Bridging the Gap: Kautilya's Arthashastra and Modern Economics

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Abstract

This paper explores two main ideas: first, that Kautilya was the first political economist, and second, that the study of political economy began long before Adam Smith. By examining The Arthashastra (written around 375 B.C.), we find evidence of rational decision-making, self-interest, and market activities similar to those in a traditional economy. A careful analysis shows that Kautilya's work is just as systematic in studying political economy as Smith's The Wealth of Nations. Since economics focuses on policies and strategies to build a nation's wealth, the Arthashastra, meaning "The Science of Wealth," can be seen as the first detailed guide on political economy. Understanding Kautilya's ideas helps us trace the true beginnings and development of economic thought. Looking at these historical ideas also helps us better understand modern economic theories and methods.

Keywords: economic history, Kautilya, market elements, political economy, self-interest, wealth creation

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Known as the "missing link" in economics, Kautilya's writings and teachings from around 375 B.C. are an important but frequently disregarded aspect of economic history. Regretfully, his work is still unknown to the majority of academics and economics students. Although his contributions have been recognized by contemporary economic theory, he is frequently dismissed as a mere "ancient economic novelist" (Waldauer, Zahka & Pal, 1996, p. 101). Even though The Arthashastra contains important economic ideas and principles, his impact on the evolution of contemporary economics has been largely disregarded by conventional economic theory. Given that Kautilya's theories address a wide range of subjects, such as global commerce, labor, wages, pricing, fiscal and monetary policies, economic growth, and corporate social responsibility, this oversight seems perplexing. According to orthodox economists, especially those who endorse Finley's (1999) thesis of "primitive economics," organized economic thought existed prior to Adam Smith (1759, 1776). Aristotle, de Jean Olivi, the late Scholastics, the Physiocrats, and Mandeville are among the early figures they identify as having influenced classical economics, at most.

Their elevation of economics to the pinnacle of 'modern science' rests on two key arguments:

1. The Invisible Hand and Individual Interests:

This concept, famously introduced by Adam Smith, suggests that individuals pursuing their self-interests inadvertently contribute to the overall good of society. When people make economic decisions based on personal benefit such as starting a business, investing, or innovating they are unknowingly guided by an "invisible hand" that aligns their actions with societal progress.

2. The Market System and Social Progress:

   The market system, driven by supply and demand, plays a crucial role in ensuring economic growth and improving societal well-being. It does so by efficiently allocating resources, fostering competition, and encouraging innovation. In an ideal free-market economy, businesses strive to produce better goods and services at lower prices to attract consumers, which leads to overall prosperity.

The Greek words oikos (home) and nomos (a complicated root of the word stupid, meaning manage, order, custom, and law) are used by Hutcheson (2010) to define economics. Xenophon claims that Oikonomicos (450 B.C.) enumerates the wisdom of over two millennia. The premise that the market did not exist three thousand years ago is the foundation for the thesis that, prior to The Wealth of Nations, markets and economic principles were only haphazardly linked to economic categories like GDP, efficiency, inflation, and unemployment are only the result of general knowledge or philosophical observation. The models of market mechanisms, economic policy, and growth theory found in Kautilya's Arthashastra must be proof of a complicated economic process and the economic analysis of that process itself, not just the outcome of a straightforward social practice or activity. The study aims to answer the following questions;

What economic tools and policies described in the Arthashastra have parallels in contemporary economic theory?

How might Kautilyan economics provide alternative perspectives to address current economic challenges?

How do Kautilya's economic principles in the Arthashastra compare with fundamental concepts in modern economics?

Review of Literature

Sihag (2014) presents perhaps the most comprehensive analysis of Kautilya's economic ideas, arguing that the Arthashastra contains sophisticated concepts regarding market regulation, fiscal policy, and welfare economics that were in many ways ahead of their time.

Trautmann (2012) examines Kautilya's theories on wealth creation and distribution, arguing that the text presents a nuanced understanding of the relationship between private enterprise and state regulation that defies simple characterization as either "socialist" or "capitalist."

