly forbidden (Chandrasekhar, 1980; Rudner, 1994). Entry into the caste was strictly hereditary; one had to be born to Chettiar lineage to attain membership. These customs can be traced back several centuries into the earliest documented history of the Chettiars (Rudner, 1994), thus being firmly entrenched prior to their ascendance as a banking entity. This aspect is significant as it will be demonstrated that these prevalent social customs and rituals constituted the foundational basis upon which the Chettiars were able to establish effective institutions conducive to the growth and prosperity of their business endeavors.

A pertinent consideration is that while substantial barriers to entry existed within the caste system, there concurrently existed a perpetual freedom to disengage from it. However, individuals who chose to exit the caste would find themselves in a position of self-reliance, devoid of access to any organized caste entities or accumulated social and financial resources. In this regard, caste affiliation can be likened to membership in a social club that offers localized public benefits; however, one was required to be born into such a club, and membership could not be attained through marital alliances. Our focus shifts to their roles as financial intermediaries around the mid-nineteenth century, when the British colonization and subsequent opening of Southeast Asian territories prompted numerous Chettiars to abandon their native lands and extend credit to a variety of newly established industrial enterprises within these regions (Mahadevan, 1978a, 1978b; Menon, 1985; Weerasooria, 1973). This banking framework operated effectively for a minimum of seventy years until approximately 1930, a year frequently acknowledged as the critical juncture marking the downturn of their financial endeavors (Mahadevan, 1978a, 1978b; Menon, 1985; Rudner, 1994; Weerasooria, 1973). The observed decline stemmed from an amalgamation of intricate external and socio-political influences, rather than a sudden disintegration of the internal mechanisms governing the caste. An extensive examination of the various occurrences contributing to this decline will be undertaken in a subsequent section. This period also coincided with the initiation of increased regulatory oversight of the economy by the Indian state, following the establishment of several national committees tasked with investigating and assessing the characteristics of diverse business practices in 1929 (Baker, 1984). The national banking inquiry committee was dependent on numerous smaller ‘provincial’ committees that reported on the banking conditions specific to their respective regions. The findings of the Madras Provincial Banking Enquiry Committee (1930) (hereafter referred to as MPBEC, 1930) delineate:

These proposals were generally accepted, and a press communiqué was disseminated on the 12th of June, 1929, indicating that the objectives of the inquiry encompassed an examination of the prevailing conditions within the banking sector and the evaluation of what measures, if any, are both practicable and advantageous under the subsequent categories: (a) The regulation of banking aimed at safeguarding the interests of the public. (b) The advancement of banking in terms of the proliferation of both indigenous and joint-stock banking in relation to the requirements of agriculture, commerce, and industry. . . The indigenous banking entities within this Presidency comprise the banking communities of Marwaris, Multanis, Nattukottai Chetti yars, and Kallidaikuruchi Brahmans. These institutions primarily extend loans based on personal credit, generally at elevated interest rates compared to larger joint-stock banks, while simultaneously assuming greater risks by relying more on personal familiarity with their clients and the businesses of their clients rather than on pledged securities for trade financing. They engage extensively in hundis and facilitate a substantial portion of the internal distribution of goods.

While their commercial activities predominantly entailed extending credit to individuals outside of their caste, the mechanisms for enforcing contracts within the caste and the associated enforcement frameworks constituted the fundamental elements that integrated the banking system. There were two principal justifications for necessitating the enforcement of business contracts within the community itself. As a financial institution, the Chettiars served as a crucial source of credit for one another. In fact, it is estimated that approximately 75% of the deposit capital for any individual Chettiar banker was sourced from fellow Chettiars, which included both banking and non-banking members of the caste, encompassing women’s savings and dowries (Rudner, 1994). The extensive network was geographically distributed across a wide area, thereby enabling the seamless and efficient transfer of funds. Consequently, this engendered a significant reliance on 'trust' and an augmented necessity for enforcement mechanisms, as the discounting and re-discounting of bills of exchange inherently involve disbursing funds on behalf of another member bank situated in a different city or town. References to the Chettiars and their proficient business organization are prevalent in all prominent historical accounts pertaining to the economic history of India or South-East Asia (Baker, 1984; Bayly, 1999; Elson, 1992; Kumar, 1983; Ray, 2002; Tomlinson, 1993). Kumar (1983, p. 373) articulates that "The great trading castes –The Chettiars of Tamil Nadu, the Komatis of the Telugu region, the Balijas of Kanara, the Muslim Labbais and many others, had been well organised for centuries, and did not lose their social cohesion during the Company's rule." (Emphasis mine) In a related context, Rudner (1994, p. 88) asserts that "Nakarattar success was clearly linked to their ability to master the changing institutional framework of British colonial government and to act as middlemen between the colonial government and colonial society at large." The substantial economic growth of the caste as a unified entity can only be comprehended as a result of the efficacy of the Nakarattar social organization in facilitating financial intermediation, capital accumulation, and investment activities. Nonetheless, this leaves unresolved the inquiry into the specific mechanisms that were operational in enforcing and sustaining their commercial dominion. These concerns will be examined in the subsequent section.

