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Customs Duty Evasion and Enforcement in the Arthaśāstra

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The first part of Chapter 2.21 of the Arthaśāstra deals with the activities of the Customs Superintendent, containing recommendations regarding the collection of customs duty. Scholars have encountered several difficulties in understanding the meaning and purposes of the activities described. An auction-like procedure described in the text has been analyzed by some as the normal operation of a market, with the payments to the treasury mentioned there taken as a hitherto-unknown market tax—the price of trading in the market. Other paragraphs in the text describe seemingly self-contradictory trader actions. Interpretations of these actions have involved the imbuing of traders with complex psychological beliefs regarding the actions of other traders. This article proposes an economic model of the underlying market structure, which leads to a different and integrated reading of the text. In this reading, the author of the text, recognizing the incentive for importers to undervalue their goods, suggests the auction procedure and accompanying penalty payments to elicit truthful revelation of importers' valuations and to maximize customs levy collections. By comparing the procedure in the Arthaśāstra to modern-day regulations intended to combat tax evasion, the article provides early evidence of the use of sophisticated mechanisms to elicit truthful value revelation.

INTRODUCTION

The State of Tax Justice document, published annually by the Tax Justice Network and other institutions, estimated in its 2021 edition that countries miss out on about \$500 billion annually due to tax evasion by individual and corporate parties.[1] Considering that world GDP in 2020 was estimated by the World Bank to be \$84 trillion,[2] this amounts to about 0.6 percent, a not insignificant amount. An important component of this is customs tax evasion. Kitsios et al. (2020) estimate that cross-border trade fraud could represent as much as 6.6 percent of GDP in low-income countries. Customs tax evasion, though, is not a new phenomenon. An inscription of a law on Delos dating from 220 BCE forbade sellers to offer their goods for a higher or lower price than they had declared on import to the tax collectors, and if anyone made a sale contrary to the regulations, he was liable to a fine of fifty drachmas (Fawcett 2016: 176). Similarly, a decree of Kyparissia in the western Peloponnese of the fourth or third century BCE states that anyone importing or exporting goods had to make a declaration to the tax collector. There was a penalty of ten times the value of the goods for not making a declaration, and if the importer/exporter undervalued the goods in his declaration, the tax collector imposed a surcharge (Fawcett 2016: 176). Duncan-Jones (2006) provides evidence for smuggling in Roman territories around the turn of the first millennium. For example, he cites an Ephesus inscription (2006: 9) that "legislates against smuggling, declaring that goods must not be brought in at night or by routes other than the proper channels." With respect to broader evasion of other kinds of taxes, too, there is ample evidence

1. https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf.
2. https://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

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(see Christ 2006: chap. 4 for evidence from classical Athens; and the articles in Parts I and II of Schonhärl et al. 2023 for further ancient and modern examples). In this article I will discuss ancient Indian evidence of customs tax evasion, as set forth in the Arthaśāstra, the remarkable text on statecraft, in portions dating from around 100 BCE. As an economist, I use demand-and-supply analysis to suggest that the state used auctions as a deliberate strategy to enforce tax compliance.[3] My explanation differs from the philological ones that have been offered to date; I will address these differences as they arise.

In the sections concerning trade the author of the Arthaśāstra discusses the collection of various kinds of taxes, as well as the operation of markets. Here I will discuss primarily chapter 2.21, which deals with the functions of the *śulkādhyakṣa*, the customs superintendent.[4] I start by examining a theory mooted in Wiese 2014 to explain the nature of the activities of the customs superintendent, followed by my own explanation.

CUSTOMS DUTIES AND MARKET TAXES

The first part of chapter 2.21 discusses the location and the organization of the office of the customs tax superintendent, including penalties for various kinds of customs evasions, other than undervaluation. This is followed by a description of an auction procedure for the sale of goods, followed immediately by a discussion of various kinds of value declaration strategies by traders, including undervaluation. The second part lists articles exempt from customs duties, followed by a discussion of rules regarding goods meant for export, including security provisions to prevent violations of import-export regulations. The purpose of the auction procedure introduced in the first part of the chapter is unclear; an explanation of this auction in a fashion that integrates the other parts of this chapter is the primary aim of my essay. I first provide the explanation given by Wiese 2014.[5] I start with the same sūtras that he does, as translated by Olivelle (2013), skipping—as Wiese does—over sūtras 2.21.2–6 in order to move directly to the auction procedure.

2.21.1 *śulkādhyakṣaḥ śulkaśālāṃ dhvajaṃ ca prāṅmukham udaṅmukhaṃ vā mahādvārābhyāśe niveśayet*[6]
2.21.7 *dhvajamūlopasthitasya pramāṇam arghaṃ ca vaidehakāḥ paṇyasya brūyuḥ: "etat pramāṇenārgheṇa paṇyam idaṃ kaḥ kretā" iti*
2.21.8 *trir udghoṣitam arthibhyo dadyāt*
2.21.9 *kretṛsaṃgharṣe mūlyavṛddhiḥ saśulkā kośaṃ gacchet*

3. Olivelle (2013: 29) dates the entire text to between 50 and 125 CE. However, in a later publication (2020: 32) Olivelle states that Book 2, where our material lies, was probably an independent work from about the first century BCE. This is supported by McClish (2019: chap. 6, particularly p. 151), who presents credible evidence that most of the Arthaśāstra, including the material discussed in this article, was composed earlier (likely in the first century before the common era), following which there were significant interpolations.

4. Chapter 3.9 describes an auction-like procedure in the context of real estate sales similar to that of chapter 2.21. I assume here that this similarity is superficial and that an auction is used in the two cases for different reasons. In the case of customs duties, the auction is used for the purpose of preventing tax evasion; in the case of real estate, auctions are often used because private valuations of real estate differ across individuals to a greater extent than with other salable commodities (just like art), and it has been shown that it is under such circumstances that an auction is most useful in eliciting the highest sale price.

5. I focus on Wiese 2014 because he has a complete explanation, albeit with troubling aspects. Olivelle (2013 n. to 2.21.13), in contrast, admits that the situation is complex and unclear. Kangle (1972: 142) also finds it difficult to interpret 2.21.9 and 2.21.13 in distinct ways.

6. All text cited after Kangle 1969.

2.21.1 The Superintendent of Customs should set up the customs house along with the flag facing the east or the north near the main gate.
2.21.7 The traders should announce the quantity and price of a commodity that has reached the foot of the flag: "Who will buy this commodity at this price for this quantity?"
2.21.8 After it has been proclaimed aloud three times, he should give it to the bidders.
2.21.9 If there is competition among buyers, the increase in price (*mūlyavṛddhi*) along with the customs duty (*śulka*) goes to the treasury.