McClish and Olivelle (2012) emphasize the text's innovative approach to governance, noting its departure from earlier dharmic traditions toward a more secular understanding of political power. They highlight how the Arthashastra develops a comprehensive theory of state administration with detailed attention to bureaucratic structures.

Waldauer et al. (1996) analyze Kautilya's economic principles in comparative perspective, noting parallels with mercantilism but also identifying unique features that distinguish his approach from Western economic traditions.

Olivelle (2005) examines the legal dimensions of the Arthashastra, noting its systematic approach to both civil and criminal law. He argues that the text represents a significant departure from earlier dharmashastra traditions in its emphasis on state authority rather than social custom as the ultimate source of legal authority.

Datta and Basu (2016) examine Kautilya's contributions to intelligence studies and argue that many modern intelligence practices can find precursors in the Arthashastra's detailed recommendations on espionage, counterintelligence, and information analysis.

Shamasastry (2010) examines the relevance of Kautilya's administrative principles to contemporary public administration, arguing that his emphasis on accountability mechanisms and performance metrics anticipated modern governance theories.

Sarkar (1919) provided one of the earliest detailed analyses of Kautilya's foreign policy doctrines, emphasizing the text's pragmatic approach to interstate relations and its sophisticated understanding of diplomatic strategies.

The literature on Kautilya's Arthashastra reveals a rich, complex text that continues to reward scholarly attention across multiple disciplines. From its sophisticated political theory to its detailed economic prescriptions, from its pragmatic approach to international relations to its comprehensive legal framework, the Arthashastra offers insights that resonate with contemporary concerns while illuminating an important chapter in the global history of political thought.

Despite extensive scholarship, several aspects of the Arthashastra remain underexplored. The text's relationship to other ancient Indian intellectual traditions, particularly the Buddhist and Jain traditions, deserves more attention. The gendered dimensions of Kautilya's political thought have received insufficient scholarly attention, with few studies examining how the text constructs gender roles and their relationship to political power. Additionally, environmental aspects of Kautilya's thought, including resource management principles, offer potential insights for contemporary sustainability discussions.

Research Design and Methodology

The research will use three methods to connect ancient Kautilyan economic thought with modern economic principles. First, a qualitative textual analysis of the Arthashastra will be used to identify key economic concepts and frameworks. Second, a comparative conceptual analysis will examine the similarities and differences between Kautilyan and modern economic principles. Third, a historical contextualization will situate Kautilyan economics within its Mauryan imperial setting, recognizing how modern economic thought emerged from specific Western circumstances. This will help understand the contextual limitations and potential contemporary applications of Kautilya's economic insights.

The Arthashastra, a text by Kautilya, is analyzed using primary source methods, comparing translations from scholars like Kangle (1972), Rangarajan (1992), and Shamasastry (1915). This method enhances research validity by identifying nuances in interpretations. The text is then examined to identify key economic concepts, policies, and theoretical frameworks. Thematic areas are organized into domains such as taxation systems, trade policies, fiscal management, market regulation, resource management, and labor economics. This helps in comparing Kautilya's ideas with modern economic categories.

This study explains the Kautilya's economic ideas by using a three-step method. First, it studies original texts. Then, it examines the content closely and organizes the main themes. This helps find important economic ideas, policies, and theories. It also helps researchers understand small differences in words and meanings, giving a clearer picture of Kautilya’s real thoughts. The method groups Kautilya’s ideas into areas like taxes, trade, government spending, market rules, use of resources, and labor.

Discussion

To fulfill the objective of the study the context is analyses on following sub-topics

Theory of Economic Growth

Kautilya's economic growth theory emphasizes the role of the King in driving economic development, encompassing key elements such as production and demand for goods and services, productivity, government and fiscal policies, price stability, monetary policy, trade, economic welfare, productive enterprises, wages linked to productivity, women's participation in the labor market, marketing, consumer protection, division of labor, and specialization. His work, The Arthashastra, and detailed model of the Indian economy support this claim, demonstrating that ancient economic theories and practices were far more advanced than commonly acknowledged.

