

DYNAMICS OF INFORMAL CROSS-BORDER TRADE IN AGRICULTURAL PRODUCTS BETWEEN NEPAL AND INDIA



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1

EXECUTIVE SUMMARY

1.1 Background

Following COVID-19, the Russia-Ukraine War severely disrupted global markets for agricultural input and output, affecting poverty and agrifood system (Arndt, et al., 2023)¹. This has sparked concerns regarding the impacts of higher world commodity prices on developing landlocked countries, such as Nepal, which heavily rely on agriculture (Bentley et al., 2022)². Literature indicates that these crises, including wars, are likely to increase informal trade (Chakunda, 2023)³. It is considered that informal economy which had been on a decline after the promulgation of Nepal's Constitution in 2015, has started increasing after the COVID-19 pandemic, and is most likely to be affected by the increasing crises.⁴ This prevailing scenario presents challenges for Nepal's Agrifood System that relies on the import of food and agricultural inputs. In this context, with the support of the United States Agency for International Development (USAID), the Cereal Systems Initiative for South Asia (CSISA) has been working to address the intricate and urgent challenges arising from the Russia-Ukraine war, such as informal trade, in the leadership of International Maize and Wheat Improvement Center (CIMMYT) and in collaboration with International Food Policy Research Institute (IFPRI), Institute for Integrated Development Studies (IIDS) and South Asia Watch on Trade, Economics and Environment (SAWTEE).

Informal cross-border agricultural food trade (ICBAT) plays a significant role in landlocked Nepal's agricultural food system. A host of demand and supply side factors account for the prominence of informal trade in relation to formal. Informal

trade comprises unrecorded flows of goods and services that escape official statistics, encompassing commercial transactions across international borders. The term "informal" refers to the nature of the trade rather than the traders' status. Literature categorizes informal trade into three main categories: a) unregistered traders, individuals, households, or firms operating outside the formal economy; b) registered firms or other entities evading regulations and duties completely i.e., smuggling; c) registered firms partly evading regulations and duties through different practices such as misclassification and mis-invoicing.

There is an incomplete understanding of the nature and volume of agricultural food trade in Nepal, comprising both formal and informal trade. The scant literature on informal trade that exists tends to focus on implausible attempts to quantify the magnitude of informal trade. Though important for assessing the notional revenue loss (the level of trade itself is determined by the trade tax or its avoidance), estimates have a significant fiscal appeal yet there is little accuracy in the estimates, and they vary widely across studies which is all but expected. The interest in informal trade is largely driven with the objective of formalizing trade to the extent possible. Towards these questions like what gets traded and how the trends vary over time (qualitatively) and what are the drivers of allocation between formal and informal trade, what are the institutional arrangements initiating and sustaining informal trade and the mechanisms for contracts (implicit) and price formation and discovery are pertinent questions that research must address if aiming to achieve comparatively high levels of formal trade.

¹ Arndt, C., Diao, X., Dorosh, P., Pauw, K., & Thurlow, J. (2023). The Ukraine war and rising commodity prices: Implications for developing countries. *Global Food Security*, 36, 100680.

² Bentley, A.R., Donovan, J., Sonder, K., Baudron, F., Lewis, J.M., Voss, R., Rutsaert, P., Poole, N., Kamoun, S., Saunders, D.G. and Hodson, D. (2022). Near-to long-term measures to stabilize global wheat supplies and food security. *Nature Food*, 3, 483-486.

³ Chakunda, V. (2023). A "war against livelihoods": Contestations over the government of Zimbabwe's response to street vending in selected cities. *City, Culture and Society*, 34, 100536.

⁴ The Kathmandu Post, 2024. [WWW Document]. Nepal's informal economy is 38.6 percent of GDP. Available at: <https://kathmandupost.com/money/2024/01/26/nepal-s-informal-economy-is-38-6-percent-of-gdp>. (Accessed 2 April 2024).

Estimating the magnitude of informal trade might not be the only important or the most important subject to assess beyond the loss of revenues from a fiscal standpoint and the importance of a comparatively scarce resource in Nepal i.e. foreign exchange. The drivers of informal trade vis-à-vis formal trade, what gets traded and how, and what are the institutional arrangements for initiating and sustaining informal trade might be comparatively important. It is essential to realize that informal trade occurs only when the benchmark or comparator, that is, formal trade, exists at least in potential. Also, trade occurs through value chains where exchanges of outputs and inputs are often linked, and their contingencies need to be incorporated.

1.2 Findings from the study

To understand the dynamics that underpin the informal trade of agricultural food products between Nepal and India, the study undertook comprehensive primary and secondary research combining disaggregated customs data at 8-digit level with high frequency for informal trade based on key informant interviews, stakeholder consultations, and focus group discussions at different locations in Nepal.

I Modes of informal trade: Informal imports of agricultural food items are undertaken by households for consumption purposes and through carriers for commercial purposes moving from India to Nepal. However, the end use of informally exported goods to India from the Nepali side is mostly for commercial purposes.

Households for consumption: Households in border towns and villages cross the border to Indian markets to purchase household items, including agricultural food items, due to the price differentials. Households near major border markets also make large purchases during festive seasons. They utilize shared rickshaws, bicycles, motorcycles, and scooters to transport these goods.

Traders through carriers: Carriers are organized and handle orders from traders, arranging pickups and drops. They use foot, bicycles, or motorcycles to carry goods, and are paid on a 'piece rate' basis. They are usually locals, familiar with the terrains, and can

make multiple trips if apprehended by security forces.

Network and price discovery: Informal trade is anchored by networks that connect buyers and sellers, ensuring the consignments are delivered in a similar fashion to formal trade. However, risks of carriers being detained, or consignments being seized, and fear of prosecution are large for traders. Yet the level of arbitrage is high enough for the trade to prevail informally.

2 Product-specific findings: Besides outputs, informal trade of agricultural inputs – seeds and fertilizers – is at least as widespread. The products cannot be exhaustive as the outputs and inputs that are informally traded varies by time as a function of trade and domestic policies in India or Nepal and other external factors like global price changes and trade possibilities like from shocks such as the Russia-Ukraine war.

Seed: Informal import of seeds involves farmers crossing the border to buy preferred varieties from India. What matters more to them is whether the seeds they want are available on time, possibly more than the price difference. The Seed Entrepreneurs Association of Nepal (SEAN) points out that there are delays in getting seed varieties officially approved. This delay could lead to problems like pests, seeds that do not work as well, and information gaps relating to cultivation practices.

Fertilizer: Informal import of fertilizer from India offers timely availability and lower prices compared to Nepal. The high subsidy on fertilizers in India, particularly on urea, has led to significant price differentials. Agroveterinarians in border towns sell subsidized urea and DAP for NPR 9 (USD 0.08) and NPR 43 (USD 0.40) per kilogram respectively. Commercial informal traders transport fertilizers to Nepal, selling them at higher prices. In some border villages, 70 to 80 percent of their total fertilizer requirement comes from Indian markets.

Rice: Households and traders drive the informal trade of rice across borders, with border authorities allowing them to transport sacks of rice, which they need to unseal and tie up in small bags for consumption. The main factor for informal imports is

the lower prices on the Indian side compared to the Nepali side, enabling retailers to save between 18 to 22 percent on a 25 kilogram sack of rice, depending on the variety. Possibly, the biggest driver of rice being informally exported is the heavy consumption subsidy in India's public distribution system. On the production side, the large complex of support prices and input subsidies has led to informal imports that has rendered domestic rice mills unable to compete, notwithstanding the government's stated objective of raising both production and processing of paddy in Nepal.

Vegetables: Informal imports of vegetables from India to Nepal is primarily small scale, catering to local markets and avoiding formalities like laboratory testing. The primary factor for informal vegetables trade is likely the counterfactual non-tariff barriers in terms of sanitary and phyto-sanitary requirements. Notably in vegetables, traders use informal routes, small consignments on bicycles and motorcycles, to avoid stringent non-tariff barriers. The higher prices in Nepal for vegetables on a consistent basis make it more profitable for traders to cross the border and engage in informal trade. Reverse flows of trade from Nepal to India has also happened, like during the tomato crisis in India in 2023.

1.3 Drivers of informal trade

Tariffs and Duties: The Nepal-India Treaty of Trade exempts primary goods from customs duties, allowing imports of agricultural products like rice and vegetables from India. However, Nepal charges the Agriculture Reform Fee on these imports, while other countries, including SAARC members, are levied customs duty. Fresh vegetables attract 14 percent duties. The Nepal government applies two types of duties on imports (Customs and VAT), with total tax incidence potentially reaching 46.9 percent. Sugar, spices, and non-basmati rice face high duties. Informal imports are lucrative, but additional payments are required.

Non-tariff barriers: Besides the need to circumvent official border points to circumvent duties and other regulatory prohibitions, traders seek informal channels to ferry their goods to avoid non-tariff barriers, in the form of laboratory certificates and

other regulatory requirements, most prominently in vegetables.

Unstable and unpredictable domestic and trade policies: One of the main factors for informal trade is possibly the trade and domestic policy uncertainty, in both Nepal and India. India for instance has very high bound tariffs; more than 100 percent for agricultural items and several products in trade agreements are clubbed into sensitive items. Also, trade policy changes have occurred to address domestic inflationary pressures with discrete and sudden changes like bans and tariff rate quotas (see below).

Price differentials: Higher tariffs and duties add up to the already existing price difference based on cost of production differences between the markets in both countries. The price difference owing to cost and easy mobility between the borders is a tempting factor for the households/traders and sellers residing in the bordering areas. The arbitrage possibility owing to price differentials is revealed most importantly in rice and edible oils on the output side.

