Kautilya on international trade policies

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Abstract

Purpose – The purpose of this paper is to present Kautilya's ideas on international trade.
Design/methodology/approach – A non-technical descriptive approach is followed.
Findings – Kautilya implicitly proposes a theory of gains from trade and recommends imports promotion rather than export promotion.
Research limitations/implications – It is indicated that our current understanding regarding international trade during ancient times is quite inadequate.
Practical implications – There will be no need for current endless negotiations if countries commit themselves to Kautilya's policy of import promotion.
Originality/value – The paper provides insights into trade patterns during the ancient times.

Keywords International trade, Globalization

Paper type Research paper

1. Introduction

> Imports shall be sold in as many places as possible, [local] merchants who bring in foreign goods by caravans or by water routes shall enjoy exemption from taxes and a 10 per cent profit margin shall be allowed on imports as compared to a 5 per cent profit margin on locally produced goods, foreign merchants shall not be sued in money disputes (Kautilya, pp. 236-7).

Kautilya suggests the promotion of imports rather than exports. During ancient times efforts were made to remove almost insurmountable hurdles rather than create them to impede the flow of imports. The challenge for the world leaders is to bring back Kautilya's internationalism in the post-modern, post-industrialized, and interconnected world and exploit the full potential. Everyone understands that globalization without a feeling of internationalism limits potential gains from trade. Thanks to the advances in modes of communication and transportation the physical integration of the world has been progressing at a brisk pace but unfortunately our thinking essentially has been stuck at the national boundaries and refuses to embrace openness. Decades have been wasted in useless negotiations as if the nations were really on the Pareto efficient contract curve.

For obtaining a fuller understanding of Kautilya's theory of the gains from trade, all of his ideas related to international trade are presented. Moreover, this may also serve as a commentary on the status of our understanding of that era. Section 2 contains his policies

JEL classification – B11, F00, F13

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related to the promotion of imports. Section 3 offers his views on the nature of trade during the ancient times. Kautilya's theory of the gains from trade is presented in section 4.

2. Kautilya's policies on promotion of imports

Kautilya's primary goal is to facilitate imports to increase the availability of a maximum number of consumer goods to a maximum number of individuals. It may be noted that before the introduction of modern technology for mass production, every product whether it was a pair of shoes or a shirt was catered to individual tastes and requirements. So there was plenty of variety. Moreover, during the ancient times the choice between having a larger variety at a higher cost and fewer varieties at a lower cost (by mass production) was not available. Also at a low level of income, a preference for two different goods rather than two varieties of one good perhaps would be much stronger.

2.1 Guidelines for fair trading

Kautilya lists guidelines for ensuring fair-trading. For example, he (p. 336) states, "Both locally produced and imported goods shall be sold for the benefit of the public. Even a large profit shall be foregone if it is likely to cause harm to the public. No artificial scarcity be created by accumulation of commodities in demand; these shall not be subjected to restrictions on when they be sold (2.16)".

2.2 Kautilya's specific policies of import promotion

The idea of devising any import substituting or export promoting policies had not germinated yet. Not surprisingly, Kautilya instead proposes import-promoting policies. He (pp. 236-7) recommends, "(i) Imports shall be sold in as many places as possible [in order to make them readily available to people in the towns and the countryside]; (ii) [local] merchants who bring in foreign goods by caravans or by water routes shall enjoy exemption from taxes and a 10 per cent profit margin shall be allowed on imports as compared to a 5 per cent profit margin on locally produced goods; (iii) foreign merchants shall not be sued in money disputes unless they are legal persons in the country (2.16)".

Kautilya believes that a policy of allowing a higher profit margin on imports than that on domestic trade (there is no evidence of any lobbying by the importers), is necessary to compensate the importers for undertaking the extra risk otherwise they may not import at all. He recommends a 20 per cent *ad valorem* tariffs on imports. Similarly, he recommends export duties ranging from 4 to 16 per cent. Tariffs are recommended to raise revenue and not to restrict trade. Thus on the whole, he is a strong proponent of free trade.

It is noteworthy that he suggests the waiver of the import duty in the case of an import of a "rare seed". There are practically no restrictions on imports (other than on those which are considered harmful or worthless) but he suggests some controls on the export of arms and any other product, which might help the enemy. Kautilya (p. 239) suggests the prohibition of exports of certain products, such as: "Weapons and armour of all kinds including coats of mail; metals; chariots; jewels and precious stones; grains and cattle (2.21)". According to him, jewels and precious stones are used to win friends or making pay-offs to avert certain adverse circumstances. Any excess of grains is used to build buffer stocks to protect against poor harvests rather than export one year and import the next year. Apparently, the concern for national security has existed since antiquity. For example, nowadays due to a concern for national security, the exports of certain items (like super computers) are banned to some countries. It appears that Kautilya's position on international trade is much more liberal than Adam Smith's, which was undoubtedly much more liberal than that of the mercantilists[1].