Wiese (p. 699) suggests that there are two kinds of taxes—one the customs duty (*śulka*) and the other what he calls a market tax (which is referred to in 2.21.9 as *mūlyavṛddhi*).[7] According to this understanding, what is described as happening at the foot of the flag is a regular market, in the context of which the customs superintendent collects the market tax. Wiese proposes the following description of the market. The seller starts out with a price V. At this point, there is an ascending auction[8] starting with a low price that rises until there is only one bidder remaining; the price at which the good is sold to this bidder is denoted p, and according to Wiese (p. 700), sūtra 9 is to be interpreted as giving the difference between V and p (i.e., p - V) to the treasury. If V > p, there would be no sale and the seller would have to incur an additional cost to try to sell the good a second time. This gives rise to an optimization problem which Wiese (p. 701) solves in his article using a probability distribution describing the beliefs of the seller about p.

At this point Wiese brings in his second tax, the customs duty. Here are the pertinent sūtras (2.21.10–11, 13, again with Olivelle's translation):

2.21.10 *śulkabhayāt paṇyapramāṇam mūlyaṃ vā hīnaṃ bruvatas tadatiriktaṃ rājā haret*
2.21.11 *śulkam aṣṭaguṇaṃ vā dadyāt*
2.21.13 *pratikretṛbhayād vā paṇyamūlyād upari mūlyaṃ vardhayato mūlyavṛddhiṃ rājā haret, dvigūṇam vā śulkaṃ kuryāt*

2.21.10 When a man, fearing customs duty, declares a lower quantity or price, the king shall confiscate the amount in excess of that;
2.21.11 Or he should pay eight times the customs duty.
2.21.13 Or, when a man, fearing competing buyers, increases the price beyond the normal[9] price of a commodity, the king shall confiscate the increase in price or assess twice the customs duty.

According to Wiese, the customs duty is unrelated to the market tax. However, in his interpretation there is a tension between the desires of the seller to pay a low customs duty (by declaring a low valuation, V) and a low market tax (by declaring a high valuation, V). The author's desire to elicit a correct valuation is reflected in sūtras 10 and 11. Sūtra 13 reverts, in Wiese's reading, to a discussion of the market tax. Finding this sūtra difficult to

7. Wiese (p. 699) translates this as "increase in price." I argue below that it is more appropriate to translate *mūlyam* as valuation, rather than price.

8. In an ascending auction, also called an English auction, the auctioneer starts with a low price, progressively raising it as higher bids are called in until there are no higher bids; in a descending auction, the auctioneer starts with a high price, lowering it until there is a taker for the good. In Wiese's model, the auction has to be an ascending auction because otherwise the market tax could be avoided altogether by choosing a very high initial ask price.

9. The adjective "normal" of Olivelle's translation is not found in the Sanskrit text, which just has *paṇyamūlyam*, i.e., commodity price/value.

interpret, he suggests that it might be discussing the seller's desire to pay a low market tax alone (ignoring the customs duty) and reflecting his possible regret if he were to declare a low value for V and the winning bid price *p* ended up being high.

In his conclusion, noting that his proposed market tax is very unusual, Wiese suggests that the text may not have been historical at all[10] and suggests that the author did not trust the operation of markets, as reflected in this imposed auction procedure, which might be more appropriate to natural monopolies and not to ordinary everyday goods. Wiese's explanation, while ingenious and providing a rationale for the confiscation of the *mūlyavṛddhi*, has nevertheless several shortcomings to be discussed in detail below. I propose a different explanation for what we find in this chapter, one that presents an integrated framework combining the customs duty and the putative market tax.

AN INFORMATION ELICITATION PERSPECTIVE

As I see it, the topic of the first part of this chapter is solely the collection of customs duties on goods imported into the country by merchants and other individuals and the steps to be taken by the customs superintendent to prevent evasion of these duties. There are other chapters that talk about taxes (2.16–17, particularly 2.16) and other kinds of revenue raised from domestic operations. Chapter 2.16 and the second half of chapter 2.17 (starting with 2.17.20) also discuss exports; however, the first half of 2.21 (2.21.1–17) deals entirely with imports. The first word in our chapter, in fact, is *śulkādhyakṣa*, translated by Olivelle as "customs superintendent." And the word *śulka* in the Arthaśāstra refers to customs duty and not to any other kind of tax. Considering the overwhelming importance of the customs duty to the first part of chapter 2.21, I provide some background to the operations at the *śulkaśālā* mentioned in the first sūtra (2.21.1).

At first glance it is not entirely clear if the *śulka* is indeed a tax on imported goods, which one might expect to be levied at the point of entry into the kingdom or into the larger political unit, whatever that might be. Sūtra 2.21.1 recommends that the customs house be set up near the main gate, but where is this gate located? It could be the gate to the capital city (as mentioned in 2.1.4 and further described in 2.4.19) or the gate to a frontier fort (as described in 2.1.5). Chapter 2.6 describes the different categories of revenue; the list is given in 2.6.1 as fort (*durga*), province, pit mine, irrigation works, forest, herd, and trade route; the next sūtra notes that *śulka* (duties) come under the classification of fort (*durga*). It would be reasonable to assume that the state would want to collect taxes sooner rather than later in order to minimize the likelihood of evasion, which would suggest collection of taxes at the frontier fort.[11] On the other hand, 2.3.3 notes that the provincial capital in the center of the countryside should be the *samudayasthānam* (collection point, presumably of revenue, taxes, etc.). This might make more sense in terms of minimizing the number of hands through which money from collection of taxes passes.[12] This is also likely the situation in Chapter 2.21 because in

10. Wiese argues that the Arthaśāstra should not be seen as a document "telling us a lot about actual diplomacy, spying, and taxing, etc." but, rather, as a teaching manual on statecraft. However, Olivelle 2020 provides evidence in support of the historicity of the matters discussed in the Arthaśāstra.

11. The Pali *Suttavibhaṅga* of the *Vinayapiṭaka* (II.4.21) says of the location of a "customs frontier": "it is established by a king in a mountain-pass, or at a ford in a river, or at the gate of a village, so that tax shall be received on a person entering there" (tr. Horner 1938: 86).