Prohibition and shortages: India's decision to halt exports or to impose export duty is one of the major driving factors for informal trade. In the past three years, India has imposed prohibition on the export of staple items such as rice, paddy, wheat, sugar, and onions. According to traders, when India imposes a ban on formal exports, imports through informal routes increase.

Lax border patrol: Strong border patrol would prevent a large scale of informal trade that happens across the border. Border forces on both sides of the border are lenient when it comes to matters of household food consumption, allowing unsealed bags of rice and chemical fertilizers, but requiring the contents to be transferred to smaller bags.

Socio-economic causes: Informal trade is a livelihood support for people in border areas characterized by strong cultural and societal links that has minimized information problems preventing or reducing any exchanges. Qualitative findings show that after accounting for risk, the income generated is sufficiently high to make it incentive compatible for different agents to engage in informal agricultural food trade.

Roles of informal trade: Informal trade between Nepal and India has helped prevent shortages and generated income for some, but it can also erode the productive capacity of domestic farmers and other agricultural food value chain agents (e.g. processors). Lower prices of essential commodities like rice and sugar might have made Nepali local production uncompetitive.

Possible costs: Goods transported outside regulatory oversight can bring sanitary and phytosanitary issues, the importance of which is amplified post pandemic. The government loses revenue as customs are skirted, and the informal channel of goods imported from other developing countries can lead to foreign currency loss. The impact on domestic production has led to one-third of Nepal's rice mills having to shut down due to ineffective government policies. Informal trade also leads to policy complacency, as the amount of chemical fertilizer required for Nepal is 20 to 50 percent less than the actual volume procured annually. Informal trade also allows for the avoidance of regulatory requirements, making it an illegal and criminal activity.

Way forward

Informal trade poses a challenge that can be exceedingly difficult or even impossible to resolve due to factors such as incomplete, contradictory, and fluctuating requirements. It must be acknowledged that ICBAT has helped in meeting Nepal's food demand while making available essential inputs such as fertilizers and seeds when needed. However, these activities foil the policy leverage by making them ineffective. Given the open border with India, the elimination of informal trade does not seem possible and given the circumstance, it may not be desirable either. Following are the policy recommendations to consider:

- Harmonize the sanitary and phytosanitary requirements between the two countries and mutually recognize the certificates issued by one country's regulatory body for faster and hassle-free movement of agricultural food products including seeds and fertilizer. Such trade facilitation can alter the share of formal trade.
- Reduce regulatory barriers where possible to remove the incentive to circumvent formal trade channels and institute quasi formal trade.
- Bring in trade and domestic policy certainty as unpredictability in policy leads to informal trading over formal trading.
- Provision should be made to allow farmers to directly sell their fresh produce, green vegetables, across the Nepal-India border up to a certain quantity. This would provide a market for the surplus produce to benefit farmers and reduce the biggest barrier in perishables i.e., time to trade.
- A comprehensive assessment of the supply chain of major informally traded agricultural food products such as rice, maize, and seeds, needs to be undertaken to understand the reasons and implications of informal trade in the agro-processing ecosystem. This would assist in designing policy interventions accordingly.
- Rationalize tariffs and other duties of the products that are most informally imported.
- Fertilizer procurement needs to be undertaken on time and to ensure smooth distribution.
- In case of export bans imposed by India, Nepal needs to negotiate promptly with Indian authorities to ensure supply to Nepal is not disrupted.

2

INTRODUCTION

2.1 Formal and informal agricultural food trade of Nepal

Nepal is predominantly an agricultural country with about two-thirds of the population engaged in agriculture and the sector contributes to about one-fourth of Nepal's Gross Domestic Product (GDP).⁵ Despite agriculture being the mainstay of the Nepali economy, the country is highly dependent on imports of various commodities including products to meet its food demand. In the past 10 years, the average annual imports of agricultural and food products made up about 18.6 percent of Nepal's total recorded imports (Figure 1).⁶ In terms exports as well, between fiscal years 2014/15 to 2022/23, food and agricultural commodities made up to 40 percent of the total recorded exports from Nepal.

The agricultural food commodities trade holds importance considering that domestic production of staples such as rice and vegetables does not meet consumption demand. Likewise, imports of agricultural products such as maize, soybean, crude palm oil, make up crucial inputs in the supply chain of animal and poultry feed, hence, these hold special importance in terms of food and nutrition security as well as support of industrial base for agro-processing. More importantly, agricultural food imports, particularly unrecorded exchanges, offset the policies and become a source of ineffectiveness for domestic policies in Nepal. Given its large incidence, the recorded figures of trade that take place only through the

official customs points provide a substantially partial picture of the actual trade of Nepal, considering the wide prevalence (qualitatively known) of unrecorded imports and exports that mostly happen through Nepal's porous border with India.

Nepal and India share a nearly 1800 km long border, being patrolled by Sashastra Seema Bal (SSB) on the Indian side and Armed Police Force (APF) on the Nepali side. The 1950 Treaty of Peace and Friendship between Nepal and India allows unrestricted movement of individuals between the two countries.⁷ These movements encompass people and goods not accounted for in formal records. In addition to households bringing goods from across the border for personal use, the porous nature of the border also fosters informal commercial trade.

Although by construction, there are no formal estimates of informal trade between the two countries, some estimates suggest that it could be as high as the formal trade.⁸ Yet, the magnitude of informal trade might not be the only important subject to assess beyond the loss of revenues and possible implications for foreign exchange from a fiscal standpoint. The drivers of informal trade vis-à-vis formal trade, what gets traded and how and what the institutional arrangements are for initiating and sustaining informal trade might be most important. Also, trade occurs through value chains where exchanges of outputs and inputs are often linked, and their contingencies need to be incorporated.

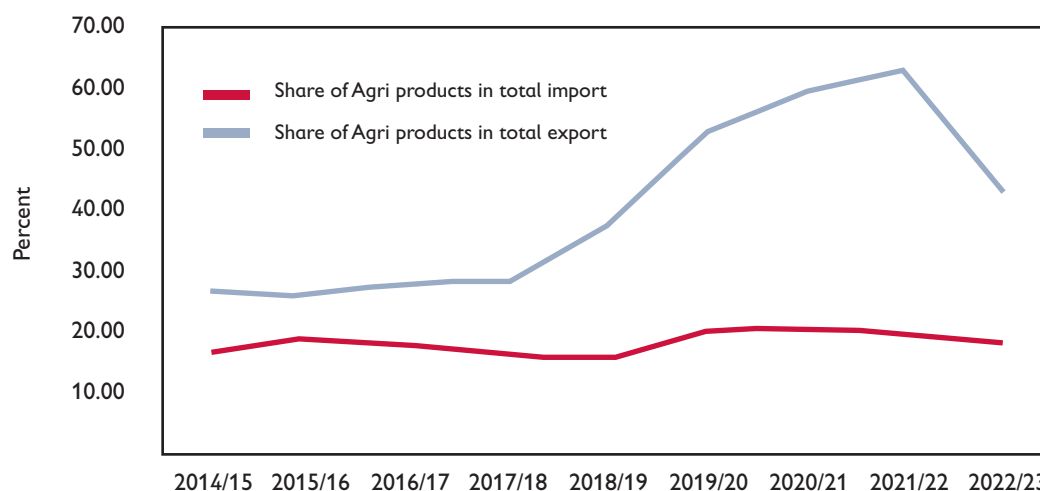
⁵ Nepal Rastra Bank. 2024. Current Macroeconomic and Financial Situation: Annual Data 2023-24. Kathmandu: Nepal Rastra Bank

⁶ In this study, products that fall between HS Codes 1 to 23 are considered as food and agricultural products. The Harmonized Schedule of sets out the tariff rates and statistical categories for all merchandise imported and exported. The international Harmonized System is the global system of nomenclature applied to most world trade in goods.

⁷ Article 7 of Treaty of Peace and Friendship between Nepal and India. Available here: <https://www.mea.gov.in/bilateral-documents.htm?dtl/6295/Treaty+of+Peace+and+Friendship>

⁸ Taneja, Nisha., Muttukrishna Sarvananthan, Binod K. Karmacharya, and Sanjib Pohit. 2004. "India's Informal Trade with Sri Lanka and Nepal: An Estimation." *South Asia Economic Journal*, 5(1): 27-54. <https://doi.org/10.1177/139156140400500102> and Karmacharya, B.K. 2010. "A Study on Cross-border Informal Trade between Nepal and India on Selected Agricultural Commodities." National Council for Development Research, Kathmandu

Figure 1: Share of agricultural and food products in Nepal's total exports and imports.



Source: Multiple year trade statistics reports released by the Department of Customs, Government of Nepal.

The informal trade, not happening through official customs channels, therefore, is unrecorded, comprises households who bring agricultural commodities for their consumption, as well as traders that bring goods to sell in Nepali markets by circumventing customs to avoid duties and other regulations. Informal cross-border trade is not just limited to agricultural outputs as Nepali farmers seek Indian markets to source agricultural inputs such as chemical fertilizers and seeds as well.⁹ Although the magnitude of informal imports between Nepal and India is estimated to be substantially higher than informal exports, some commodities also get partially or informally exported to India like ginger and could also be in response to shocks like the price spikes in tomatoes in India.