3. Nature of international trade in ancient times

Cooper (1978, vol. 26, pp. 910-16) indicates that during the ancient times trade was risky, consisted of light and high-valued products due to the presence of risk and poor means of transportation, was based on natural advantages implying its pattern to be self-evident[2]. Kautilya's *Arthashastra* is the only known book, which has survived and describes issues related to international trade during the fourth century BCE. There are, at least, four points worth noting. First, Kautilya considers both high value and low value products as tradable. He (p. 239) suggests, "The frontier officer shall inspect the caravans carrying foreign goods and classify as those of high value or of low value (2.21)". He adds, "All dutiable goods shall be weighed, measured or counted and the duty payable on goods of low value shall be determined carefully [not ignoring them as insignificant] (2.21)". Clearly goods of both high value and low value are considered importable.

Second, according to Kautilya, the precious goods attract the bandits much sooner than the inexpensive ones implying that the risk directly varies with the value of the product. It may appear reasonable to believe that transportation of goods of light and high-value should be cheaper and easier, but Kautilya points out that it could be more than neutralized by the increased cost of extra protection needed for high-value products. He (p. 238) states, "If the Chief Controller of State Trading sends a caravan by a land route, he shall choose a safe route. One quarter of the goods shall be of high value. Jungle chieftains, frontier officers and governors in the City and the countryside shall be contacted beforehand for assuring security. Steps shall be taken to ensure the protection of the members of the caravan and goods of high value (2.16)".

It is obvious that the existence of high risk for high-value products, to some extent, works against them. Additionally, Kautilya notes that the market in precious goods is very thin. He (p. 623) states, "Buyers of high-valued products are rare and found only after a long search; there are many buyers and a steady demand for products of small value (7.12)". Apparently, trade in high-valued products was not that attractive during ancient times. Interestingly, instead of the buyer undertaking the search it is the seller, who has to do it.

3.1 Risk minimization through diversification

It may be noted that Kautilya emphasizes the principle of diversification by requiring a combination of high-value and low-value goods. Since extra spending on protection would reduce both expected return and risk implying that Kautilya considers risk, to some extent, as endogenous. An awareness of the trade-off between expected return and risk is also discernible in his analysis[3].

3.2 Handling missing markets

At the time there were no markets to insure against theft. Kautilya (p. 235) states, "Frontier officers shall be responsible for the safety of the merchandise passing on the roads and shall make good what is lost (2.21). Traders may stay inside villages after letting the village officers know of the value of their merchandise. If any of these is lost or driven away, the village headman shall recompense the trader (4.13)".

Third, Kautilya is aware of the transportation constraint and tries to relax it. He (p. 235) recommends, "The king shall promote trade and commerce by land and by water and market towns/ports. Trade routes shall be kept free of harassment by courtiers, state officials, thieves and frontier guards and from being damaged by herds of cattle (2.1)". He makes here two additional points: integration of markets and economies of scale.

(1) *Integration of markets*: Kautilya (p. 623) states, "Many inferior routes are preferable to a few important ones (7.12)". His goals are to open new markets and facilitate a fuller integration of the existing ones.

(2) *Economies of scale*: Kautilya (p. 623) explains, "A route usable by carts is preferable to a foot path for men and animals only because of the larger quantities that can be transported on carts (7.12)". This statement implies that he has at least some idea of the concept of the economies of scale.

Fourth, even during ancient times some choices had to be made regarding trade and some of them appear quite sophisticated. The conclusions by Caves *et al.* (2002) are based on the assumptions of the existence of inexpensive modern transportation and communications facilities, low insurance premiums, credit extensions from financial institutions, foreign exchange markets, and of already identified markets[4]. However, it was not so self-evident 2,000 years ago when there were potentially too many risk factors.

4. Kautilya's theory of gains from trade

Kautilya (p. 237) states, "The Chief Controller of State Trading shall ascertain the profitability of a trading operation with a foreign country using the following method. The price of the goods to be sold in the foreign country and the price likely to be realized on the goods imported in exchange shall be estimated. From the gross margin, all expenses, as described below, shall be deducted.