12. Pagels (2014: 58) in his review of tax revenue collection as reflected in Buddhist sources says: "*śulka* was levied at a formal collection point en route to *Śravasti*, identified as the customs house (*śulkasthāna*). The customs house is also the most common venue for tax collection in other Buddhist and brahmanical sources. Yet, even though it features so frequently, it is fairly rare for a text to reveal its precise location. Many position it simply along

sūtra 2.21.2 we are told that the customs collectors should note down details of the merchandise, including where the identity card or the seal was issued. This suggests that the tax collection point in question is not the first point of contact of the goods with officialdom. In fact, 2.21.26 notes that "he [= *antapāla* 'frontier commander'] should dispatch to the superintendent [= *adhyakṣa*, mostly likely the *śulkādhyakṣa*, the customs superintendent] any foreign caravan after examining its goods of high and low value and providing an identity card and a seal" (*vaideśyaṃ sārthaṃ kṛtasāraphalgubhāṇḍavicayanam abhijñānaṃ mudrāṃ ca dattvā preṣayed adhyakṣasya*). The merchant will most likely want to take his merchandise to the city so as to get the best price for it; as a result there is unlikely to be tax evasion by the merchant by selling his merchandise before coming to the city tax collection point. Furthermore, centralizing the collection of taxes at the gates of the main city also allows the stationing of an expert customs superintendent who is knowledgeable in the different kinds of goods and their value at a single location instead of at the different frontier posts. This may well be the customs duty described in 2.22.8. Once the *antapāla* has issued an identity card and sealed the goods, presumably they cannot be disposed of prior to their being brought to the city for collection of customs duty and then eventual sale. Pagels (2014: 83) refers to the identity card and seal as "transit papers." He also notes that sale of the merchandise prior to payment of customs duty in the city is discouraged by secret agents (often in the guise of merchants or ascetics) who collect information about the payment (or nonpayment) of customs duty and related charges (2.35.11–13). It seems reasonable to conclude from this that the *śulka* is a customs duty on imported goods, but one that is not collected at the frontier but rather at the entrance to the main city.

With this in mind we can identify the customs house and its identifying flag as being located at the city gates. Reference to the base of the flag (*dhvajamūla* 2.21.7) probably identifies an area just outside the customs house (*śulkaśāla*) but inside the city gates where auctions would take place.[13] Some goods are exempt from customs duty—these are primarily religious items (listed in 2.21.18).[14] All other goods are subject to import duty on their value.[15] How this value is determined is an important part of this chapter. My interpretation is that the dutiable value is the market value, the value-in-exchange. However, this value

busy trade routes or on roads leading to remote provinces. Some, however, are more specific. They place customs offices at an international border crossing, near an intersection between two domestic administrative units or at the entrance to a city or market town (*karvaṭa*)."

13. Although the flag here might simply be a means of drawing the attention of traders to the auction location, a flag might have been a more universal symbol of a marketplace in ancient India. McHugh (2018) brings up the example of the *surādhvaja*, the *surā* banner, which he suggests may have been an ancient Indian alehouse sign. The *Silappadikaram*, a third- to fourth-century CE Tamil work, describes the use of flags in the shops of goldsmiths to identify the different kinds of gold sold in each shop (XIV.201–4; Dikshitar 1939: 207–8). Mukund (2012: 47–48) cites the flags marking toddy shops in the coastal city of Puhar, as described in various Sangam texts such as the *Maduraikkanchi* (vv. 366–67), the *Perumpanarruppadai* (vv. 336–37), and the *Pattinapalai* (vv. 179–83). According to the description in the *Pattinapalai*, "There are flags of many shapes in many places where different things are sold, blocking the sun's moving rays in the prosperous city" (tr. Vaidehi Herbert, https://sangamtranslationsbyvaidehi.com/pathuppattu-pattinappalai/).

14. "Articles for use in a marriage; wedding gifts accompanying a bride; articles meant for gifts; what is received on the occasion of a sacrifice, a religious ceremony, or a birth; and articles for use in special rituals such as divine worship, tonsure, Vedic initiation, first shave, and consecration for a religious observance" (*vaivāhikam anvāyanam aupāyanikaṃ yajñakṛtyaprasavanaimittikam devejyācaulopanayanagodānavratadīkṣaṇādiṣu*).

15. The standard amount of duty is twenty percent of the value (2.22.3). According to Duncan-Jones (2006: 4), in the early Roman empire the duty on goods imported from abroad was twenty-five percent. Fawcett (2016: Table 1, p. 154) records import/export tax rates in classical Athens ranging from one percent to ten percent. According to Young 1997, the Nabateans charged import duties of twenty-five percent in the first century CE, similar to the Romans.

is primarily determined through a declaration by the importer. When there is a doubt as to the value-in-exchange, when there is a suspicion that the declared value is too low, then an auction is conducted at the foot of the flagpole to determine what this value is.[16] This chapter does not deal with sales taxes or taxes on market transactions (contra Wiese 2014). For example, in the list detailing items exempt from payment (2.21.18), we have items unlikely to be commodities meant for sale, such as wedding gifts (see n. 14). Although in today's economy, we may have specialized companies (and registry websites) dealing in wedding gifts, this is unlikely to have been the referent of the sūtra. Similarly, the items dealt with in 2.21.1–17 are not limited to goods that are to be sold. If, in fact, the author meant the discussion to be restricted to items that were sold, the listing of items that were not meant for sale would be irrelevant. Rather, the scope of this chapter includes all items brought into the country. This is similar to the procedure today when goods brought into a country are liable for customs duty, whether or not they are to be sold, unless specifically exempted. There was also a procedure for collecting a levy on export items, which is explained in the second part of 2.21.

Having established the central role of customs duties, I note, too, the importance of customs duty evasion in this chapter. In fact, in addition to customs tax evasion through a false declaration of value, the chapter discusses five other kinds of evasion:[17]

1. (2.21.3) A merchant may try to bring items into the country without having them subject to customs inspection and hence not obtaining a customs seal for them (*amudra-*).
2. (2.21.4) A merchant might try to forge the customs seal (*kūṭamudra-*) and thus try to evade the correct amount of customs duty.
3. (2.21.5) A merchant might tamper with the customs seal on a goods container or it might be broken inadvertently (*bhinnamudra-*).[18]
4. (2.21.6) The customs seal might be altered or the name (perhaps on the identity card) might be changed, again perhaps with a view to somehow evade customs duty, though it is not clear how.
5. (2.21.16) The merchant might try to avoid paying the customs levy at the levy point (the foot of the flag or *dhvajamūlam*).[19]

In other words, customs duty collection and dealing with customs duty evasion is the primary topic of the first half of this chapter.