Note that porous borders, however prevalent, may be a necessary but not a sufficient condition for informal trade, particularly in relation to formal trade. Quite simply, informal trade exists if the exchanging parties gain more from skirting the formal channels, both in terms of pecuniary (taxes avoided) and non-pecuniary (time in crossing the border, official harassment, and paperwork in registry and clearance) benefits, including risks of fine and other penalties. Repeated transactions (like in repeated games), social ties, or

systems for the avoidance of official oversight sustain informal trade and have done so globally, standing the test of time. The extent of informal trade and its nature varies by the context, technology, and levels of enforcement capital (determining which commodities are traded, and which routes are exploited). There are three main interrelated barriers associated with informal trade, viz. those related to time to trade (important for agricultural food trade), costs to trade (all pecuniary costs or those that are monetized like unwritten commissions), and invisible barriers like harassment by officials at ports.

There is an incomplete understanding of the volume and nature of agricultural food trade in Nepal, comprising both formal and informal trade which we believe need to be looked at conjunctively. Most of the research about informal trade has focused on estimating the level of informal trade. This may be particularly important for getting a sense of the actual levels of trade (also providing supplementary information to gauge presence or extent of under-trading i.e., level of trade flows relative to the potential which is a function of fundamentals comprising demand and supply factors, determining trade flows and for assessing potentially lost revenues.

⁹ USAID and EAT. 2014. Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth across South Asia. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

The analysis of the determinants of informal trade for understanding issues such as why informal trade occurs in the first place, how is it initiated, how is it sustained in the face of shocks, and how it relates to formal trade that exists alongside, remains largely unassessed. It becomes important to delve into the mechanisms designed for sustaining the exchange in terms of contract enforcement, price formations and price discovery, and quality control. It is essential to realize that informal trade occurs only when the benchmark or comparator, that is, formal trade, exists at least conceivably.

Already Nepal's policy discussions are dominated by a narrative that hold unabated imports of agricultural food commodities from India as responsible for eroding the competitiveness of the agricultural sector and policy choices for failing to yield intended effects or result in unintended outcomes.¹⁰ There are growing voices calling to impose restrictive measures on agriculture imports to boost domestic agriculture without considering the nuances that underline the agricultural food trade and production landscape between the two countries.^{11 12} Trade theory clearly states that small countries like Nepal (with limited market power in global markets) benefit more from trade, and all kinds of trade, exports, and imports, are advantageous to the economy. Further, trade improves efficiency by allocating resources to increase the amount produced for a given level of effort/technology. At this level, the efficiency gained from trade does not depend on whether the trade is formal or informal. Trade based on comparative advantage where a country specializes in the production of commodities is equivalent to adoption of technology i.e. producing outputs with the least number of inputs.

However, informal trade is not without its issues. At the forefront, informal trade with its circumvention of customs means the countries lose out on revenue leading to fiscal costs. The trade taxes (like tariffs) constitute an important portion of government revenue (as much as 18 percent for Nepal in 2021

based on recorded trade, and potentially even higher now), and issues of quality and safety attributes like possibilities of delivery of transboundary animal diseases via informal channels become important concerns. Most importantly, informal trade undermines the capacity of policymaking to be effective. For example, a policy in Nepal for technology upgrades with improved seeds in paddy could be completely offset by the unstinted flow of rice from across the border with India. Moreover, the Nepali government's attempt to protect domestic sugar industries by imposing high tariffs on sugar imports seems less effective due to the informal flow of sugar from across the border. Likewise, the prominence of informal trade in filling the deficit during shortages or balancing the domestic prices and having an overall positive impact also brings policy complacency. It possibly reduces the urgency to solve the issues of insufficient domestic production or availability. This is evident in the case of chemical fertilizer supply in Nepal. In addition, informal trade in some cases may have economic and social costs when a section of the population at the border is encouraged to make a living by engaging in activities that break laws and feed corruption. Recorded trade between Nepal and India

India is the largest trading partner of Nepal. More than two-thirds of Nepal's formal trade happens with India—including both agricultural and non-agricultural products. Between 2010 and 2022, trade with India comprised 65 percent of Nepal's total recorded trade (Figure 2). Among total trade, agriculture products make up about 60 percent of the total trade volume, including both imports and exports, between the two countries. Forty percent of Nepal's exports are made up of agricultural and food commodities, such as tea, cardamom and ginger, and in recent years palm and soybean oil have become major export items. Of the total imports of agricultural and food commodities, 54 percent of the total recorded volume was from India.

Nepal's agricultural and food imports have been

¹⁰ Adhikari, Jagannath, Milan Shrestha and Dinesh Paudel. 2021. "Nepal's growing dependency on food imports: A threat to national sovereignty and ways forward". Nepal Public Policy Review Volume 1. <https://nppr.org.np/index.php/journal/article/view/10/17>

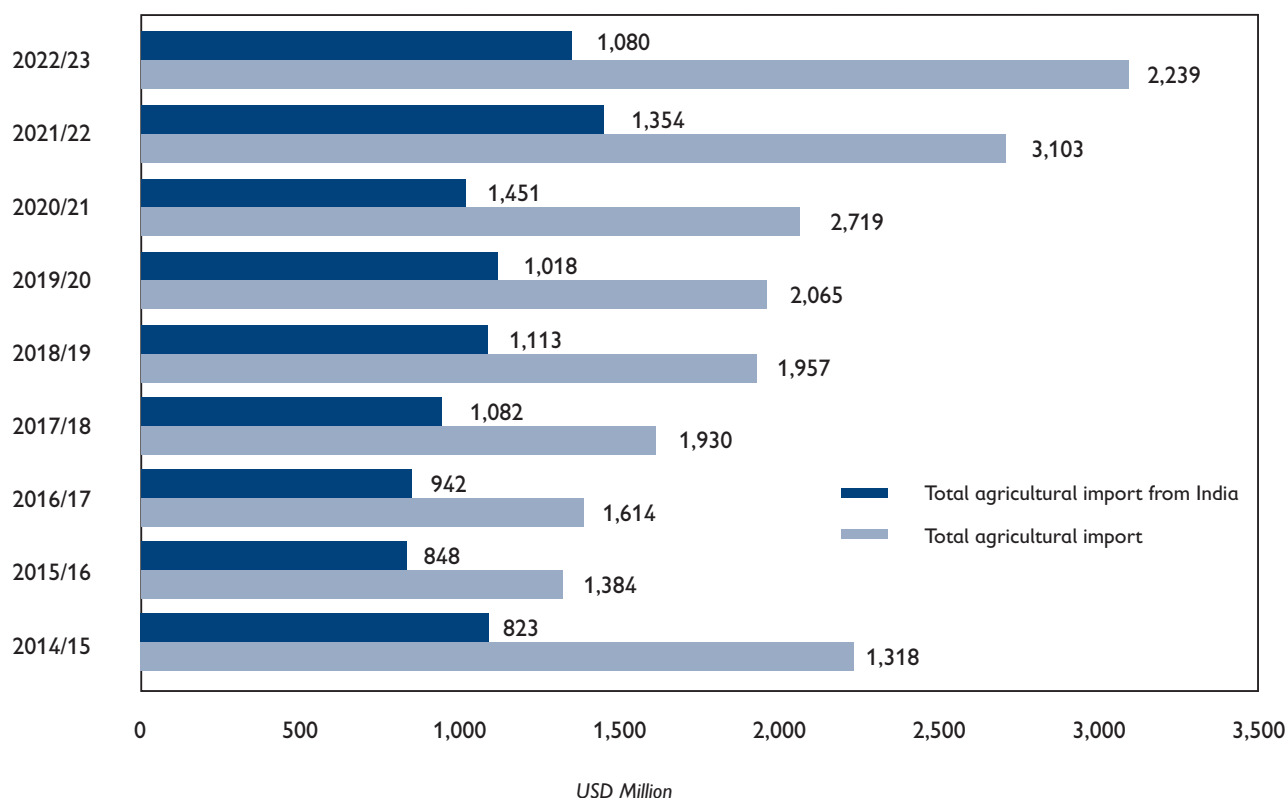
¹¹ Republica. 2022. "Experts insist on banning import of agricultural products". Republica 17 October 2022. <https://myrepublica.nagariknetwork.com/news/experts-insist-on-banning-import-of-agricultural-products/>

¹² Dahal, Kshitiz and Dikshya Singh. 2019. "Vegetable imports: To regulate or not to regulate?". The Himalayan Times, 16 July 2019. <https://thehimalayantimes.com/opinion/vegetable-imports-to-regulate-or-not-to-regulate>

dominated by edible oil comprising palm oil (mostly crude oil to be exported with minor changes to meet the rules of origin requirements in regional and bilateral trade agreements), soybean oil and sunflower oil since FY 2018/19. Likewise, since that period, exports have also been dominated by

refined oil of those varieties (Table 1). If crude palm and soybean oil are excluded, then rice, maize and potatoes remain in Nepal's import basket. In terms of exports, large cardamom, juice, and tea remain among the top exports.

Figure 2: Nepal's agricultural imports from India and the world (In USD Million).



Source: Department of Customs, Government of Nepal.

Agricultural commodities make up a substantial chunk of Nepal's export basket as these products make up about 40 percent of Nepal's recorded exports, the main commodities comprising tea, cardamom, and ginger. At the same time, Nepal imports a substantial number of agricultural commodities, including food grains such as paddy, rice, wheat, legumes, and pulses, fruits, and vegetables, among others. Nepal imports these products in a substantial volume from India. Between 2014 and 2023, about 54 percent of the total formally traded agricultural and food commodities were imported from India.

Nepal's average global exports of agricultural food products during the pre-COVID period (2016-19) was around USD 204.51 million, which rose to USD 812.35 million post-COVID (2020-23), registering a whopping threefold growth.¹³ This phenomenal growth was mainly attributed to the extensive product margin (Soybean and Palm Oil). Nepal's global soybean oil exports share in formal agricultural food exports increased from zero to 35.2 percent between pre-and post-Covid periods. Notably, the period coincided with increased tariff on imports of edible oils in India creating incentives to channelize

¹³ We have used Nepal to USD exchange rate as of 2016. The conversion factor is 1 USD = 107.38 NPR.

exports to India through Nepal that had concessional tariffs. Meanwhile, palm oil's cumulative global share in agricultural food exports increased from zero to 18.4 percent during the corresponding period (Table 1).