Role of temples in enforcing contract

Temples and religious practices constituted the initial of three pivotal institutions integral to the prosperity of the Chettiar community. The significance of the Hindu faith was critical in the existence of the Chettiars and was prominently expressed through their temples. These temples functioned not only as sites of worship but also as vital social and economic hubs for the entire community. Each of the nine exogamous clans previously referenced possessed its own designated clan temple, which governed and legitimized the principal marriage ceremonies occurring among community members. In addition to clan temples, any village with a substantial Chettiar demographic within their rural homeland in Tamil Nadu was also equipped with a Chettiar village temple, whereby membership was contingent upon residential locality. Consequently, nearly all Chettiars concurrently belonged to at least two temples overseen by the Chettiar community, one determined by their clan affiliation and the other by their place of residence. Beyond this extensive interconnectedness of temples, each international business establishment also incorporated a temple along with a communal residence that accommodated Chettiars engaged in commercial activities. Each of these Chettiar temples was financed and overseen by individuals within the community. Those who contributed significant financial donations to the temples would ultimately find themselves appointed as guardians or trustees of the temple's interests. Although clan the temples exercised paramount authority concerning the sanctification of matrimonial unions, while village temples also possessed specific powers associated with marriage rituals. Matrimony constituted merely one of the numerous social ceremonies that were profoundly intertwined with religious rituals and, consequently, with the temples themselves. Beyond the realm of social rituals, however, temples and religious practices were closely linked to the business operations of the Chettiar community as well. The initiation of any new business endeavor was contingent upon commencing on an 'auspicious' day as delineated by the Hindu calendar, which was only pursued subsequent to the execution of the requisite ceremonial practices at the temple. Rudner's (1994, p. 98) reproduction of one of their account books discloses an entry at the top of the page (albeit a nominal amount) made in reverence to the deities under the designation "Auspicious credits in the name of various deities." Evers and Pavadarayan (2006, p. 856) elucidate the significance of religious beliefs in inter-Chettiar transactions: In instances where credit is extended to fellow Chettiar money-lenders, the deity Murugan is invoked as their divine witness. He is regarded as the presiding authority at every business and social assembly. Furthermore, he is perceived as the ultimate witness to every oral agreement and financial transaction conducted among the Chettiars. Acts of dishonesty and failure to fulfill payment obligations invoke religious sanctions through divine intervention, manifesting in repercussions such as calamities and misfortune. Regardless of whether the Chettiars awaited divine retribution to address business disputes, they also possessed the option of a more terrestrial method of conflict resolution by filing a complaint at the temple, which would then assemble a panel of esteemed elders to adjudicate the matter.

Role of caste panchayat in enforcing contract

The 'panchayats' were groups of respected elderly individuals within the community who were called upon to settle disputes among caste members, whether personal or commercial. These panels were located within temples and were typically composed of the temple's trustees. They could be tasked with resolving conflicts over various issues, such as sibling disputes over family property or disagreements between bankers regarding interest payments or contract breaches. It's important to note that the temple's panel handled both commercial and social disputes.

The panel's discretionary powers and customary precedents, rather than written rules or constitutional arrangements, formed the basis of the judgments. The selection of the temple to lodge a complaint depended on the context of the dispute and the commonalities between the two disputants. If the disputants came from the same clan, they would turn to their common clan temple to resolve the conflict. Disputants from different clans could seek resolution at village temples or temples in the location of their business dealings, based on what was mutually acceptable. There were no established rules or written codes specifying which temple's jurisdiction applied to particular situations. Nevertheless, this system effectively functioned as Rudner has described.

It is worth noting that Nakarattar conflict resolution processes were not centralised under a single Nakarattar chief or overarching Nakarattar caste panchayat. On the contrary, they were highly segmented and context-sensitive, responding to a variety of local interests arising from disagreements between Nakarattars from various villages, clans, and commercial stations. This segmentation in no way stopped the caste from responding collectively to panchayat decisions. Rudner (1994, pp. 128)

In cases where refractory accused were judged guilty, temple councils utilised their authority over marriage procedures to prohibit marriage between caste members and the guilty individual. Two separate authors who have written about the Chettiars' conflict resolution ways describe this procedure below. The temple council is responsible for resolving issues like as marriage contract arrangements, financial conflicts, family conversations, and so on. Final decisions are never made in paper, but rather by word of mouth. Those who do not follow the council's decision do not obtain a garland from the temple for their marriage, and no marriage can take place without it. (Thurston, 1909, pages 263-264)

There is also a strong communal system of arbitration obtain ing among the Chettiars. Attached to every temple (kovil) is a temple council (Panchayat), which is composed of the elders among them and adjudicates on all matters relating to mar riage, monetary transactions, family disputes, etc. The manager of the Kovil arranges for meetings and records evidence; and the award is given orally and not usually in writing. If the par ties do not abide by the decision, they may be ostracized, and their marriages may not be celebrated under the auspices of the Kovil. (Thomas, 1941, p. 846) This leads us into the next subsection describing the role of the elite or parent bankers within the community and ultimately within the conflict resolution procedure.