Kautilya's model includes bi-directional causality and interconnected variables of interest, such as agriculture and fishing, state monopolies, state-controlled industries, state-regulated small industries, and private industries like potters and basket makers. The state plays a crucial role in this model by encouraging fair trade, customer protection, harmony in profit and wages, stable fiscal policy, treasury management, stable prices, and positive expectations. The state, or King, is responsible for administering this sophisticated mechanism of the economy, as evidenced by the Arthashastra.

Theory of fiscal policy

The Mauryan State's fiscal policies and operations were well-organized, similar to the budget under the Chancellor's supervision. Government officials established standard blueprints for the treasure's construction and meticulously designed budget accounts and strategies. These budgets were more thorough than contemporary state budget strategies. However, Kautilya's writings do not include a concept of national accounts (Sihag, 2005).

The Mauryan State's budget policy method for a fiscal year includes all departments and reports responsibly elaborated under the Chancellor's supervision. Kautilya explained government spending, recognizing that strict budget cuts could harm people's spending power and reduce the supply of goods. However, he did not support extreme financial restrictions, which some still believe can harm the economy by reducing wealth and ability to buy goods.

Monetary Policy

The Mauryan Empire's money served two main purposes: helping people collect wealth and making trade easier, and demonstrating the government's control over money. To maintain control, the Empire used a single type of currency and strict rules regarding money circulation. A Coin Examiner was responsible for managing the currency, based on the gold standard. Fake money was punishable by severe punishment, especially for treasury workers. Inflationary forces were implied when counterfeiting was permitted and the amount of money in circulation was not controlled.

According to Monnet (2005, p. 7), state officials were required to maintain price stability and manage inflation while managing the currency, as combining real and counterfeit coins would cause the government's treasury to run out. Loans and deposits were a significant topic in Kautilya's economics, with contracts filled with specifics and witnessed. Early Indian conceptions of justice dictated that debtors' obligations should not be increased if they have been performing rites for longer, are ill, are tutored, are minors, or are insolvent.

Trade Policy

In ancient India, trade was a crucial driver of development, with kingdoms aiming to create prosperity by establishing trade routes and promoting markets in cities. A stringent system of trade control was applied to both import and export policies, with merchants being strictly regulated to prevent pricing distortions. Imports were aimed at creating wealth through price subsidies, spot, and future methods, excluding useless goods. Import also played a role in market protection, encouraging merchants to import more goods to build a buffer stock.

A system of comparative advantage was used to advance exports to profitable regions, while unprofitable areas were avoided. A complete system of trade tariffs, import rates, trade duties, price subsidy, and trade control was set up to facilitate and safeguard trade activities. Exports played a crucial role in generating wealth for kingdoms, with the gross margin from trade covering all operational expenses. Trade officers and government officials were responsible for protecting and expanding trade while establishing safe trade routes. Kingdoms sought strategic partnerships through bilateral agreements and reciprocal trade policies that leveraged comparative advantages benefiting both nations.

Labour and Wages Theory

Kautilya regarded productivity as a crucial factor for economic development. According to his theory, the level of productivity is influenced by the division of labor, wages, incentives, and inequality. This connection between productivity and wages is clearly evident in the following passages.

The Superintendent of Yarns ought to determine the wage after evaluating the fineness, coarseness, or medium quality of the yarn, as well as the quantity being produced. Therefore, laborers' wages in the textile sector were carefully regulated and set based on their output levels (productivity). Workers were offered incentives when favorable results in the production process were attained.

Upon determining the quantity of yarn, he should treat them with oil and myrobalan ointments. On celebration days, they ought to be encouraged to work by bestowing honors upon them and by offering gifts. Should there be a decrease in yarn, and based on the worth of the staff, this will lead to a reduction in pay (Kangle, 2003).

The efficiency wage theories appear to have applied to the Kautilyan economy, where the State had to decide to pay wages higher than the going rate in order to boost productivity and future state revenue.