Similarly, Nepal's agricultural food exports to India increased in tandem with their global exports (Figure 4 for formal agricultural exports). Nepal's agricultural food exports increased from USD 164.93 million to USD 740.45 million, showing a growth of 349 percent. This growth was mainly attributed to the soybean oil, which grew from USD 3.66 million (2.2 percent share of the total agricultural food exports) in pre-Covid

period to USD 286.09 million (38.6 percent share of the total agricultural food exports) and palm oil, which grew from zero percent share of the total agricultural food exports to 8.86 percent during pre- and post-Covid period (Table 1). It is also worth mentioning that during Covid, India imposed border restrictions where people's movement was strictly prohibited, significantly impacting the informal trade happening along the India and Nepal border before Covid, and it could also be one of the potential reasons why Nepal's formally recorded trade grew substantially. The forced allocation between formal and informal trade highlights the need for looking at the two forms of trade in conjunction.

Table 1: Nepal's global export and export to India.

Nepal's Global Export				Nepal's Export to India			
HS 8digit	Commodity Name	Share – Pre Covid	Share – Post Covid	HS 8digit	Commodity Name	Share - Pre Covid	Share – Post Covid
07134090	Lentils	3.61	0.00	09024000	Other Black Tea	13.47	4.29
09024000	Other Black Tea	11.88	4.14	09083110	Large Cardamoms	22.60	7.94
09083110	Large Cardamoms	18.23	7.28	12119090	Agarwood-Others	3.15	0.00
12119090	Agarwood-Others	3.64	0.00	14049020	Vegetable Products	3.06	0.00
14049020	Vegetable Products	2.47	0.00	15079000	Soyabean Oil	2.24	38.63
15079000	Soyabean Oil	0.00	35.21	15119000	Palm Oil	8.78	5.21
15119000	Palm Oil	7.08	4.75	15119010	Palm Refined Oil	0.00	7.01
15119010	Palm Refined Oil	0.00	6.39	15119020	Palmolein Refined	0.00	8.82
15119020	Palmolein Refined	0.00	8.04	15119090	Refined Oil - Other	0.00	4.31
15119090	Refined Oil - Other	0.00	3.93	15121900	Other Sunflower Oil	0.00	2.35
19021900	Pasta - Other	3.08	0.00	19021900	Pasta - Other	2.76	0.00
20099000	Mixture Of Juice	11.16	4.88	20091100	Frozen Orange Juice	2.66	0.00
23064100	Rape/Colza Seeds	5.94	2.71	20099000	Mixture Of Juice	13.76	5.34
23091000	Dog Or Cat Food	2.84	3.04	23064100	Rape/Colza Seeds	7.36	2.98

Note: Grey cells indicate a decline in share during the post-COVID period, while blue cells indicate an increase in share during the post-COVID period.

This pattern of substantial exports of edible oils to India from Nepal emerged only recently in 2018, thanks mainly to regional free trade agreements (FTA)—exports from Nepal to India enjoy zero duty benefits under the South Asia Free Trade Agreement (SAFTA) and India-Nepal Trade Treaty. India, meanwhile, places significant tariffs on edible oil-producing countries, including Indonesia and Malaysia for palm oil, Argentina and Brazil for soybean oil, and Ukraine, Argentina, and Russia for sunflower/safflower oil (Notification No. 29/2018

dated 01.03.2018/Notification No. 84/2018-Customs and No. 82/2018-Customs dated 31.12.2018). These import duties created a substantial tariff wedge—a price gap in India between imported from edible oil-producing countries and imported from Nepal which already imported from large producers of edible oil— incentivizing importers to reroute their edible oils through Nepal, from where they could be exported to India duty-free. Emergence of palm and soybean oil at the top of Nepal's export basket is thus due to some oil processors taking advantage of difference

in tariffs caused by India hiking the import duties on crude import while granting preferential rate access to final outputs from Nepal due to Agreement on South Asia Free Trade Agreement (SAFTA).¹⁴ There is a fear that this could be a blip as export volumes declined following India's decision to reduce the duties.¹⁵

It is evident from Nepal's customs data that, Nepal's formal global agricultural food exports are highly concentrated; in the pre-Covid period, India alone contributed around 81 percent, which increased to 91 percent post-Covid, making Nepal lack diversification on both product and partners margin, thus becoming more vulnerable to external shocks and issues like change in India's trade policies.

Table 2: Nepal's global import and import from India.

Nepal's Global Import				Nepal's Import from India			
HS 8digit	Commodity Name	Share – Pre Covid	Share – Post Covid	HS 8digit	Commodity Name	Share - Pre Covid	Share – Post Covid
07019000	Potatoes	2.45	2.19	01042000	Goats	2.20	0.00
07031000	Onions	1.94	0.00	07019000	Potatoes	24.67	4.58
08081000	Apples	2.35	1.95	07031000	Onions	24.67	2.78
10019900	Wheat & Meslin-Other	0.00	1.56	08081000	Apples	1.15	0.00
10059000	Other Maize	5.05	4.45	09093100	Cummins	0.00	1.23
10061000	Husk Rice	2.38	3.96	10011900	Durum Wheat-Other	1.70	0.00
10063000	Semi-Milled Rice	10.08	4.24	10019900	Wheat & Meslin-Other	2.21	3.36
12019000	Soyabean	0.00	2.35	10059000	Other Maize	8.68	8.74
12051000	Rapeseeds	2.28	2.81	10061000	Husk Rice	4.23	1.20
15071000	Soyabean Crude Oil	6.51	11.26	10061090	Husk Rice-Other	0.00	8.53
15111000	Palm Crude Oil	2.57	6.24	10063000	Semi-Milled Rice	17.67	2.46
15121100	Sunflower Crude Oil	2.56	4.55	10063010	Parboiled Rice	0.00	2.15
21069040	Sugar Syrups	1.79	1.64	10063090	Other Rice	0.00	9.11
23040000	Oil Cakes	4.22	4.16	12075000	Mustard Seeds	0.00	1.44
23099000	Other Fish/Prawns Feeds	2.13	0.00	17011390	Sugar - Other	1.33	0.00
31021000	Urea	3.01	3.45	17011490	Jaggery - Other	0.00	2.43
31053000	Diammonium Phosphate	2.91	3.20	19019000	Food Malt - Other	1.56	0.00
				19053100	Sweet Biscuits	1.20	0.00
				23040000	Oil Cakes	7.01	5.63
				23099000	Other Fish/Prawns Feeds	2.29	1.97
				24012000	Tobacco	2.19	1.69

Note: Grey cells indicate a decline in share during the post-COVID period, while blue cells indicate an increase in share during the post-COVID period.

¹⁴ More information here: Dahal, Kshitiz. 2020. "Has Nepal broken out of its trend of export stagnation?" Trade Insight Vol 16 No 4: 32-34. https://sawtee.org/publications/TI_Vol_16_No_4.pdf

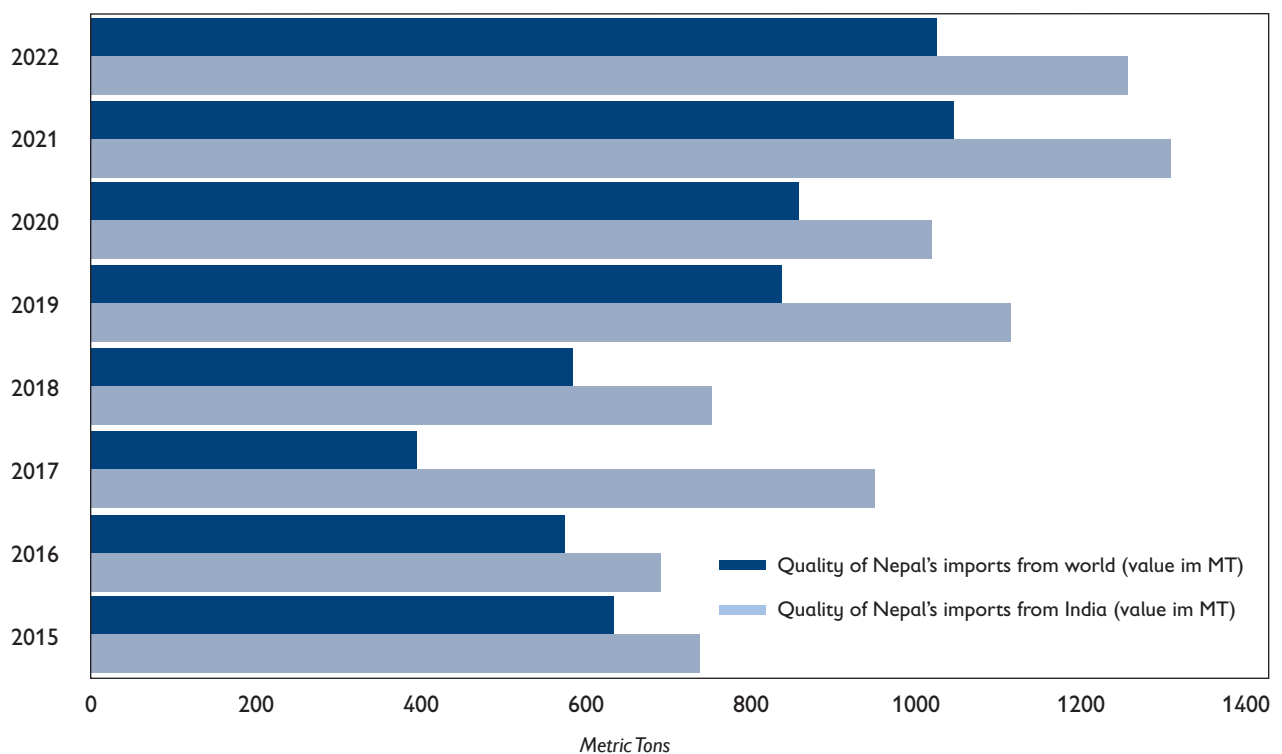
¹⁵ Lamsal, Himal. 2023. "Palm oil export from Nepal to India declines by 50 percent." My Republica, October 11, 2023. <https://myrepublica.nagariknetwork.com/news/palm-oil-export-from-nepal-to-india-declines-by-50-percent>

