

## Kautilya's Arthashastra : A Neglected Precursor to Classical Economics

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### ABSTRACT

This paper demonstrates that Kautilya, a great Indian philosopher-statesman and contemporary of Aristotle, and whose work was lost for more than 1400 years, anticipated classical economic thought by some 2,000 years in the areas of international trade, taxation and a labor theory of value. This aspect of Kautilya's philosophy of government has been overlooked by historians of economic thought and we believe that his contributions should receive appropriate and overdue recognition.

**Jel Classification** : B1, B3

### 1. INTRODUCTION

Kautilya, the great Indian philosopher-statesman and contemporary of Aristotle, wrote his *ARTHASHASTRA* as a primer for good rule by the king. The goal of this treatise was to increase the monarch's wealth and that of his realm - as was true of ancient and medieval philosophers, Kautilya did not distinguish between the wealth of the sovereign and that of his subjects. In this respect, Kautilya's approach is akin to the seventeenth century German Cameralist School of Economic Thought (Dasgupta, ch. 3). Kautilya's work continues a long-standing Indian tradition of inquiry into the creation of wealth, which goes at least as far back as the *ARTHARVAVEDA*, circa 1000 BC (Chand).

Unfortunately for the development of economic thought, Kautilya's writings were lost toward the end of the Gupta Dynasty in India, around 500, and were not rediscovered until early in the twentieth century (Choudhary). Translations from Sanskrit into English and Hindi did not occur until 1915, and subsequent translations into other languages did not take place until the 1920s and 1930s. Unlike his contemporary, Aristotle, Kautilya's views were unknown to medieval and renaissance philosophical and, consequently, had no influence on the creation of modern economic theory. David Hume, Adam Smith, David Ricardo and John Stuart Mill, among others, therefore did not have the benefit of Kautilya's thoughts on the best policies and practices for creating and enhancing a

nations's wealth.

In proposing rules and practices by which the king will rule successfully, Kautilya explicitly recognizes that international trade (trade among kingdoms) in goods and services is a major vehicle for increasing the sovereign's wealth as well as that of his subjects. Kautilya also counsels his monarch that the wealth and well being of the realm can be most advanced by a fair and efficient system of taxation, one which will supply the king with tax revenue while not stifling economic growth. Finally Kautilya advocates a wage system which rewards workers for the economic value they have created and encouraged them to work harder and more efficiently.

## 2. KAUTILYA'S VIEWS ON INTERNATIONAL TRADE -

The importance of international trade is emphasized by Kautilya in that he advises the sovereign that foreign relations should be guided strongly by trade considerations. He counsels that relationships with southern kingdoms are to be favored over those with northern kingdoms because the southern kingdoms possess greater mineral wealth. As he puts it "Possessing immense gold is better than a friend ruling over a vast population... for armies and other desired objects can be purchased with gold." (Sen, p. 10) Kautilya also advantages attracting foreigners who possess good technical and other economic development of the realm.

Unlike the Mercantilists, Kautilya also explicitly recognizes that imports represent a very important way in which the wealth of the realm can be increased, in that imports can provide the kingdom with products which are either not available domestically (e.g., natural resources and agricultural commodities) or can be obtained more cheaply from foreign sources through trade than through domestic production. Kautilya fully realizes that exports are not more important than imports as a means for enhancing the kingdoms's wealth.

Kautilya explicitly formulates a comparative advantage view of international trade patterns by stating that it is mutually beneficial to the various kingdoms when the products being imported are cheaper than those that can be obtained domestically and will fetch higher prices to the exporter than can be gotten in domestic markets (Sen, p. 29).

Kautilya proposes heavy state regulation of trade, both so as not to undermine state monopolies and not to aid potential adversarial kingdoms. Kautilya also advocates price and profit controls, being concerning about "just" and "fair" prices and profits (this is similar to Aristotelian and Christian Schoolmen doctrines concerning economic justice and fairness in commercial transactions). "Kautilya imposed a heavy taxation on imported foreign goods of luxury. On the articles of common consumption, light duties were imposed." (Choudhary, pp. 124-125).