However, if a discrepancy between the productivity level and wage level was observed, the wages were pushed down to the productivity wage equilibrium level since policymakers and controllers knew that paying workers efficiency wages could result in involuntary unemployment. The following remark illustrates how wages were paid to employees in line with specialization theory and the theory of division of labor (Bagwe, 2009).

'Women should spin, while males should weave (ropes, protective wear straps, and similar goods should be created by persons who specialize in their creation). The Chief Commissioner must first reach a consensus with the artisans on the quantity of weaving that must be completed in a specific time frame and the wages that must be paid. Weavers of unique fabrics, such as those created from silk, exquisite yarn, deer wool, etc., will receive incentives' (Rangarajan 1992).

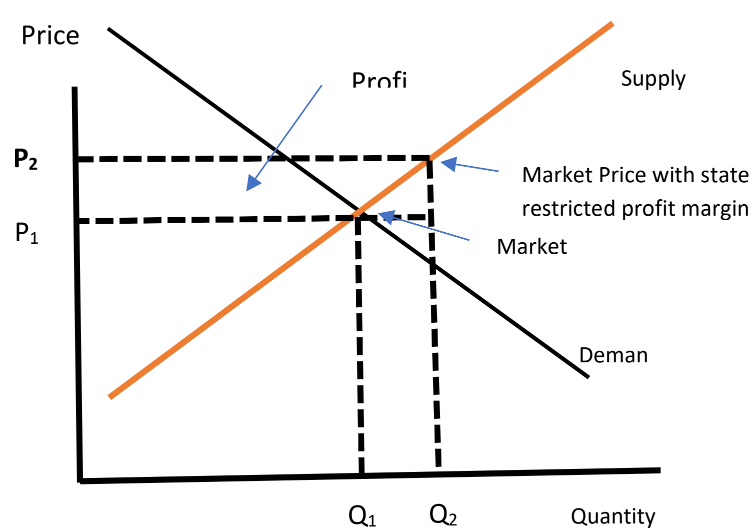
Price and Market System

Kautilya's market system was characterized by high levels of government intervention, similar to classical economics. The current global financial issues, which began in 2008, have seen governments, particularly in OECD nations respond to crises with harsh measures, including nationalization. Banks and businesses have been involved in numerous initiatives, and international economies that have adopted nationalization are considered normal market economies. Nationalization is the most powerful force in the realm of state interference in the market, but its implementation in extreme forms in 2008 and beyond, from the United States to Iceland, will be documented as a historical truth.

In a planned economy, the government uses a fixed pricing mechanism to determine the prices of goods and services, which is the formal difference between a market economy and a planned economy. This was not the case for the Kautilyan economy, though; since the government did not employ a fixed price mechanism, there is no scientific justification for us to not regard the economy in question as a market economy. A different mechanism, that of a fixed profit margin rate was employed in its place. The figure below shows the price-setting mechanism that the Kautilya state has in place.

Figure 1

Price operating mechanism in the Mauryan empire



Markets were functioning under a free market framework, as the image illustrates, but Kautilya (like Adam Smith) thought that markets led to an unequal distribution of income in society. Additionally, it appears that Kautilya was fully aware of the negative externalities inherent in taxation and tax policy that is, that greater taxes result in weaker personal incentives, reduced consumption, lower productivity, which in turn raises unemployment and economic cycles. He therefore believed that using tax policy for income (re)distribution would cause more harm than good, so he had no intention of doing so. His plan was to restrict market profit margins while simultaneously preventing or limiting the creation of an unequal income distribution. How manufacturers, business owners, and merchants would respond to such a policy mechanism is still an open topic. The market system was widely accepted since they were all adhering to the concept of Dharma. It is important to note that the same policy mechanism is no longer in effect in contemporary Nepal, which ranks 115th in the world with a Gini score of 32.8. We are therefore unable to assess the extent to which the "restricted profit margin policy" ultimately affected poverty and income distribution because, undesirably, The Arthashastra has no information regarding income distribution (except from wages throughout the State).