16. Standard auctions, as mentioned before, either start from a high asking price that is gradually lowered until a bidder accepts the price (Dutch auction) or involve bidders competing by increasing the bid until no one is willing to bid higher (English auction). In this case, the bidding starts from the value declared by the importer and increases until no one is willing to bid higher. However, I do not rule out the possibility that there are no buyers at the initial ask price; in this case, the auction could well switch to a Dutch auction format. Even though this is a hybrid kind of procedure that is not usually used in auctions proper, I continue to use the term "auction" in the sense of a sale through open outcry. I explain later why it is unlikely that there will be no takers at the seller's opening ask price, making it closer to a standard English auction.

17. Other methods of tax evasion are reported in other times and places as well. For example, Young (1997) reports tax evasion in Nabatea around 25 BCE by means of attempts to physically evade the customs officers.

18. The text is ambiguous regarding the circumstances in which the seal comes to be broken. However, from the context, intentional tampering would seem to be included.

19. Pagels (2014: 103–11) describes many cases of attempts by merchants to avoid paying taxes altogether by trying to enter the city at a location where there is no customs house.

CUSTOMS TAX EVASION THROUGH DECLARATION OF FALSE VALUE

With this background we now address the case of customs tax evasion through a false declaration of value.[20] This is addressed in sūtras 2.21.10–11. (For convenience I reproduce the text and Olivelle's translation given above.)

2.21.10 *śulkabhayāt paṇyapramāṇam mūlyaṃ vā hīnaṃ bruvatas tadatiriktaṃ rājā haret*
2.21.11 *śulkam aṣṭaguṇaṃ vā dadyāt*

2.21.10 When a man, fearing customs duty, declares a lower quantity or price, the king shall confiscate the amount in excess of that;
2.21.11 Or he should pay eight times the customs duty.

We are told that, in an attempt to avoid paying customs duty (*śulkabhayāt*), the merchant declares a lower quantity of the good being imported or a lower valuation. Olivelle translates *mūlya* here as price, but it is better translated as valuation. There are two words used in our chapter that have closely related meanings, *argha* and *mūlya*; in my view, *argha* generally refers to a market price in the context of a trade, while *mūlya* refers to a value or a valuation in a market or nonmarket context. My basis for taking *argha* as price is 2.21.7, where it is used in the context of a sale. That these two terms are not synonyms is clear from 2.16.18, where both words are used next to each other and where Olivelle, in fact, translates *argha* as valuation and *mūlya* as sale price (opposite to my usage):

2.16.18 *paraviṣaye tu paṇyapratipaṇyayor <u>arghaṃ mūlyaṃ cā</u>gamayya śulkavartanyātivāhikagulmataradeyabhaktabhāgavyayaśuddham udayaṃ paśyet*

2.16.18 With regard to other territories, however, he should estimate <u>the value and the sale price</u> of the commodities exported and the commodities imported in return, and calculate the net profit after subtracting expenses for duties, road toll, escort charges, payments at security stations and ferries, rations, and shares.[21]

The use of *mūlya*, i.e., valuation by my interpretation, is an indication that we are not discussing a market price; keeping this in mind will help us better understand the flow of events. It avoids the unnecessary (and incorrect) assumption of a transaction where none is indicated (as in 2.21.10 and 2.21.13).

Coming back to the merchant, what is the nature of his declaration? I suggest that this is a situation where the merchant is not interested in selling the goods being imported; in such a case, his declaration as to the quantity and value of the goods is used as a basis for computation of customs duty. There could be a standard valuation by experts on every item of an imported good, but that would be time consuming. It would make much more sense to use the merchant's valuation but at the same time set up a procedure to incentivize him

20. Although this chapter talks about other methods of customs duty evasion, more space is given to undervaluation as a tax evasion method. In Kyparissia as well as in Delos, according to Fawcett (2016: 176), undervaluation seems to have been a problem, though we do not know what means were taken to prevent it other than the promulgation of a law preventing subsequent transactions in the imported commodities at a price different from that declared to customs inspectors.

21. The word *argha* is defined by Olivelle et al. (2015: 57) as "sale price of a commodity, especially in the context of price control by the state"; the word *mūlya* (p. 322) as either the "price paid for a piece of merchandise" or the "value of goods or property."

to declare the true value. In such a situation sūtras 2.21.10–11 direct the king to confiscate the excess amount if the declared quantity is too low or if the declared valuation is too low (*mūlyaṃ vā hīnaṃ bruvatas tadatiriktaṃ rājā haret*). If the *śulkādhyakṣa* is suspicious regarding the quantity, he can confiscate the excess quantity after a comparison between the declared quantity and the actual quantity sought to be imported. But how is he to determine that a declared *valuation* is too low (*hīna*)?

The answer is given by 2.21.7–9, which sets up an auction procedure to elicit the objective market value (as a proxy for the true value) with which the merchant's valuation will be compared. That is, the *śulkādhyakṣa* is authorized to forcibly sell the goods at auction if he suspects undervaluation by the merchant. In connection with this I suggest that 2.21.9 (*kretṛsaṃgharṣe* <u>*mūlyavṛddhiḥ*</u> *saśulkā kośaṃ gacchet*) is better interpreted thus: "<u>the increase in</u> valuation when there is competition among buyers goes to the treasury, along with the customs duty." This explains the purpose of the procedure: the auction will elicit a higher valuation (*mūlyavṛddhi*) because of the competitive bidding that is the natural result of the auction procedure, and this increase in valuation will be claimed by the treasury. This interpretation is also supported by the requirement of the text in 2.21.7–8 that the price and quantity of the goods to be sold be proclaimed three times—the treasury would want to ensure that the resulting price is as high as possible. Olivelle translates 2.21.9 as "If there is competition among buyers, the increase in price along with the customs duty goes to the treasury," again reading *mūlya* as price. Recognizing that the primary meaning of *mūlya* is valuation signals that the increase referred to is not between two prices but between the merchant's declared valuation and the market valuation as reflected in the auction price.

Wiese suggests that what is happening here is the regular operation of a marketplace with the merchant being required to state a valuation for the good prior to the sale with the excess of the market price over the merchant's valuation going to the royal treasury. One might argue that a close reading of the text supports this position. Line 2.21.7, which refers to *dhvajamūlopasthitasya . . . paṇyasya* ("the commodity . . . that has reached the foot of the flag") arguably requires *all* goods that come to the flagpost to undergo the auction procedure, in the absence of a restriction. If we believe that all goods were brought to the flagpost, then provision 2.21.9 would be read as a procedure whereby the price increase in every sale goes to the treasury, whether or not this procedure makes economic sense. A reader preferring this reading might maintain that an underlying rationale for the market tax may well exist and needs to be discovered, or that it is unwarranted to ascribe modern-day economic rationality to the author of the Arthaśāstra.