Kautilya supports the use of tariffs, both import and export duties, primarily as revenue-raising devices for the monarch rather than as mechanisms for altering trade patterns. "Import rates, intended for revenues rather than for trade limitation, generally ranked between 4 per cent and 20 per cent ad valorem." (Braibanti and Spengler, p. 249).

Kautilya urges the monarch to create trade missions to promote trade with other

kingdoms and he especially supports bilateral trade arrangements in products. In fact, he counsels against unilateral trade, where products are exported or imported for money (bullion) only. He stresses the need to exchange commodities for commodities so that both kingdoms may be mutually enriched (Sen, p. 27). This stress on two-way trade in products is based on the desire to raise tax revenues for the monarch through both export and import duties.

His views on international trade are most clearly spelled out in Book II of the *Arthashastra*, Chapter XVI, which specifies the duties of the king's Superintendent of Commerce:

"...The superintendent shall show favour to those who import foreign merchandise: mariners and merchants who import foreign merchandise shall be favoured with the remission of the trade taxes, so that they may derive some profit... Foreigners importing merchandise shall be exempted from being sued for debts unless they are (local) associations and partners." (Shamasastri, p. 107)

Kautilya also enunciates rules governing the export of state-owned commodities:

"the sale of the king's merchandise in foreign countries...[having ascertained] the value of local produce as compared with that of foreign produce that can be obtained in barter, the superintendent will find out (by calculation) whether there is any margin left for profit...If no profit can be realized by selling the local produce in foreign countries, he has to consider whether any local produce can be profitably bartered for any foreign produce ... he may take his merchandise to other countries through rivers .... Having gathered information as to the transactions in commercial towns along the banks of rivers, he shall transport his merchandise to profitable markets and avoid unprofitable ones." (Shamasastri, pp. 108-109)

Thus, Kautilya recognized that trade based on the principle of comparative advantage would be to the material benefit of both exporting and importing nations.

### 3. KAUTILYA'S PRINCIPLES OF TAXATION

This section of the paper focuses on the Kautilyan tax system, which was remarkable for how extensive it was and how well it conformed to modern principles of good tax systems (Choudhary, pp. 128-130). In advising the ideal tax system, Kautilya enunciates a set of "principles of taxation" remarkably similar to the modern-day criteria first formulated by Adam Smith as "canons of taxation" in his *Wealth of Nations*, published in 1776. Thus, Kautilya's views on the elements of a good tax system predate modern economic thought by some two thousand years:

"Kautilya's discussion of taxation and expenditure, apparently in keeping with traditional doctrine, gave expression to three Indian principles: taxing power is limited; taxation should not be felt to be heavy or exclusive; tax increases should be graduated." (Spengler, 1971, p. 72).

Kautilya recognized that a prosperous and stable kingdom had to be founded on a well-developed and administered tax system. The importance of public finance to the

successful reign by a monarch is underscored by his succinct advice to his sovereign:

"All undertakings depend on finance. Hence foremost attention must be paid to the treasury...Thus, when both the receipts and expenditures are property earned for, the king will never find himself in financial or military difficulties." (Gopal, p. 19).

"...the army is sometimes the means of securing the wealth acquired; but wealth is always the means of securing both the treasury and the army. Since all activities depend on finance, financial troubles are more serious." (Gopal, p. 20)

In Kautilya's view, finance was so important to the success and well being of the sovereign that it, along with the army, was under the direct control of the king. In the ideal Kautilyan state, the monarch's revenues came from two major sources: sales of minerals, timber and agricultural products from the king's lands and mines, and taxes levied on private income, wealth and products (including exports and imports).

As presented in the *Arthashastra*, Kautilya's advice to his monarch on the ideal tax system is based on achieving the following objectives: gaining as much tax revenue as possible for his king; promoting economic growth and development within the kingdom; ensuring that resources are used efficiently; and applying taxes that are "fair" and "just".