As per Nepal's customs data, Nepal's average global imports of agricultural food products during the pre-Covid period (2016-19) was around USD 1783.11 million, which rose to USD 3536.88 million, post-Covid (2020-23), registering a growth of 98 percent. This growth was attributed to the crude soybean oil imports, which grew from USD 116.04 million (6.5 percent share of total agricultural food imports) to USD 398.40 million (11.26 percent share of total agricultural food imports), thereby registering a growth of 243 percent between pre and post covid period (Table 2). Similarly, crude palm oil imports also increased from USD 45.91 million to USD 220.53 million, a growth of 380 percent during the corresponding period. Nepal's edible oil imports consist primarily of crude oil from producing countries (98% of total edible oil imports), which is a major source of contributor to Nepal's total agricultural food imports. Nepal uses imported crude edible oil mainly for exporting purposes. Nepal refines the imported crude oil domestically (to address rules of origin requirements) and then exports it to India with zero duty under the SAFTA and India-Nepal Trade Treaty. This setup is akin to the operations of a Global Value Chain (GVC)—when different countries contribute a part of the production process—albeit

policy-induced rather than based on the comparative advantage. This is likely because Nepal imposes lower tariffs on major edible oils than India, with duty differentials ranging from 22.5 percent to 30 percent in 2021.

Similarly, Nepal's agricultural food imports from India increased in tandem with their global imports, as India is a major contributor to Nepal's global agricultural food imports. Nepal's agricultural food imports from India increased from USD 998.88 million to USD 1640.06 million, showing a growth of 64.19 percent during pre and post Covid period. This lower growth performance as compared to Nepal's global agricultural food import was mainly attributed to India's ban on export of non-basmati rice. During pre-Covid period, Nepal's import of non-basmati/semi or wholly milled rice was USD 176.48 million (17.67 percent share in Nepal's global agricultural food import), which fell to USD 40.23 million during post-Covid period (2.46 percent share in Nepal's global agricultural food import). This was a fall of 77 percent in Nepal's formal imports from India for semi or wholly milled rice (Table 2) and naturally led to spurt in informal imports of rice from India.

Figure 3: Nepal's recorded imports of seeds.

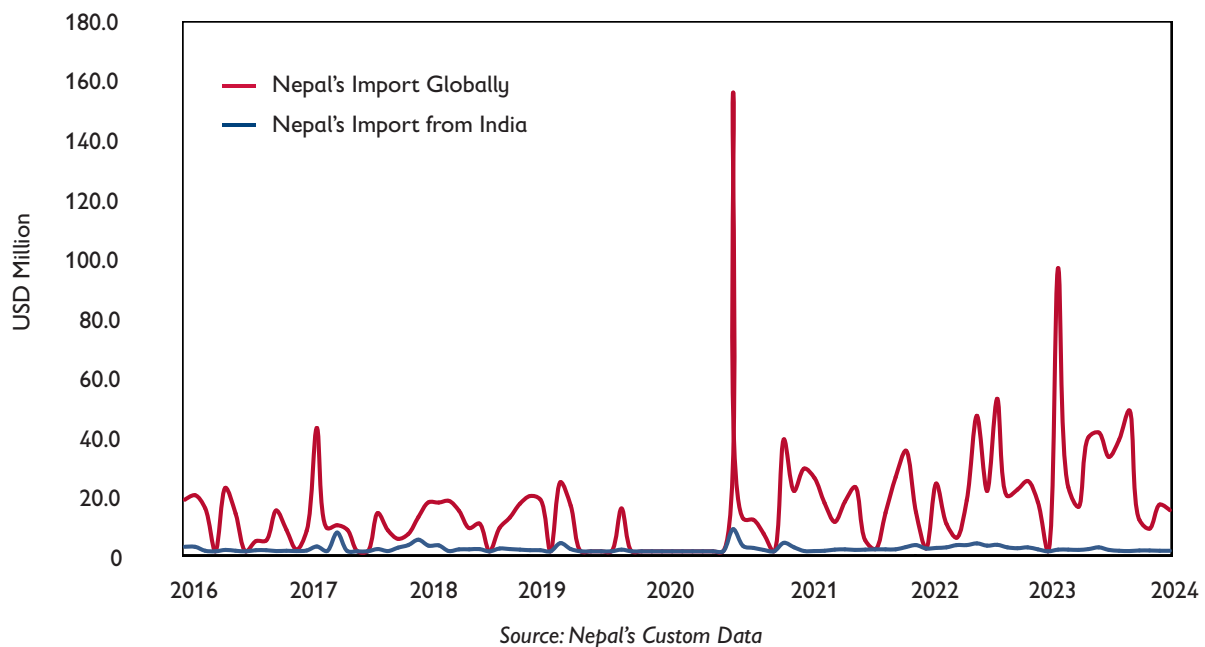


Source: ITC Trade Map

On the inputs side, Nepal is quite dependent on India. Formal seed imports from India were no less than 75 percent of Nepal’s annual import of seeds (Figure 3). Formally, Nepal imports fertilizer from Oman and Jordan but formal imports formally from India are insignificant. Informal imports in fertilizer are a completely different story. Because of the filling in role of informal trade in fertilizers, there is no clear sign of seasonality in Nepal’s fertilizer imports either from India or Oman and Jordan (Figure 4). To meet their domestic demand for fertilizer, Nepal depends on fertilizer imports. However, during Nepal Prime

Minister Pushpa Kamal Dahal’s visit to India from May 31 to June 3, 2023, at the invitation of Prime Minister Narendra Modi, an agreement was signed on cooperation to set up a fertilizer plant in Nepal. It will be important to see how the establishment of a plant will alter fertilizer imports, both formally and informally, in Nepal. Even in formal imports, the price shocks from Russia-Ukraine war are evident in the major spikes in value of fertilizer imports in Nepal. Field research in the study captured a significant spike in informal imports as well, albeit with higher prices.

Figure 4: Nepal’s fertilizer imports from India and global



2.2 India-Nepal trading regime

Nepal and India are part of the South Asian Association for Regional Cooperation (SAARC), hence are parties to the Agreement on SAFTA. Since both Nepal and India are also members of the WTO, they are bound by different agreements under the WTO. These agreements are aimed at improving overall trade for the region by reducing tariffs and other forms of barriers to trade for the overall development of the member countries where Most Favored Nation (MFN) tariffs and rules on non-tariff barriers govern the process of exchange.

Besides the World Trade Organization’s rules, the bilateral trade treaty between Nepal and India is the

governing document for the trade between the two countries. The regional trade agreement—SAFTA—dictates the conditions of the trading between Nepal and India. Nepal’s first treaty on trade with India was signed on 31 July 1950 which is renewed every seven years, latest being renewed in 2023. This treaty allows Nepali goods—those listed as primary goods—duty-free-quota-free access to Indian markets. However, there is a quantitative restriction imposed on the four items—vegetable ghee, acrylic yarn, copper products and zinc oxide.¹⁶ In order to formalize informal trade, an agreement for cooperation between India and Nepal to control unauthorized trade was signed on 27 October 2009 and it provides the legal framework for checking informal trade.¹⁷

¹⁶ Nepal-India Treat on Trade and Transit. Available here: <https://nepaltradeportal.gov.np/>

¹⁷ Nepal-India Treat on Trade and Transit. Available here: <https://nepaltradeportal.gov.np/>

The bilateral trade treaty requires reciprocal treatment to duty-free and quota-free treatment to a mutually agreed list of primary products. It means that if India grants duty-free, quota-free access to Nepali agricultural products, then Nepal is obligated to extend similar concessions to Indian products. However, this provision is often cited as the reason for the Nepal government's lack of capability to protect its agriculture sector from imports from India. India is generous in providing subsidies to her farmers, helping to bring down the prices of agricultural products significantly. Since the reciprocity clause renders Nepal unable to impose tariffs on these products to protect domestic farmers, Nepali agricultural commodities have difficulty competing with Indian products in terms of price. To circumvent this reciprocity clause, Nepal imposes an Agriculture Reform Fee to agricultural product imports and in some cases, charges Value Added Tax, Excise duty and Advance Income Tax at the customs point.

2.3 Dynamics of informal trade in Nepal: Literature review

Sights at the border crossings between Nepal and India provide an insight into the extent of cross-border movements. The movement of people are accompanied by the movement of goods as well, especially from the Indian side to Nepal. Informal cross-border trade between Nepal and India appears to be mimicking the formal trade figures as more goods are supposed to be entering Nepal than exiting. The border crossings between the countries see households carrying grocery items, cereal, readymade garments, and plastic utensils, among other things from India to Nepal. Traders also transport such items through their specialized carriers in small quantities. There is no telling whether the goods being brought from the other side are for consumption or commercial sales. Among these are also items that are restricted for export by India, mostly food and agricultural products, which find a way to Nepal through informal routes and then sold through retail outlets through different agents in the chain. These restrictions include inter alia the recent ban by India on rice exports and sporadic export bans on onions, sugar.