There are several problems with this view. First, the context seems to be one of customs duties, not of a sales tax, as already argued above. Second, it does not seem optimal for a market to be located at the city gates,[22] which was most likely not the standard market venue.[23] In fact, we see in 2.21.16 that there are traders who avoid the customs house at the foot of the flag altogether, presumably on their way to a point of sale located in a different place; the secret agents deployed on roads and on areas without roads are charged with detecting such traders (2.21.17). What is likely is that there was some sort of market at the site of the customs house, but not necessarily the main market. Since merchants congregated in that location, there may have been some kind of wholesale market. And, of course, those goods

22. Chapter 2.4 describes the layout of the fortified city and identifies the eastern part of the city as the location of traders dealing in perfumes, garlands, and juices (2.4.9); the southern part as the location of traders dealing in cooked food, liquor, and meat (2.4.11).

23. Location theory also suggests that transactions costs are minimized when markets are located close to the consumer (Webber and Symanski 1973).

whose value was disputed were auctioned off in that location; but not all goods that came through the gate were required to be sold or were actually sold in that location. Third, as Wiese acknowledges (2014: 706), a market tax is an unprecedented kind of tax that we do not see anywhere else, either in India or elsewhere. Furthermore, while a market-use tax is not unreasonable, a tax structured as a confiscation of the excess of the market price from the initial ask price puts unnecessary pressure on the seller to get the initial estimate exactly right and imposes a penalty where there is no wrongdoing.

Finally, the reference to the auctioned goods as *dhvajamūlopasthita- . . . paṇya-* does not necessarily mean that all goods were auctioned. It can also mean that there were other goods that were *not* auctioned; in other words, all goods that came to the *dhvajamūla* might have been auctioned, but all goods may not have come to the *dhvajamūla*.[24] In this interpretation, these would be the goods for which the merchant's valuation is accepted by the customs superintendent, as well as nondutiable goods (cf. 2.17.18). I believe that the auction at the customs house may have been a common procedure for traders to sell their goods, but not necessarily one that all traders used. Sūtra 2.21.10 clearly discusses a situation where the merchant declares a valuation on which duty would be levied, something that would have been unnecessary if the auction were available in every case to provide a market valuation. Sūtras 2.21.20–23 also seem to treat goods that were taken from the customs house to be sold elsewhere, once again suggesting that not all goods on which duty was paid at the customs house were also sold on the spot.[25]

My interpretation of what is being described here, furthermore, is very similar to what would happen in other comparable contexts, such as transfer pricing. One example of this is a transfer of a good by one entity to a second in a nonmarket transaction (non-arm's length transaction); this could happen in a case where the second entity is a subsidiary of the first, but pays taxes in a different jurisdiction with lower tax rates than the jurisdiction in which the first entity is taxed. In such a case there is an incentive for the transfer to take place at a lower valuation than is really the case; this procedure transfers the profit from the higher tax jurisdiction to the lower tax jurisdiction. One of the methods used to preempt tax avoidance of this kind is the use of the transactional net margin method (TNMM). In this method, which is used in transfer pricing, the net profit margin of a taxpayer arising from a non-arm's length transaction is compared with the net profit margins realized by arm's length parties from similar transactions (Rogers and Oats 2022). The auction price in our case is the parallel of the arm's length profit margin in the TNMM method.

What I suggest, then, is that the text provides the remedy first (in 2.21.7–9), i.e., the auction to determine the extent of the merchant's undervaluation, and then provides the context in which the remedy needs to be applied (2.21.10), i.e., when the merchant undervalues the goods.[26] Instead of imposing a fine equal to the excess of the market price over the merchant's valuation, the customs superintendent can also impose a penalty equal to eight times the amount of the duty (2.21.11). This is exactly the penalty paid in the other case of active fraud (goods with forged seals or *kūṭamudra*, 2.21.4). Both cases of active fraud are penalized in the same way, as opposed to cases of passive fraud (not obtaining a seal at all, *amudra*, 2.21.3). The penalty that the customs superintendent is likely to choose is the greater of the two amounts, in order to benefit the treasury. Thus, if eight times the amount

24. Thanks to David Brick for this suggestion.

25. We still have to explain 2.21.13, which both Olivelle 2013 and Kangle 1972 find difficult; this is discussed below.

26. Appendix 1 below provides Olivelle's translations of the relevant paragraphs 2.21.1–15 along with mine when they differ.

of the duty is greater than the amount of the overvaluation, the eightfold penalty would be applied; however, the threat of the auction procedure is still necessary in order to incentivize the merchant to declare a true value.

In other words, the merchant's valuation will normally be accepted and the levy applied on the basis of that valuation. However, if the customs superintendent has a doubt as to the veracity of the merchant, he will use the valuation procedure which has been established, viz., by requiring the good to be sold at auction.[27] If the probability of an auction is set appropriately, then the expected loss to the merchant by being caught will be equal to the expected gain by cheating and he will have no incentive to cheat.

The stylistic device suggested here whereby a *seemingly* general statement is first made and is then followed by another that indicates the context of application of the first is not common, as far as I know, in the śāstric literature and its use in this case may be the only such instance. It is, however, commonplace in at least one set of Jewish legal texts, viz., the Mishnah, which was also compiled around the first century CE. The Mishnah frequently employs the phrase *bameh devarim amurim* or "in what case was this taught?" to introduce a discussion that limits the scope of an earlier statement (Basser 2001: 81).[28] In our case in Chapter 2.21 of the Arthaśāstra, we are presented with the seemingly general auction procedure of 2.21.7–9. However, this is followed by 2.21.10–14, which gives us the customs duty evasion context, i.e, that the auction is only necessary in the case of an attempt to evade customs duty. Still, the unusual nature of such a rhetorical style in śāstric texts must be carefully weighed against the interpretive power of the approach suggested here.

The procedure proposed here is consistent with the idea that markets in the Arthaśāstra were allowed to operate and discover their own prices. Of course, the Arthaśāstra does not envisage a completely laissez-faire system and there is an entire chapter (2.16) devoted to the regulation of the marketplace, but the government itself does not seem to have been in the business of setting prices. The superintendent of commodities (*paṇyādhyakṣa*) does seem to have been involved in price setting, but this seems to have been only in unusual cases, as in 4.2.36, where the superintendent of commodities is recommended to set prices after taking various factors into account. In this case, the commodities are described as *deśakālāntarita-* Olivelle "remote in terms of place or time" (sim. Kangle). It is not clear what remoteness in time means in the context of commodities for sale, but it would seem that these are illiquid markets where sales at extreme prices are likely and which would therefore invite price setting by a competent authority. Another case where the superintendent seems to be charged with setting a price is 2.16.2, which seems to discuss a situation of a temporary imbalance between supply and demand with supply being higher than normal. Most of chapter 2.16 is devoted, in fact, to ensuring that the market operates openly, efficiently, and without cheating.[29]

27. For modern methods of arriving at a customs valuation when the goods have no established transaction value, see the treatment by the World Trade Organization, https://www.wto.org/english/tratop_e/cusval_e/cusval_info_e.htm#3. This website lays out six alternative procedures to determine the dutiable value of imported goods, one of which is "transaction value of similar goods."