As a noted student of Mauryan public finance observed, the Kautilyan system of taxation resembled that of the Roman Empire at its height: taxes were levied on income, wealth in the form of both real and personal property, and market transactions (sales) including both export and import duties, as well as poll taxes on all adult males. (Gopal, P. 22) Further, Kautilya recognizes that the "ideal" tax system should embody the following principles: it would be convenient to pay, easy to calculate, inexpensive to administer, fair (equitable) in its burden, non-distortive of economic behavior in its impact (neutral), and in general not inhibit economic growth and development. (Gopal, pp. 23-26)

In keeping with the criteria of convenience, equity, neutrality, and promoting economic growth, Mauryan taxes could be paid in gold, coins (usually silver or copper), livestock (mostly cattle), agricultural products, minerals and timber, and personal services (e.g., working on the construction of roads, canals and forts, laboring in the king's mines or logging in the king's forests, or serving without pay as a soldier). Kautilya counsels that taxes should be collected only when people have the capacity to pay:

"Just as fruits are gathered from a garden as often as they become ripe, so revenue shall be collected as often as it becomes ripe. Collection of revenue or of fruits, when unripe, shall never be carried on, lest their source may be injured, causing immense trouble." (Gopal, p. 23)

Further, Kautilya advises that taxation should not be raised to such a high degree that it destroys people's economic incentives to engage in productive undertakings, thereby lowering the level of economic activity and the material wealth of the kingdom:

"Thus, a wise Collector-General shall conduct the work of revenue collection...that production and consumption should not be injuriously affected...financial prosperity depends on public prosperity, abundance of harvest, and prosperity of commerce among other things." (Gopal, pp. 23-24)

According to Kautilya, the amount of tax liability should be certain and known, and convenient to pay:

"...collection of revenue at a season when people were unable to pay is forbidden because it injures the source and causes immense trouble." (Gopal, p. 24)

In Kautilya's view, the tax system should be fair, and tax rates should reflect people's ability to pay in terms of wealth or income or sales revenue:

"...the policy is to make the richer section of the peasantry or those who hold lands in fertile areas of high productive calibre to contribute more [have higher tax rates apply], and to grant exemptions from this liability where the cause of production and development may suffer through high taxation." (Sen p. 119)

Higher rates of sales taxation apply to the most expensive commodities traded (e.g., gold, silver, diamonds, pearls, etc.) and progressively lower rates of sales taxation apply to less expensive commodities (e.g., cloths and threads, grains and dairy products, and finally firewood/earthen vessels/bamboo). (Sen, pp. 121-122) A similar system of graduated tax rates apply to the occupational privilege and income taxes levied on artisans and craftsmen, where the highest rates are levied on the most skilled workers and the lowest rates are assigned to the least skilled. (Sen, pp. 122-123)

Kautilya advocates a highly structured and centralized revenue system, with extensive usage of broad-based taxes. The system is supervised by the Collector-General of Revenues (Samaharta), who reports directly to the monarch and is equal in importance and influence to the Commander-in-Chief of the Army. All the Superintendents of the king whose activities generate revenues for the sovereign report to the Collector-General of Revenues as concerns the revenues collected (Superintendents of Gold, Mines, Storehouse, Commerce, Forest Products, Tolls, Weaving, Agriculture, Liquor, Slaughter-House, Prostitutes, Ships and Passports).

Responsibility for gathering information on which the collection of tax revenue and its auditing is based resides in the Village Accountants (Gopas, each responsible for from five to ten villages), who in effect are the census takers. These Gopas are required to inventory all the real and personal property wealth in their domains for wealth tax purposes, the number of adult males for poll tax purposes, the annual income and expenditure of each household for income tax purposes, and the number and type of merchants and artisans (as well as volume of business done) for both sales and occupational license tax purposes. The breadth and detail of Mauryan census-taking revealed that of ancient Egypt under the Pharaohs, and was the most extensive census existing before the industrial revolution (Bandyopadhyaya, p. 138). With reference to the U.S. federal government, the Gopals combined the functions of the Internal Revenue Service and the Bureau of the Census.

Under the tutelage of Kautilya, the Maurya tax system was as extensive as any that exists in this modern age. As would be expected in a pre-industrial economy, real property and excise taxes were major sources of tax revenue. Because of the detailed census conducted by the Mauryan kingdom, however, considerable revenue was derived from personal property and poll (head) taxes, as well taxation in the form of occupational

licenses. Even income taxation was employed. Thus, Kautilya clearly enunciated-well before the rise of classical economic thought-a detailed, all-inclusive and effective tax system.