Market Character and Consumers

Markets function as processes within communities, not as external entities. The notion that markets exist only outside communities and operate solely through consumer choices and positivist principles is incorrect and hazardous, leading to economic crises and severe global consequences.

The Kautilyan economy resembled today's market economy but featured strong state intervention. According to Kautilya, market and government failures were interconnected—market failure couldn't occur without government failure, which itself stemmed from moral shortcomings and poor organizational structures (Sihag, 2009b).

Kautilya believed that privately-driven market forces pursued their own interests, and the invisible hand couldn't adequately protect public interests. Thus, government intervention was essential to address negative market externalities. While supply and demand forces determined prices in the Empire rather than the government, the government's role was to monitor and correct market operations when problems arose.

Private manufacturers and merchants were required to pay licensing fees, and those dealing in state-monopolized goods paid a monopoly tax. Additionally, the State controlled cartelization, another market externality, by imposing a fine of 1000 panas on artisans and craftsmen who attempted to reduce quality, increase profits, or obstruct sales or purchases (Sihag, 2009).

Kautilya's economy was a regular 'mixed' economy that rested on five common pillars of any market economy:

1) Private ownership and property rights
2) Price system
3) Entrepreneurship
4) Competition, and

5) Moral-hazard problem.

A comparison (Table 1) offers crucial insight into the differences between ancient economies and their "virtually zero" growth rates. Scholars have questioned why ancient economies lacked growth orientation (Maddison 2006). Kautilya's writings provide critical evidence addressing these questions. He definitely believed markets were inherently unethical and corrupt, necessitating state control in harmony with Dharma. The government maintained authority over profits, incentives, pricing systems, and trade, explaining the limited economic growth during this period.

Table 1

Market economy comparison to Kautilya's economy

Mechanism	Modern market economy	Kautilya's market economy
Ownership	Capital and resources owned by individuals (Private ownership)	Capital and resources owned by a State and individuals (Private and State ownership)
Price system	Resources are allocated in the economy through the forces of supply and demand	Used to allocate resources in the economy by the forces of supply and demand under government's supervision and intervention
Entrepreneurship	Invisible hand and risk-taking	invisible hand under government's supervision and controlled risk-taking
Competition	Healthy competition between buyers and sellers in the marketplace encourages efficient allocation and wise utilization of resources	Regulated competition between buyers and sellers under state oversight promotes and safeguards the efficient and sustainable utilization of resources.

	throughout the production process.	
Problem	Existence of moral-hazard problem	Controlled moral hazard by the State
Total	Efficient Market Economy	Moral Market Economy

Ancient civilizations focused on growth through government investments in public infrastructure and housing, but not in equipment and technology. This led to a lack of significant economic growth in Nepal, as the Kautilyan model failed to achieve significant growth. Moral market economies, like those in Greece, China, and Rome, were unable to generate high growth rates. However, Kautilya, an ancient thinker, believed in protecting consumers and creating rules for fair trading.

Marketing systems were not only present in ancient times with mass consumer markets and free economies, but also in ancient India. Farm goods had to be brought to city markets and taxed before selling, and products from Pinnacle lands were sold through central channels. Traders could get special permission to sell Crown goods in different places, but they had to follow prices set by the Chief Controller of State Trading.

Market forces were controlled to ensure regular people received what they needed, rather than letting sellers make as much money as possible. Kautilya believed that letting merchants make too much profit would lead to unfair trading, harming ordinary citizens and reducing their well-being. Merchants and traders who broke fair trading rules faced harsh punishments.

The Welfare Economics

Scholars interpret the economy of the Mauryan Empire under Kautilya's writings in various ways: as "socialized monarchy" (Wolpert, 1982), "state socialism" (Basham, 1963), or as a welfare state. The welfare state interpretation has received less attention since this concept is traditionally associated with Western industrial economies, particularly Britain. Orthodox economists might consider applying the welfare state concept to Arthashastra's era anachronistic, arguing that welfare states require modern economic systems without monarchical rule. However, The Arthashastra provides evidence that welfare policy mechanisms existed in ancient Mauryan society.