Informal cross-border trade of agricultural and food products between Nepal and India demonstrates the characteristics of informal cross-border trade as defined in the Box I. Informal cross-border movements involve unregistered small traders, but these traders are couriers (also known as carriers in the border towns) that do the bidding of larger formal traders who are allegedly at the top of the informal supply chains. In most commodities, such trade happens bypassing the border posts and via concealment while there are a few instances of mis-invoicing.¹⁸

Nepal-India informal cross-border trade is recognized as a common phenomenon in any trade-related studies. The government policy documents, including Agriculture Development Strategy 2015-2035 and Nepal Trade Integration Strategy 2023, acknowledge the informal trade of agricultural products as a policy concern that needs to be factored in while devising agriculture- and trade-related policies.¹⁹ The few studies about India-Nepal cross-border trade attempt to quantify informal trade, and examine drivers of informal trade and implications on informal trade. A study by Taneja et. al., (2001) also investigated informal trade between Nepal and India as SAARC countries were preparing for SAFTA. Importantly, the study excluded agricultural food items in any detail. The study used the Delphi method for survey-based estimation. The study found that informal trade between Nepal and India takes place through carriers on non-motorized and motorized vehicles. In fact, there is a well instituted vehicle and cycle renting system in border areas for this purpose. The total informal trade from India to Nepal in 2000-2001 was estimated at US\$180 million in the Indian territory and the corresponding estimate in the Nepalese territory was US\$211 million.

Notwithstanding the measurement error in these estimates, qualitatively and through dynamics, the high level of informal trade in relation to formal trade is well established. Total informal trade between India and Nepal as estimated in the Indian territory is about 3 percent greater than formal trade between the two countries (Taneja et al 2001). The Nepali estimates,

¹⁸ Sugar was transported as rice which was apprehended by the authorities.

¹⁹ Ministry of Agriculture Development. 2014. Agriculture Development Strategy (ADS) 2015 to 2035. Kathmandu: Ministry of Agriculture Development. MoICS. 2023. Nepal Trade Integration Strategy 2023. Kathmandu: Ministry of Industry, Commerce and Supplies, Government of Nepal

however, show that total informal trade is only 38 percent of formal trade. The study found that in Indian territory, Naxalbari (Kakarvitta on the Nepali side) is the largest center for informal trade from Nepal to India, accounting for 33 percent of the total. In the Nepali territory, Birgunj (Raxaul on the Indian

side) was found to be the largest center, accounting for 53 percent of informal trade from Nepal to India. Indian estimates showed that textiles account for 17 percent, processed food for 16 percent, unprocessed foods for 14 percent, and cement for 12 percent of goods traded informally from India to Nepal.

Box 1 – Defining Informal Trade

Informal cross-border trade should not be equated with illegal trade or smuggling which is moving contraband goods from one country to another.²⁰ Informal trade could be of the goods that are legitimate but moved across borders to circumvent different regulatory requirements, including tariffs. Lesser and Moisé-Leeman (2009) describe informal cross-border trade as ‘trade in legitimately produced goods and services, which escapes the regulatory framework set by the government, as avoiding certain tax and regulatory burden’.²¹ Hence, trafficking of illegal and contraband goods, such as narcotics, is not the same as informal trade. They classify informal cross-border trade into three categories—first, being unregistered traders operating entirely outside the formal economy; second, formal traders avoiding official border crossings to evade trade-related regulations and duties; and third, formal traders partially evading trade-related regulations through illegal practice such as mis-invoicing.

Informal cross-border trade is often associated with small traders that take advantage of relaxed borders to earn a livelihood. Such informal commercial trade could be of small quantities meeting de minimis²² threshold or happening in the remote outposts where border regulations—in terms of customs—are not rigorously enforced.²³ These transactions could be taking place out of necessity as complying with regulatory burden of formal trade is difficult for them. The United Nations Conference on Trade and Development (UNCTAD) also defines informal cross-border trade as unrecorded trade “between neighboring countries conducted by vulnerable, small, unregistered traders. Typically, it is proximity trade involving the movement of produce between markets close to the border.”²⁴ The Common Market for Eastern and Southern Africa (COMESA) regards informal trade as carried out by small businesses and traders that are unrecorded in official statistics and undertaken by bypassing border posts, concealment of goods, under-reporting, false classification, under-invoicing, and other similar tricks.²⁵ The UN United Nations Committee of Experts on Business and Trade Statistics’ Guidance Note defines informal trade as “imports and exports of legal goods and services, by informal economic units, which do not comply with the regulatory framework and other procedures set by the government, and often go unrecorded into official national statistics of the trading countries.”²⁶ Neither in India nor in Nepal there have been attempts to include measures of informal trade flows in official statistics.

²⁰ United Nations Committee of Experts on Business and Trade Statistics Task Team on International Trade Statistics. 2023. Guidance Note v.4 Informal cross-border trade (ICBT): goods and services.

²¹ <https://www.oecd-ilibrary.org/docserver/225770164564.pdf?expires=1708785034&id=id&accname=guest&checksum=87ADA87F08CB5C3D83A71C2E35DE7DD4>

²² The World Trade Organization defines de minimis as ‘Minimal amounts of domestic support that are allowed even though they distort trade — up to 5% of the value of production for developed countries, 10% for developing.’ https://www.wto.org/english/thewto_e/glossary_e/de_minimis_e.htm

²³ United Nations Committee of Experts on Business and Trade Statistics Task Team on International Trade Statistics. 2023. Guidance Note v.4 Informal cross-border trade (ICBT): goods and services.

²⁴ Harper, Erica. 2020. “Informal cross-border trade for empowerment of women, economic development and regional integration in Eastern and Southern Africa.” United Nations Conference on Trade and Development (UNCTAD), Development Account Project 1617]. https://unctad.org/system/files/official-document/0sginf2020d2_en.pdf

²⁵ COMESA. 2014. “Regulations on the minimum standards for the treatment of small scale cross-border traders in the COMESA region.” Official Gazette of the Common Market for Eastern and Southern Africa (COMESA), Volume 19, No. 2: 191-194. https://www.comesa.int/wp-content/uploads/2020/05/comesa-gazette-Volume-19-No.2_final_email-1.pdf

²⁶ United Nations Committee of Experts on Business and Trade Statistics Task Team on International Trade Statistics. 2023. Guidance Note v.4 Informal cross-border trade (ICBT): goods and services.

Karmacharya (2010) study also attempted to quantify cross-border informal trade between Nepal and India in agricultural commodities.²⁷ The study used sample surveys of the selected informants (respondents) from the border areas on their perception of the extent of informal trade at five border towns. The study found that the gap between formal and informal trade is the largest for paddy – with an informal import value of about 668 times its formal import value. Singh (2018) conducted a small survey in border villages which found that farmers in border areas were heavily dependent on the informal import of fertilizer from India.

A report by USAID EAT (2014) reports that a substantial volume of grains enter Nepal on bicycles and rickshaws, loaded with two to four 60 kg bags at a time, through informal channels.²⁸ The report acknowledges that estimates of the volume of flows were not available, which leaves official import and export statistics providing a partial picture of the actual trade. The report estimates that the informal trade volume of cereals could be as much as 72 percent of formal trade. The report presents variations in estimates of informal trade between officials and the market actors. The officials estimate 20-30 percent of the total rice was likely to be informal while other market actors estimated informal rice imports could be as high as 60 percent of available rice in the market.

The USAID (2014) report suggests that the volume of informal trade between Nepal and India signals incentives for trade to bypass official channels. The report also points out the lack of access to information and channels for communication as abetting informal

trade.²⁹ The report also examines the reasons for informal imports of seeds and fertilizers from India to Nepal. Seeds from India to Nepal is transferred via informal channels since the Nepali seeds' certification process is lengthy. CUTS (2019) also identify tariff and non-tariff barriers and restrictive trade policies exercised by both Nepal and India as reasons for the informal trade of agricultural inputs.³⁰

Karmacharya (2010) found that India's policy of banning the export of agricultural items such as rice provides a strong incentive for informal imports while evading duties and charges levied on imports from India. The results revealed that institutional factors – quick realization of payments, no paperwork, no procedural delays, and lower transportation costs – were all instrumental in driving the traders toward informal channels. Taneja and Pohit (2002) identified the role of policy related factors in thriving informal trade in South Asian region. These factors are tariffs, non-tariff barriers and ineffective trade facilitation.³¹

There are studies that acknowledge India's role in maintaining agricultural food supply in its neighboring countries, especially Nepal and Bangladesh.³² Citing India's ban on rice export from 2008 to 2011, a report by USAID EAT, points out that domestic prices of major cereals such as rice and wheat in Nepal could remain dependent on India's export policies. The report also cites the leakages from India's public distribution system, that provides cereals at subsidized rates to India's extremely poor population, promotes informal export of rice and wheat to Nepal. The report also calls attention to the positive aspects of informal trade in stabilizing the price of important

²⁷ Karmacharya, B.K. 2010. "A Study on Cross-border Informal Trade between Nepal and India on Selected Agricultural Commodities." National Council for Development Research, Kathmandu.