For caravans: customs duty, road cess, escort charges, tax payable at military stations, ferry charges, daily allowances paid to merchants and their assistants and the share payable to the foreign king.

For trade using ships: all the above plus the following additional charges: i.e. the cost of hiring ships and boats, provisions for the journey.

He shall, in general, trade with such foreign countries as will generate a profit; he shall avoid unprofitable areas (2.16)".

Although there is no theory of comparative advantage here, in the sense of predicting the pattern of trade, the rule proposed for gainful trade is the one that correctly implies that gains from trade will ensue if the rule is followed by the ruler of a country where market prices reflect social costs.

A few further points are worth noting. First, Kautilya explicitly incorporates the cost of transportation and other expenses into his gains from trade argument. During his time not only travel between two countries was hazardous but also the costs of transportation associated with international trade were significant. Second, Kautilya, unlike mercantilists, does not argue for generating trade surplus.

Kautilya does not have any systematic theory on what determines the trade pattern, however, *The Arthashastra* contains several intriguing and pertinent observations[5]. There he lists sources of imports depending upon climate or presence of mines implying that he is aware of the influence of natural factors on production patterns. He mentions that pearls could be imported from Ceylon, Barbara and Arachosia, aloe from Burma, woolen cloth from Nepal, furs and horses from Gandhara, Vanayu (Arabia or Persia) and Bahilika (Bactria) and wine from Afghanistan and Scythia. As for exports, he mentions (pp. 803-4) live animals, food, fresh produce, preserved food, liquor, medicines, spices and perfumery, raw materials, manufactured goods (garments, carpets, leather goods, earthenware) and gems and jewelry. Aside from natural resources as a factor that confers production and trade advantage, Kautilya also refers to the role of exogenous productivity differences and also of capital both physical and human.

5. Conclusions

Kautilya never realizes that his condition for generating a profit is an alternative way to approach the theory of the gains from trade. He understands the contribution of both physical and human capital on labor productivity 2,000 earlier than the classical economists. Pirenne (1937) points out the existence of internationalism before the emergence of mercantilism. Kautilya understands that a country does not need a trade surplus to enjoy the gains from trade and he, in fact specifies the condition to engage in trade. Trade was not considered an engine of growth. Rather, the objective was to expand the availability of a maximum number of products at a maximum number of places. It is obvious that there was no need for a WTO at the time and its existence now serves only as a reminder of nationalism. It is also obvious that our understanding of the nature or level of trade during the ancient times is painfully inadequate. For sure international trade was not an engine of growth. But perhaps it was not insignificant either[6]. The point emphasized is that the history of economic thought is still incomplete[7].

Notes

1. *Adam Smith and Laissez Faire*: Historically, Adam Smith has been hailed as a messenger of unfettered free trade. However, in recent years that view has been challenged. The change in tone may be captured by the following comments by a few writers during the last four decades. Letiche (1960, p. 70) asserts, "Smith was not a doctrinaire advocate of *laissez faire*. He recommended at least four major programs of reform: the removal of impediments to free choice of occupation; to free trade in land; to internal free trade; and to free trade in foreign commerce. Moreover, he recognized the need for government activity in such fields as public education and hygiene, public works, regulation of currency and coinage, progressive (in effect, proportional) taxation, patents, copyrights and even moderate export and import taxes for the purpose of revenue and development".

   Tribe (1999, fn. 49) remarks, "For example, Smith did not employ terms 'free trade' or '*laissez-faire*', although he would have known of their use by others".

   Grampp observes that "In the extended debate from 1815 to 1846 over the British Corn Laws, the protectionists cited Smith's statement that there should be a duty on an imported good that competed with a domestically produced good subject to a tax". He adds, "He expressly said domestic 'industry necessary for the defense of the country' should be 'encouraged'. Domestic trade is superior to foreign because domestic trade gives twice the encouragement to industry that trade gives and also receives its returns more quickly (pp. 463, 377-78, 426, 368)". He points out that "In the Wealth of Nations and in the Lectures on Jurisprudence there are (depending on how finely one makes distinctions) some 35 or 40 measures of government intervention of which Smith approved or which he advocated. They are of five kinds. The fourth restricts foreign trade, and the most important measures are those that contribute to defense".

   The comments from Grampp clearly cast doubt on Adam Smith's historical image. Since he did favor domestic industry over imports. Perhaps, Adam Smith went too far in attacking the Mercantilists on their obsession with trade surplus and wanted to change the focus towards domestic production.