28. See, e.g., Mishna Peah 7:2.

29. Thus, 2.16.4 discusses bringing sellers of the same good to a central location; this would reduce search costs. Sūtras 2.16.5–6 are about preventing prices from being excessively high; 2.16.7 about ensuring adequate supply of goods; 2.16.13 about reducing the probability of lawsuits for foreign traders who bring necessary commodities into the country. Sūtra 2.16.16 regulates measures and weights. The state does seem to also participate in trade, particularly in international trade: sūtras 2.16.18–25 recommend trading practices for the commodities superintendent to ensure that these activities yield a profit for the state.

Except for such situations, traders are allowed to set their own prices, as is evident also in 4.2.22 (Olivelle's numbering), where traders are fined for colluding and selling goods at inordinately high prices. If there were no freedom in setting prices, such a situation would not occur at all. Just as in our case where an auction is used to find the correct valuation of an object on which to impose customs duties, the author seems comfortable with the use of market mechanisms, albeit with corrective mechanisms—just as in our day.

There is one other problematic provision, which was introduced above, with Olivelle's translation:

2.21.13 *pratikretṛbhayād vā paṇyamūlyād upari mūlyaṃ vardhayato mūlyavṛddhiṃ rājā haret, dviguṇaṃ vā śulkaṃ kuryāt*

2.21.13 Or, when a man, fearing competing buyers, increases the price beyond the normal price of a commodity, the king shall confiscate the increase in price or assess twice the customs duty.

I believe a reasonable alternative way of reading it is as follows: If an individual (who might or might not be a merchant) increases his valuation above the (original) valuation of the good because of fear of counter-buyers, then the king confiscates the increased valuation or a two-fold duty is levied.

I read the next provision in a manner consistent with this:

2.21.14 *tad evāṣṭaguṇam adhyakṣasya cchādayataḥ*.

2.21.14 That very eightfold penalty will apply to the merchant who conceals (the true value) from the customs superintendent.

That is, I read the genitive *adhyakṣasya* as a case of *śeṣe ṣaṣṭi*. Olivelle translates this as "eight times that much when the Superintendent conceals this." His reading is attractive and plausible syntactically because we then have both genitives (*adhyakṣasya* and *cchādayataḥ*) referring to the same person. On the other hand, there is no discussion anywhere else in this chapter of a deceitful superintendent.[30] Furthermore, the following sūtra is difficult to understand if we accept Olivelle's translation:

2.21.15 *tasmād vikrayaḥ paṇyānāṃ dhṛto mito gaṇito vā kāryaḥ, tarkaḥ phalgubhāṇḍānām ānugrāhikāṇāṃ ca*

2.21.15 Therefore, the sale of commodities should be made by weight, measure, or number, while an estimate should be made in the case of articles of low value and those enjoying special concessions.[31]

How would the deceit of the superintendent be checked by this procedure? Rather, if we interpret *adhyakṣasya cchādayataḥ* in 2.21.14 as one who conceals from the superintendent, then 2.21.15 suggests steps that the superintendent might take to prevent such concealment—

30. Elsewhere (see, e.g., Chapters 2.9 and 4.9) the text treats the question of officials who might cheat and how to monitor them.

31. As provided for in 2.22.8.

specifically that the sale (i.e., the sales price) normally be established or supported (*dhṛtaḥ*) with respect to weight, measure, or number, while an estimate should be made for special cases.[32] This is attractive in light of the estimation procedure referred to in the second half of the sūtra. I note here that the interpretation of 2.21.13–15 is independent of my theory of the auction as a customs duty evasion prevention device. Of course, I do believe that both my interpretations are valid and are consistent with each other; still the two hypotheses rise and fall on their own merits.

Coming back to 2.21.13, I suggest that what is happening is that the customs superintendent—following the procedure suggested in 2.21.15—gives the owner of the object the opportunity to raise his valuation.[33] If he does so and his new valuation is accepted, he forfeits the increase in valuation, but there the story ends. If he does not raise his valuation or his increased valuation is not accepted by the customs superintendent, he runs the risk of having to pay duty on a much higher market-determined valuation and losing the excess of the market price over his initial valuation. Furthermore, if the customs superintendent chooses to apply the alternative punitive tax, he would have to pay eight times the customs levy; on the other hand, if he voluntarily raises his valuation, he only pays two times the customs levy. This procedure avoids the incurrence of the cost of an auction. The text does not specify much detail, but it may be the case that the customs superintendent has the right to decide whether to give the merchant an opportunity to revise his valuation. This would provide the merchant an even greater incentive to provide the right valuation at the very outset, rather than play a two-stage game where he quotes a low valuation, followed by a higher valuation. There is an additional incentive for the individual to declare the true value of the item if he is not a merchant, but actually desires to have the item itself. In this case, he would either have to bid against the *pratikretṛ-* or forfeit the good.[34] He can avoid this potential loss by valuing the item correctly to begin with.

At this point, I would like to sketch out a possible economic model to serve as a foundation for my interpretation. I employ a standard economic demand-supply analysis, where the demand curve (D) indicates the demand for the good being sold at different prices and the supply curve (S) indicates the amount offered for sale at different prices. The demand curve is downward-sloping and the supply curve is upward-sloping for obvious reasons. Since my reading suggests that the auctions are meant to elicit information from the importer, I assume that he has information about the demand that is superior to that available to the superintendent.[35] Fig. 1 illustrates the situation.

32. While the word *vikraya-* itself does not mean 'sale price' but 'sale', the question arises as to what aspect of the sale is being referred to by the past participle *dhṛta-*. Given the context, the most likely element is the price. This is similar to Manusmṛti 7.127 *krayavikrayam adhvānaṃ, bhaktaṃ ca saparivyayam / yogakṣemaṃ ca saṃprekṣya vaṇijo dāpayet karān*, which is translated by Olivelle (2004) as "the king should levy taxes on traders after taking into consideration the price of purchase and sale, the distance of transport, maintenance and other expenses, and the cost of security." The context in Manusmṛti makes it reasonable to interpret the aspect of the sale being referred to there as the sales price. I argue for a similar interpretation here.