²⁸ USAID and EAT. 2014. Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth across South Asia. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

²⁹ USAID and EAT. 2014. Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth across South Asia. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

³⁰ CUTS International. 2018. Linkages and Impacts of Cross-border Informal Trade in Agricultural Inputs in Eastern South Asia. Jaipur: CUTS International. https://cuts-citee.org/pdf/Research_Report_on_Linkages_and_Impacts_of_Cross-border_Informal_Trade_in_Agricultural_Inputs_in_Eastern_South_Asia.pdf

³¹ Taneja, Nisha, and Sanjib Pohit. 2002. "Characteristics of India's Informal and Formal Trading with Nepal: A Comparative Analysis." *Indian Economic Review* 37, no. 1: 69–89. <http://www.jstor.org/stable/29794260>.

³² USAID and EAT. 2014. Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth across South Asia. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

grains such as rice in Nepal, which tends to have a positive impact on food prices. Karmacharya (2010) findings suggest that informal imports of agricultural products have implications for the competitiveness of the farmers in Nepal, particularly to the extent of the price-depressing distortions due to Indian farm policies.

But the studies caution against the informal trade of agricultural products which diminishes effectiveness of phytosanitary requirements between the trading partners. The USAID EAT (2014) report calls attention to policies such as seed registration that force farmers to seek informal channels to undermine the development of Nepal's seed industry. Similar caution about biosafety is pointed out by CUTS (2018). Among the impacts of informal trade on

livelihoods, Hannan (2018) analyzed informal trade to livelihood opportunities as informal trade provided sustenance at Dhulabari-Bagdogra-Siliguri corridor.

The paper observed the participation of women as carriers in facilitating cross-border informal trade. However, the study did not focus on agricultural goods. CUTS (2019) also found a positive impact of the informal trade of agricultural inputs on the farmers in Nepal and India, as the informal trade of inputs helped them access fertilizers and seeds which were not otherwise accessible. All the literature also points to the existing socio-cultural ties between the people at the border which help them access information about the available products, routes for informal trade and conflict resolution when needed.

3

OBJECTIVES OF THE STUDY

Given these considerations regarding agricultural food commodities—including outputs and inputs, this study is an attempt to analyze the nature and drivers of cross-border informal trade of agricultural food products. Understanding the trade dynamics of agricultural products between Nepal and India would require acknowledging and examining the informal cross-border trade of these products. This study is an attempt to uncover the underpinnings of such informal trade. This study examines the drivers of informal trade in major agricultural commodities and policy changes in each country to guide the quantum and the nature of informal trade between two border countries.

The report starts with providing a background to the study along with a literature review of the existing informal trade between Nepal and India. This is followed by a description of the objectives of the study and the research methodologies, including the analysis of recorded agricultural food trade between Nepal and India. The findings of the study detail the modes, modalities and the actors involved in this trade, highlighting different motivations and drivers that enable and encourage cross-border informal trade. The report concludes by sharing the implications of informal trade and the way forward.

4

DESIGN AND METHODOLOGY

4.1. Survey design and study methodology

To understand the dynamics that underpin the informal trade of agricultural products between Nepal and India, the study undertook primary and secondary research combining key informant interviews and focused group discussions at different locations in Nepal. Informality is considered to be inherently difficult to measure.³⁴ Usually, when it comes to cross-border informal trade, studies use mirror data to assess the volume.³⁵ Mirror data uses mirror trade statistics, which are data reported by trading partners, to compare the data reported by one country with the data reported by its trading partner to identify discrepancies or inconsistencies in international trade statistics. Mirror analysis assesses the difference in value in trade statistics for the same flow of goods, helping to capture informal international trade activities.³⁶

There have been some exercises in comparing discrepancies through mirror data with respect to trade between Nepal and India.³⁷ However, since informal trade in Nepal is mostly undertaken to circumvent formal customs channels, hence these transactions are not reported in Indian or Nepali customs. Another common method used in cross-border informal trade study is surveys and interviews of knowledgeable persons.³⁸ Similar techniques were used in the previous studies undertaken in the early 2000s by Taneja and Pohit (2004) and Karmacharya (2010). In addition to interviews, observation of the trading activities at the border was also undertaken

to understand the flow of goods and the medium employed to transport those goods.

4.2. Preliminary consultation and desk research

A comprehensive desk research of existing literature, studies, and media reports about the informal trade of agricultural products between Nepal and India was initiated. Along with that, study of available trade statistics was undertaken to get an insight into the trend of trade with India and the items traded the most. Further preliminary consultation was done with traders, policymakers, and experts in agricultural and trade to understand the current landscape of formal and informal trade.

The secondary research, in addition to consultation with experts on agriculture and trade, helped in narrowing down the products that are known to be prominently traded informally between Nepal and India. The International Food Policy Research Institute (IFPRI) conducted a brainstorming session and stakeholder consultation in Kathmandu in April 2023 with national partners, government officials, leading researchers, and key industry persons. The discussion helped gather perspectives and understand the dynamics and policy landscape of informal cross-border trade in agricultural food, including inputs. This exercise provided valuable insights related to the selection of commodities, borders and ports, price discovery, governance structure, and mechanisms for contract enforcement.

³⁴ Bensassi, Sami, Joachim Jarreau, and Cristina Mitaritonna. 2016. Determinants of Cross-Border Informal Trade: The Case of Benin. AGRODEP Working Paper 0034. <https://ebrary.ifpri.org/digital/api/collection/p15738coll2/id/130804/download> and Golub, Stephan. 2015. "Informal Cross-Border Trade and Smuggling in Africa" In Handbook on Trade and Development edited by Oliver Morrissey & Ricardo Lopez & Kishor Sharm. Cheltenham: Edward Elgar Publishing. [https://www.swarthmore.edu/sites/default/files/assets/documents/user_profiles/sgolub1/Smuggling%20Literature%20Survey\(0\).pdf](https://www.swarthmore.edu/sites/default/files/assets/documents/user_profiles/sgolub1/Smuggling%20Literature%20Survey(0).pdf)

³⁵ Bouet, Antoine and Pace, Kathryn and Glauber, Joseph W. William. 2018. Informal Cross-Border Trade in Africa: How Much? Why? And What Impact? IFPRI Discussion Paper 1783. <https://ssrn.com/abstract=3305336>

³⁶ Geourjon, Anne-Marie, Bertrand Laporte, and Gilles Montagnat-Rentier. 2023. "The Use of Mirror Data by Customs Administrations: From Principles to Practice", Technical Notes and Manuals 2023, 005 (2023). <https://doi.org/10.5089/9798400251283.005.A001>

³⁷ Nepal Rastra Bank. 2017. Aayaatko Bhuktani Prabritti [Payment trends of import] (in Nepali). Kathmandu: Nepal Rastra Bank. <https://shorturl.at/vxKNW>

³⁸ Bouet, Antoine and Pace, Kathryn and Glauber, Joseph W. William. 2018. Informal Cross-Border Trade in Africa: How Much? Why? And What Impact? IFPRI Discussion Paper 1783. <https://ssrn.com/abstract=3305336>

These activities helped narrow down the products to focus on, broad identification of stakeholders to be interviewed and designing of survey questionnaire (Annexure A). A set of locations were also identified to undertake field research.

4.3. Primary interviews and survey

To understand the major products that are informally traded at different locations and the nature of informal trade of these products, the primary interviewees comprised of larger traders, processors, wholesalers, retailers, agrovets, customs agents, clearing agents,³⁹ and government officials at the customs and plant quarantine, among others. A structured questionnaire was prepared, which covered aspects such as items that are most frequently traded informally, modes and drivers of informal trade of the selected commodities, among others.

Informal trade is an extra-legal activity as circumventing customs authorities is recognized as a criminal act by the law.⁴⁰ While asking the questions through a structured questionnaire, it was observed that respondents were expectedly less forthcoming in discussing informal trade. Hence, researchers used the questions in the questionnaire more as guiding questions to explore aspects of informal trade, which yielded better responses from the respondents. As a result, the interviews provided qualitative information on the modes, nature, and drivers of informal trade of agricultural commodities rather than providing numbers required for quantification of informal trade. Nevertheless, for some commodities, qualitative consultations also provide an overview of the extent of informal trade.

The researchers interviewed a total number of 74 key informants. These respondents were selected with a combination of snowballing and purposive sampling due to the impossibility of random sampling in this case. Formal importers of agricultural items were interviewed at all the locations. Likewise, traders

who deal in wholesale and retail were interviewed; some of the traders were involved in food processing. Since informal trade is a sensitive topic, chain referral of traders helped the research team to have a comparatively credible response. However, none of the respondents (traders and processors) would admit that they have engaged in informal trading, hence information about informal trade is qualitative. About one-fourth of traders signaled that informal trading is an option during tough times such as shortages. The study does not disclose which of the traders interviewed mentioned this and only referred to their practices.

To validate the responses, the study also conducted informal focus group discussions (FGD) of traders at Birgunj, Biratnagar, Bhairahawa and Kakarvitta. Interviews either preceded FGDs or some FGDs were followed up by in-depth interviews with government officials, mostly officers at the Department of Customs who were consulted. The customs officials discussed the cases that had led to the informal traders being apprehended. Similarly, civil society representatives and academics in the field locations were also interviewed. In addition to these, researchers also gathered information about informal trade being undertaken at the locations through informal and casual conversations with the shop attendants, border patrol forces and carriers to elicit information.

4.4. Survey locations

Among the 29 official customs points of Nepal, 22 are located at Nepal and India border. In addition to these formal crossings there are numerous smaller customs (chhoti bhansar) and unrecorded cross-border gateways at the border, that aid the movement of people and goods. Consultations and literature review pointed out that routes near and around the major customs points are most used to transport informally traded products.⁴² Moreover, the consultations also pointed out that major traders,

³⁹ Clearing agents in Nepal are hired by importers or exporters to undertake customs clearance procedures that manage documents such as plant quarantine and food laboratory certificates, arrange and coordinate with transporters, customs agents and customs officials. Usually, customs agents perform these tasks.