In addition, the Chettiars have a powerful communal arbitration system. Every temple (kovil) has a temple council (Panchayat), which is made up of the elders and decides on all problems concerning marriage, monetary transactions, family disputes, and so on. The Kovil's manager arranges meetings and documents evidence; the reward is usually given orally rather than in writing. If the couples do not follow the decision, they may be shunned, and their weddings may not be held under the auspices of the Kovil. (Thomas, 1941, page 846). This leads us to the next subsection, which describes the function of the elite or parent bankers in the community and, eventually, in the conflict resolution process.

Role of Parent Bankers in Enforcing Contracts

The wealthier caste members or natural elite among the Chet tiars also acted as parent bankers in the banking system. They often possessed a significant number of banking branches, which enabled them to serve as clearinghouses for the whole financial system. According to Rudner (1994), these 'adathis' or parent bankers made up 5–10% of the caste community. Smaller Chettiar enterprises would keep accounts with these parent bankers, allowing for easy and quick money transfers over large distances by simply drawing bills of exchange on the 'adathi' firms. Because the parent bankers possessed a huge network of banking branches in India and abroad, outstanding debits and credits could be cancelled against each other, resulting in effective clearinghouses. This function increased the value of bills of exchange drawn on parent banks compared to non-parent banks. According to Rudner (1994), such bills were frequently left unredeemed as insurance in case money was required on short notice. 'Adathis' also had a greater role in the communal setting of inter-lending interest rates, which occurred every month in a temple or common house. Aside from that, the 'adathis' were known for their philanthropy and the endowment of temple money.

In certain ways, these parent bankers fulfilled the functions of central banks. Central banks are generally ascribed with functions such as clearinghouse operations, interest rate setting, and the provision of secure credit instruments. However, the father bankers' rank was bestowed organically by other caste members, rather than through government force or regulation. Their commercial skill and altruism earned them a higher social status or esteem. As philanthropists, they were also the major donors to temple trusts, which typically earned them trusteeship of the temples. They were regularly summoned to sit on panels or councils constituted to settle conflicts among caste members. Adathi position was not a hereditary honour. It was entirely based on business abilities and respect. Any caste member has the opportunity to climb in social position and become a 'adathi'. According to Rudner (1994, p. 232), "from the inside, it was recognised as an asset or an investment; something to be achieved, not something ascribed; and something equally achievable by any Nakarattar businessman." As a result, there was an established system in place wherein the most successful businessmen and philanthropists ascended to the top of Chettiar society and held positions of control over temple trusts. This gave them the authority to adjudicate commercial and social issues among their fellow caste members.

Because this greater position was not a hereditary honour, it did not provide the image of a de facto governi ng class in the community.This aspect also functioned to reinforce the legitimacy of judgements made by ho lders of such positions in the view of the other caste members.

Conclusion

The Chettiar banking system is an example of self-enforced order, in which group members used reputation, marital restrictions, and the benefits of repeated contacts to enforce financial contracts throughout the nineteenth century. These mechanisms explain why their communal institutions functioned efficiently, and hence form the foundation of their banking business's success. Baker's (1984) history of their home state, Tamil Nadu, nicely summarises this institutional framework. According to Baker (1984, p. 282):

As they grew, they developed an appropriate set of communal institutions. They established a council to set interest rates and a tribunal to resolve disputes without resorting to court. They developed an agency structure that permitted an apprentice (usually a kinsman) to work on the parent firm's capital for three years. They also devised a system for exchanging money among Chettiar enterprises in Southern India and across the Bay of Bengal, using intermediaries known as adathis to act as clearinghouses for Chettiar bills in each of their major business hubs.

Aside from questioning the need for government enforcement of banking contracts, this work takes a step forward in applying rational choice theory to the social institution of caste. Caste is demonstrated in this scenario to be a reasonable, self-enforcing structure among persons. Further research in a similar vein, applying rational choice theory to the functioning of other castes, is sure to be rewarding. Finally, the existence of a caste system or caste society is sometimes cited to justify substantial affirmative action initiatives implemented by government agencies in India and abroad. Existing economic analysis justifies such regulations by assuming caste is detrimental to economic development.

However, demonstrating that a "endogenous" or spontaneous institution such as caste can and does stimulate trade and wealth provides a new perspective on how and why caste as a social institution functions within society. The Chettiars leveraged their caste links to support a complicated banking system, and economic historians' work indicates that their case is far from unique (Markovits, 1999; Roy, 2010). One upshot is that it opens up the potential of new solutions to old issues about the extent and efficacy of government actions to eradicate caste. On the other hand, it also points towards a need for more research in the relatively unexplored area of how market mechanisms them selves can play a role in making caste boundaries ineffective or obsolete. On the other hand, it highlights the necessity for additional research into the relatively untapped topic of how market mechanisms themselves can play a role in rendering caste borders ineffective or outdated.

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