33. Appendix 2 provides a flowchart sequence of events as suggested by my interpretation.

34. Since *pratikretṛ-* is a first compound member, number is neutralized and it could stand for either singular or plural. I believe it is reasonable to opt for the latter, as does Olivelle as evidenced by his translation.

35. It is possible to make the same point with different assumptions as to what superior information the importer has and whether he is the only importer of the good or one of many.

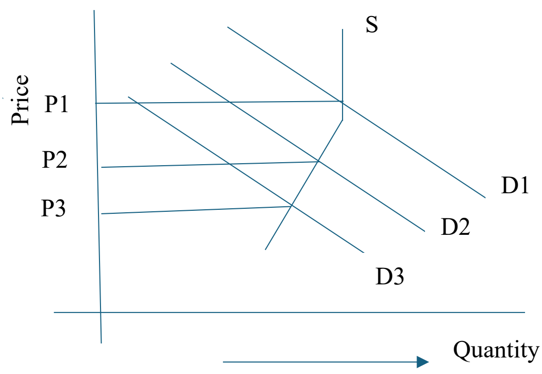


Fig. 1

The curve S is the supply curve. At high enough prices, the importer will offer all that he has brought to market—this accounts for the vertical portion of the supply curve. However, if the price in this wholesale market is too low, he will hold back from selling it and wait for a better time. This is why the supply curve is indicated in the diagram as downward sloping. Since the seller has superior information regarding the demand for the good (which is quite reasonable since he is in the business of selling that good, which the superintendent is not—even though the latter will have some idea of what is a reasonable price and what is not), he has to be forced to divulge the true value in case he is suspected of lowballing. The different demand curves, D1, D2, and D3 are possible demand curves given the superintendent's information; the importer knows which of them is the correct one.[36] The true market valuation can be P1, P2, or P3. What will the seller's asking price be, in this scenario? Since the seller has better knowledge of the likelihood of the different possible market values, he is unlikely to declare a price that is too high, since that would only leave him paying an excessively high tax. This, by the way, explains why the text only considers the case of a positive *mūlyavṛddhi* 'increase in value' and not a decrease, that is, why the text does not consider the case where the market sale price ends up lower than the declared price. In terms of Fig. 1, if the seller believes/knows that the true value is P2, he will never declare a value of P1, though he might declare a value of P3 if he believes he can fool the superintendent. Since the seller does not know the superintendent's information set perfectly, he has to take a chance on declaring a very low ask price P3 and paying a low *śulka*, or risk getting caught and having to pay a penalty. If the correct value is P1 and the seller declares a value of P3 and is challenged by the superintendent, he can either brazen it out and stick with his valuation of P3, allowing him to pay a lower *śulka*. Alternatively, if he is afraid that the superintendent will call his bluff, then fear of counter-buyers bidding up the price will lead him to increase his valuation (2.21.13 *paṇyamūlyād upari mūlyam vardhayataḥ* "increases his valuation above the [original] valuation of the good" in my translation). In my interpretation there is no problem in distinguishing between 2.21.10 and 2.21.13 because they happen under two different circumstances.

My interpretation of 2.21.13 reads the text in the context of an economic framework, while previous commentators have read the text locally without attempting to fit it into a broader context. Various questions arise in the reading of the sūtra. Who is the actor here (the referent of *vardhayataḥ*)? The economic context of the chapter allows me to assert that it is the seller. Who are the *pratikretṛ*-? And why is the seller (*vardhayataḥ*) apprehensive of them? The word

36. For convenience of exposition, I assume that the seller knows the true demand curve.

pratikretṛ is a hapax and so it is not possible to refer to previous occurrences to understand who they are or why they would inspire apprehension. Olivelle in his note on 2.21.13 (2013: 555) suggests that it is a rival seller, though in the text he translates the word as "competing buyers"; Kangle (1972: 142) thinks it is a buyer, while Scharfe (apud Olivelle) believes it is a particular kind of seller, a retailer. My underlying theory of what is being described in this chapter allows me to identify them as buyers who, in the event of a forced auction, would bid higher and raise the valuation of the good; hence the merchant is apprehensive about being forced to pay a high penalty. Why does the text talk about an increase in the price/valuation (*mūlyavṛddhi*) but does not consider a reduction in the price/valuation? My framework, which models the trader as having better information regarding the true value, explains why. And why does *śulkabhaya-* lead the seller to come up with a low price in 2.21.10, whereas *pratikretṛbhaya-* leads him to raise the price in 2.21.13? Kangle (1972: 142) thinks they refer to the same case. My economic framework allows me to distinguish between the two cases and explain why the trader would lowball the price in the first case and raise the price in the second.

CONCLUSION

Previous researchers have proposed readings of chapter 2.21 in the Arthaśastra that do not provide an overall coherence to the chapter. Wiese (2014) uses a combination of a market tax interpretation of *mūlyavṛddhi* buttressed by the requirement of an ascending auction procedure along with a customs tax. Others suggest that the chapter describes the implementation of a deliberate policy of requiring all long-distance imports to be assessed customs duty *and* auctioned at the customs house upon arrival, presumably to local merchants.[37] These interpretations either suggest that the text is ahistorical (Wiese) or fail to explain the context of some of the sūtras (such as 2.21.13) without making local assumptions. In this article I propose an integrated way to read the first part of chapter 2.21 (from 2.21.1 to 2.21.17) that resolves these issues, but at the cost of assuming an uncommon rhetorical structure to the text. In keeping with the chapter heading, viz., *śulkādhyakṣa* 'customs superintendent', I suggest that the entire chapter deals with customs issues, with the first part dealing with the collection of customs levies on imports. In my interpretation, the author recognizes the incentive for importers to undervalue their goods and suggests an efficient procedure whereby to elicit truthful revelation of the importer's valuation and to maximize customs levy collections. The problem faced by the author is similar to the problem faced by customs inspectors today as well as those dealing with issues of transfer pricing; the solution he proposes is also similar to the solution often used today, although the auction method that he proposes is specific to his situation.

APPENDIX 1

Arthaśāstra 2.21.1–2.21.15: Olivelle's Translations, with My Modifications

1	The Superintendent of Customs should set up the customs house along with the flag facing the east or the north near the main gate.
2	The customs collectors, four or five in number, should write down with reference to the traders arrived in caravans—who they are, where they are from, how much merchandise they have, and where the identity card or the seal was issued.