2. Cooper (1978, vol. 26, pp. 910-16) describes the nature of international trade in ancient times. He observes, "Early trade was attended by large risks – both natural risks such as storms and human risks such as piracy and brigandage – and was hampered by poor transport. Because of risks, trade was limited to easily transportable, high-value products. Trade was based largely on goods derived from natural advantages-the presence of desirable natural resources such as tin, gold, amber, or ebony-but occasionally also on the products of special technology and unique skills, as in the case of Egyptian glass beads and cloth dyed with the famous Tyrean purple".

3. For details see Sihag (2008).

4. Caves *et al.* (2002) believe if the trade is based on "natural advantages" then there is not much to be explained and definitely the services of an economist are not needed. They (p. 13) assert, "Some trade patterns need little explanation. If you live in the United States and like coffee, you have your coffee imported from Brazil or some other coffee-growing country because it is not produced at home". They add, "There would be little need for the economist either to expound on the virtues of trade or to explain trade patterns. These would be almost self-evident".
5. Kautilya explicitly considers two countries and two commodities. Let P_x^{F} and P_y^{F} be the respective prices of products X and Y in a foreign country and P_x^{H} and P_y^{H} are their respective prices in the home country. The home country should export say product X only if after paying transport cost and security expenses for passage, C, and tariffs and gratuity to the king, T, can get more of product Y in exchange in the foreign country than could have gotten at home. Also, the phrase "the price likely to be realized" indicates his concern for price uncertainty. Let Z captures the risk element in the price. According to him, a country should engage in trade if it is beneficial to do so, that is, a country should export product X and import product Y only if

$$\frac{P_y^{\mathrm{H}}(P_x^{\mathrm{F}}X - C - T - Z)}{P_y^{\mathrm{F}}} - P_x^{\mathrm{H}}X > 0 \tag{1}$$

Or

$$\frac{P_y^{\mathrm{F}}X - C - T - Z)}{P_y^{\mathrm{F}}} > \frac{P_x^{\mathrm{H}}X}{P_y^{\mathrm{H}}} \tag{2}$$

Or

$$\frac{(1-\mu-t-\pi)P_x^{\mathrm{F}}X}{P_y^{\mathrm{F}}} > \frac{P_x^{\mathrm{H}}X}{P_y^{\mathrm{H}}} \tag{3}$$

Or

$$\frac{(1-\mu-t-\pi)P_x^{\mathrm{F}}}{P_y^{\mathrm{F}}} > \frac{P_x^{\mathrm{H}}}{P_y^{\mathrm{H}}} \tag{4}$$

where $\mu = C/P_x^{\mathrm{F}}X$, $t = T/P_x^{\mathrm{F}}X$, and $\pi = Z/P_x^{\mathrm{F}}X$.

It is quite clear from Equation (4), which incorporates tariffs and transportation costs that Kautilya understands that there are gains from trade but it is ambiguous whether he understands the principle of comparative advantage. However, Waldauer *et al.* (1996) conclude, "Thus, Kautilya recognized that trade based on the principle of comparative advantage would be to the material benefit of both exporting and importing nations".
6. Wilford (2002) reports, "So robust was the India trade 2,000 years ago that Emperor Tiberius, concerned over Rome's increasingly adverse balance of payments, complained that 'the ladies and their baubles are transferring our money to foreigners'". There is no evidence yet that the Emperor did anything to curtail imports. He adds, "Also, it was not an overwhelmingly Roman enterprise, as had been generally assumed. The researchers said artifacts at the sight indicated that the ships might have been built in India and were probably crewed by Indians". He describes the archaeological trove at Berenike seaport in Egypt as: "'Mind-boggling' find: teak and metal, beads and gems, batik and peppercorns". Of course, by the time of Adam smith, international trade had become quite significant.
7. Recently, McCormick (1999) asserts, "Specifically, this paper is about the independent advocacy of a policy of *laissez-faire* by both ancient Taoist philosophers and Classical economists.

Recognizing the independent development of this idea has not only intrinsic historical interest but also provides the doctrine of *laissez-faire* with another substantial philosophical leg on which to stand". He finds that "This 'hands off' approach to government is central to Taoism. There is a natural harmony in the social order, which can be achieved only by a policy of non-interference. Passivity on the part of the ruler allows the Tao to bring about harmony and prosperity". He claims that "*laissez-faire* is simply an extension of the doctrine of 'wu wei' to government policy". He defines "wu wei" as "do nothing".

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