To validate the interpretation of Kautilya's economic framework, it is essential to explore the relationship between his welfare state concept and its economic foundations, particularly the growth-welfare relationship. Kautilya identified three economic pillars—agriculture and cattle breeding, productive manufacturing, and trade—as crucial for creating material wealth, with inactivity leading to distress (Mishra, 2003). His welfare regulations spanned protection for various social groups, including elders, consumers, women, children, and widows, forming a comprehensive welfare structure. While his strict rules may seem to limit social ethics, they also reflect a body of knowledge and values that have long been overlooked by scholars and the public.

The idea that Kautilya's economic model is primitive is challenged by both textual evidence and analysis, which highlight the modern economic principles embedded within his work. Kautilya's model emphasizes that an economy must align with Dharma to thrive, much like Adam Smith's notion of the "invisible hand" driving progress (Smith, 1977, 1982). Kautilya proposed moral market economies as the solution to ensuring economic success without moral collapse.

From Arthashastra to Modern Economics

Kautilya's economic theories mark a significant milestone in the development of economic science, influencing fields like labor economics, growth theory, international economics, and welfare economics. His writings, grounded in the facts and theories of his time, laid the foundation for pre-classical economic schools, positioning him as the first pre-classical economist (Mishra, 2003). Kautilya's work also impacted both Western classical economics and 20th-century Keynesian theory, demonstrating a connection between his ideas and those of Adam Smith. While Smith created a comprehensive economic theory for the 17th century, Kautilya had already developed a systematic framework for the 4th century BCE.

Kautilya and Adam Smith both studied economic systems but approached them differently. Smith emphasized free trade governed by natural laws, while Kautilya focused on agricultural production with state oversight. Kautilya's theories also anticipated many concepts later developed by David Ricardo, such as the labor theory of value and differential rent. He advocated for fair wages based on time and skill, warning that insufficient compensation would harm the economy by causing labor shortages and reduced consumption.

Kautilya's theory of international trade and comparative advantage shares similarities with Ricardo's, emphasizing the importance of both imports and exports in wealth accumulation. His views on economic inequality, self-interest, and public welfare also align with those of Malthus, while his ideas on economic growth resonate with Marx's belief that productive labor drives progress.

Kautilya's work aligns with Keynesian thought, particularly in advocating for a positive state role in managing macroeconomic activities. Both Kautilya and Keynes stressed the importance of state intervention to stabilize markets and protect the economy from business cycles.

Kautilya's economic contributions deserve recognition as a "cumulative theory," influencing not only classical economics but also Marxian, Neoclassical, and Keynesian schools. His comprehensive growth model, anticipating Marshall's concept of "organic economic growth," presents a view of economic progress as humanity's ultimate frontier, a perspective that predates modern mainstream growth theories.

Conclusion

It is clear from the reasons we present in this study that Arthashastra has significant relevant relevance for the theory of modern economics. As a significant addition to economic theory and a methodical examination of political economics, Arthashastra merits reclaiming its long-forgotten rightful place in the annals of contemporary economic theory. Without a doubt, Kautilya was one of the first political economists and the forerunner of classical economic theory.

Using Phillips' 1962 definition of economics as a science that explains "how the system works," we can consider the Arthashastra the missing link between pre-classical and modern economics, illuminating the evolutionary pathway through valuable insights into historical policies and practices. Kautilya's economic contributions deserve recognition, as studying the Arthashastra reveals not only the methodological challenges, investigative boundaries, and assumption realities of his time, but also provides perspective on methodological, epistemological, and practical issues facing modern economics. We can confidently conclude that the Arthashastra represents a significant systematic study of its period's political economy. The economic concepts and variables present in Kautilya's model are clearly the same standard exogenous and endogenous variables that constitute any contemporary economic model.

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