#### 4. KAUTILYA'S LABOR THEORY OF VALUE

Two millennia before Adam Smith enunciated his labor theory of value, Kautilya in the *Arthshatra* held that a "just" wage to be paid to workers should be based on the amount of time spent on the job, the amount of output created, and the skills necessary to perform the required tasks. Kautilya explicitly recognizes three distinct components for determining the market value of labor: the level of skill required (the human capital element), labor hours worked and units of output produced (the labor productivity element). As stated by Benoy Chandra Sen in his treatise, *Economics in Kautilya* (p. 51):

"A uniform and flat rate of wages for laborers of all sorts is impracticable in an advanced economic condition where commodities of various gradations of value representing different kinds and degrees of manufacturing skill are produced and used by consumers. The wages of a laborer cannot but be dependent on the market-value of the article produced. The latter again depends on the cost of its production, including the cost of material used. Thus the settlement of just wages is a complicated matter depending not only on the skill of the worker employed but also on the total out-turn of his work; i.e., both the quality and quantity of the job completed by him."

R. Shamasastri in his translation, *Kautilya's Arthshastra*, cites that among the duties of the Superintendent of Weaving shall be the setting of wages paid to weavers (pp. 125-126):

Wages shall be fixed according as the threads spun are fine, coarse or of middle quality, and in proportion to a greater or less quantity manufactured, and in consideration of the quantity of thread spun...Wages shall be cut short, if, making allowance of the quality of raw material, the quantity of the thread spun out is found to fall short.

In determining wages for labor in general, Shamasastri quotes Kautilya in establishing the following procedure (p. 208):

As to wages not previously settled, the amount shall be fixed in proportion to the work done and the time spent in doing it. Wages being previously unsettled, a cultivator shall obtain 1/10th of the crops grown, a herdsman 1/10th of the butter clarified, a trader 1/10th of the sale proceeds. Wages previously settled shall be paid and received as agreed upon.

V. Nagarajan, in his book on *Evolution of Social Polity of Ancient India*, observes that (p. 114).

To prevent deception by employers, Kautilya lays down that cultivators or merchants shall either at the end or in the middle of their cultivation or manufacture pay the labourers proportionate wages. Payment to labour is not contingent on marketing of goods. Production should not be hampered by the irresponsible conduct of the workers.

Guilds of Artisans ("Sanghabhrta") often functioned as contractors and employed semi-skilled and unskilled laborers. To protect these laborers, Kautilya, as cited by Narayan Chandra Bandyopadhyaya in his book, *Kautilya*, (p. 203) recommends that a board of overseers review the guild contracts concerning wage rates and working conditions.

## 5. SUMMARY AND CONCLUSION

Kautilya, the great Indian philosopher and statesman, in writing his epic treatise on the art of good government, the *Arthashastra*, enunciated classified views on international trade, principles of taxation, and a labor theory of value.

Writing more than two thousand years before Hume, Smith, Ricardo and J.S. Mill, Kautilya anticipated their thoughts on the importance of conducting trade in accordance with the principle of comparative advantage, that imports are as important as exports in promoting a nation's economic development and growth, and that reciprocal demand will determine the value of commodities in bilateral and multilateral trade.

He also clearly anticipated Smith and Ricardo on the principles of effective taxation that will result in an ideal system of taxation: one which will promote economic growth and development, ensure that resources are used efficiently, whose burden is borne fairly, and which distorts economic decision-making as little as possible.

Kautilya was also far ahead of his time in developing a labor theory of value in trying to determine what was a "just" wage for workers. Anticipating the thoughts of Smith and Ricardo, he explicitly recognized that the value of labor depend on the level of skills employed, time spent on the job, and the amount of output produced. He also was cognizant that the market value of labor also reflects the market value of the product created.

One can only conjecture that trade theory, principles of taxation, and the labor theory of value associated with classical economic thought might have evolved much earlier (perhaps in the fourteenth or fifteenth centuries) if Kautilya's views had been known to scholars such as St. Thomas Aquinas in the late middle ages or early Mercantilists in the Renaissance. This is another example of occidental philosophical thought suffering from not having access to oriental philosophical thought.

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