37. I thank an anonymous referee for this suggestion.

3	The penalty on goods without a seal is twice the amount due.
4	The fine on good with forged seals is eight times the customs duty.
5	The penalty on goods with broken seals is distraint in the Ghatikāsthāna.
6	When the royal seal has been altered or the name has been changed, he should be made to pay one and a quarter Paṇas for each load.
7	The traders [38] should announce the quantity and price of a commodity that has reached the foot of the flag: "Who will buy this commodity at this price for this quantity?"
8	After it has been proclaimed aloud three times, he should give it to the bidders.
9	If there is competition among buyers, the increase in price along with the customs duty goes to the treasury.
9*	**The increase in valuation, when there is competition among buyers,** along with the customs duty goes to the treasury. [39]
10, 11	When a man, fearing customs duty, declares a lower quantity or price, the king shall confiscate the amount in excess of that; or he should pay eight times the customs duty.
10*, 11*	*This is the procedure to be followed* [my interpolation] when a man, fearing customs duty, declares a lower quantity or **valuation.** The king shall confiscate the amount in excess of that; or he should pay eight times the customs duty.
12	He should do the same when someone decreases the value of a package containing merchandise by presenting a lower-quality sample, or when someone conceals a package with goods of high value within a package containing goods of low value.
13, 14	Or, when a man, fearing competing buyers, increases the price beyond the normal price of a commodity, the king shall confiscate the increase in price or assess twice the customs duty—eight times that much when the Superintendent conceals this.
13*, 14*	**Or, if an individual** (*who might or might not be a merchant,* my clarification) **increases his valuation above the (original) valuation of the good because of fear of counter-buyers, then the king shall confiscate the increased valuation or a two-fold duty is levied—that very eightfold penalty will apply to a merchant who conceals** (*the true value*, my clarification) **from the customs superintendent.**
15	Therefore, the sale of commodities should be established by weight, measure, or number, while an estimate should be made in the case of articles of low value and those enjoying special concessions.

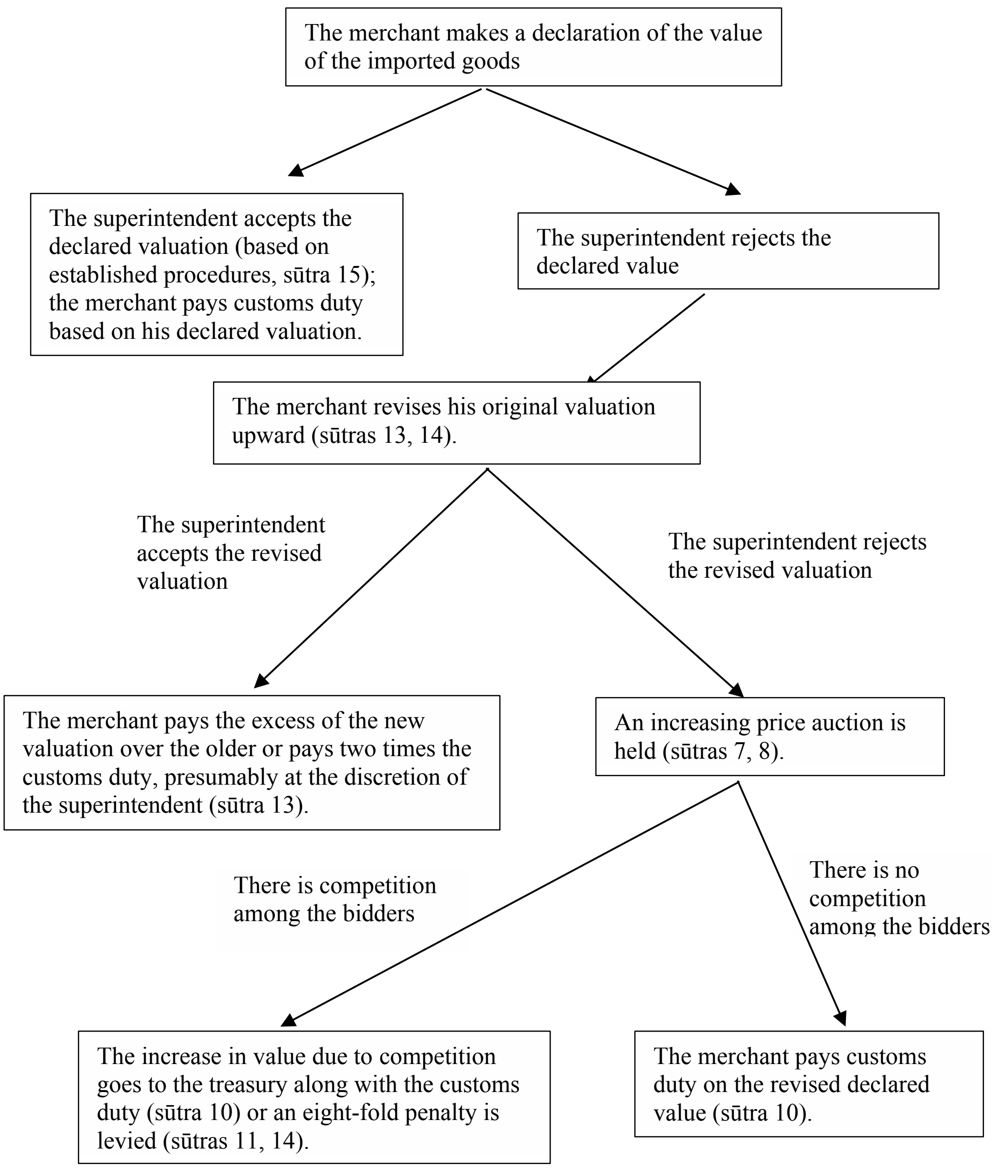
38. As Mark McClish pointed out to me (p.c.), the term used here is *vaidehaka-*, which is also found in 2.21.20, as opposed to *vaṇij-* in 2.21.2. It is not clear what the distinction is—Olivelle et al. 2015 translate them both as "merchant, trader" (pp. 344 and 368 repectively)—but *vaṇij-* may refer to the importer (wholesaler?), while *vaidehaka-* may refer to the local trader (retailer?).

39. For sūtras where my reading/translation differs from Olivelle's, my reading/translation is indicated with an asterisk by the sūtra number and boldface in the translation.

15*	Therefore, the sale **price** of commodities should be established by weight, measure, or number, while an estimate should be made in the case of articles of low value and those enjoying special concessions.

APPENDIX 2

A Flowchart of the Suggested Sequence of Events



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