⁴⁰ Government of Nepal. The Customs Act, 2064 (2007) <https://customs.gov.np/gaur/page/customs-act-2064-1>

⁴¹ Department of Customs. 2024. Annual Foreign Trade Statistics 2079-80. Kathmandu: Department of Customs, Ministry of Finance, Government of Nepal.

⁴² Taneja, Nisha., Muttukrishna Sarvananthan, Binod K. Karmacharya, and Sanjib Pohit. 2004. "India's Informal Trade with Sri Lanka and Nepal: An Estimation." *South Asia Economic Journal*, 5(1): 27-54. <https://doi.org/10.1177/139156140400500102>. Karmacharya, B.K. 2010. "A Study on Cross-border Informal Trade between Nepal and India on Selected Agricultural Commodities." National Council for Development Research, Kathmandu.

including informal, are in the larger cities around the borders. Warehouses where informally imported products are collected are also on the periphery of the borders and the carriers that take products back and forth reside in the border areas with the hub of the informal trade built around the formal crossings. Hence, fieldwork was also conducted in those areas.

The volume of trade at these points also indicates the movement of people at these major crossings (Table 3). These crossings are manned by Armed Police Force (APF) at Nepali side and the Indian side has the Sashastra Seema Bal (SSB). At all these crossings, most of the people coming from India would be carrying bags and sacks containing their shopped items—on foot, bicycles, motorcycles, rickshaws, and buses.

Table 3: Volume of trade across border points.

Borders	Share in total recorded trade (imports and exports)	Trade originating from and destined for (including formal and informal) **
Birgunj-Raxaul*	35.62	Whole Nepal
Bhairahawa-Sunauli	14.43	Whole Nepal; mid-western Nepal--Lumbini and Karnali Province
Biratnagar-Jogbani	12.77	Whole Nepal
Nepalgunj-Rupaidiya	3.97	Mid- and far-western Nepal--Karnali and Sudurpaschim Province
Mechi (Kakrvitta)-Panitainki	3.86	Eastern Nepal
Krishnanagar	1.24	Mostly used by industrial establishments in western Nepal
Jaleswor-Bhittamorh	0.56	Smaller consignments in surrounding areas in Madhesh province and Bagmati province
Suthauli-	0.23	Smaller consignments in surrounding areas in Lumbini province
Maheshpaur	0.02	Smaller consignments in surrounding areas in Lumbini province
Bhadrapur	0.02	Smaller consignments in surrounding areas in Koshi province

Note: *This area also has another customs office at Inland Container Depot which processes goods brought on trains to Nepal. **Based on the consultation

4.5. Limitations

Since the study is an attempt to understand informal trade— trade that happens outside official channels without any record— gathering accurate and comprehensive data is a challenge. Although the study tried to get information to help quantify the extent of informal trade, there was a lack of documentation and concerns about the validity of the information, hence the study focused on qualitative aspects of the informal trade and understanding the nature and drivers of informal trade in agricultural food products as well as its incidence compared ordinarily across commodities.

Moreover, informal trade being subject of penalties, traders often presented the information as second-hand – ‘something that they came to know from

someone who does this kind of activity’. To validate such ‘heresy’, the study undertook multiple rounds of interviews and focused group discussions for validation. This exercise resulted in discarding information whose validity could not be confirmed. Even government officials were not willing to admit to some of the information “on the record”. Similarly, carriers, for obvious reasons, were not open to discussing their activities so researchers engaged them in informal chats to extract information. At one small border crossing –Sirsiya, Parsa near Birgunj, security forces on the Indian side interrogated researchers for trying to talk to people who were bringing goods from India. Hence researchers had to improvise as and when needed to avoid possible inhibitions and injunctions.

5

FINDINGS FROM THE FIELD

5.1. Nature, modes, and drivers of the most informally traded agricultural food products at Nepal-India border

This section presents the findings from the field about how the informal trade takes place, analyzes the mechanics of the major products that were found to have been traded informally the most and what are the possible drivers that divert their trading from formal to informal. As part of the interviews, the presence of a fleet of carriers at all the border points that were visited also signaled informal trade taking place in plain sight. The number of such carriers being questioned by the security forces and customs officials is also a familiar sight. Similarly, rickshaws, two-wheelers and bicycles with people and bags of goods passing through the border to Nepal are also common. By just plain observation, the extent and magnitude of cross-border informal trade between Nepal and India are significant. This statement is reiterated and emphasized by all the respondents who were interviewed and consulted for the study. The flow of people and their shopping suggest that more goods enter Nepal from India than the reverse.

All respondents pointed out that the most frequently traded items include grocery—items that are available at standard grocery stores selling products of daily use such as rice, flour, lentils, and sugar; packaged snacks such as potato chips and crackers; beverages such as juice and aerated drinks; household items such as detergent powders and soaps. Ready-made garments were another item that respondents mentioned as one of the top items brought in by evading customs authorities. Other household items comprised small appliances, cookware, and plastic items as informally imported. Since border areas are major farming regions of Nepal, with the entire Terai region being part of the fertile Indo-Gangetic plains, informal import of agricultural inputs was quite common mostly because seeds and fertilizers are often chronically in short supply domestically and are relatively more expensive; small agricultural

machinery was also mentioned among major items.

The consultations showed that the flow of informal imports increases and declines depending on various factors such as differences in prices at the markets across the border, shortages, and surges in seasonal demand. Another major factor influencing informal imports is attributed to changes in tariff rates, policy decisions by the governments of Nepal and India including the ban on import or export of any product and policies that affect market prices such as minimum support prices and subsidies among others.

5.2. Modes of informal trade

As discussed above, informal imports of items are undertaken by households for consumption purposes and through carriers for commercial purposes. However, the end use of informally exported goods from the Nepali side, according to the respondents, including government officials, is mostly for commercial purposes notwithstanding the use of same modes of transport. The informal trade undertakings could be categorized into three categories—informal trade by households for personal consumption; traders through ‘carriers’; and traders through larger consignments. Modes used for informal trade were found to be similar across all the field locations.

5.3. Households’ imports for consumption

Households residing in the border towns and villages cross the border to Indian market to purchase household items such as cereals and other fast moving consumer goods and readymade garments. These products are comparatively cheap in India, but the difference might be wiped away with customs and other duties applicable at the border in formal exchange. A similar variety of rice, for example, on average is at least 12 percent cheaper in the Indian market, according to the retail shop owners at Nepalgunj and Birgunj. Rice is purchased by the households who do not cultivate their own paddy or do not have enough stock to last throughout the year.

Larger markets are preferred for bulkier purchases even by those residing in smaller towns and villages. During festive seasons buying from Indian markets becomes prevalent. According to the traders, vegetable imports by households happen only when they are visiting the markets on the other side during their trips. As for agricultural inputs—seeds and fertilizers—also are purchased by farming households and brought across to their farms.

Households use shared rickshaws (cycle rickshaws and electronic rickshaws) to ferry these goods, and mostly women use such transport. They can bring about 20-25 kg of goods on a trip. Two wheelers, bicycles, motorcycles, and scooters are also used to transport these goods. These vehicles can carry as many as two quintals of products. Cars are also used but whether Nepal-registered four wheelers are allowed to travel further into Indian Territory is uncertain. Indian-registered vehicles are allowed to enter Nepal after paying an entry fee of USD 4.66 per day.

Households bringing goods from India are usually let in by the border security forces. However, if the volume of goods seems large and appears to be intended for resale, then the person might be asked to pay duties. In late June 2023, the Department of Customs announced strict enforcement of existing law under the Customs Act 2064 (2007) that allows personal consumption goods worth NPR 100 (USD 0.93) in value to be brought duty-free from the Indian side by issuing an Order in the Gazette Notification.⁴³ This rule was strictly enforced for a couple of weeks at the border crossings. In places like Bhairahawa, strict enforcement was followed till August, which became lax as the festive season approached, according to the officials and locals interacted for the study.

Usually, items up to five kg of sugar, lentils, pulses are not apprehended. And if people are bringing in items such as a sack of rice, up to two sacks (25 kg each) are allowed with a person provided the bags are unsealed to ensure that they will not be resold. A similar approach is applied to fertilizer imports too. For fertilizers such as urea and DAP, border security forces, even at the Indian side, they only allow the bags

that are unsealed and repackaged into smaller bags for the same reason. People living in the border areas point out that border security forces demonstrate greater tolerance towards households that import essential food items such as rice, sugar, oil, and seeds and fertilizers in smaller quantities.

5.4. Traders through carriers

Traders using carriers to ferry goods from India to resale at Nepali markets is another prevalent mode of informal trade. Although motivation for these ‘carrying’ operations is like that of households—arbitrage through difference in prices and avoidance of additional duties—they operate on a larger scale and use individual carriers. The system is popularly known as ‘carrying’—where goods are carried by ‘carriers’ from the Indian side and brought to certain collection centers in Nepal. For some products, such as electronics, large orders, carrying is known to offer home delivery services as well. However, the most common form is traders in Nepal (buyers) either arrange for the pickup from India or sellers on the Indian side arrange the carriers to drop off the goods to their buyers (traders) in Nepal. The traders that engage in such informal trade are also referred to as ‘Blackia’—the ones engaged in black marketing.

Figure 5 represents how commercial-level informal trade occurs using carriers as per the consultations. The orange dotted lines show that cargo is transported by individual carriers bypassing formal customs channels and reaching warehouses where such items are stored. From there, informally imported goods are sold to processors, traders, or directly to consumers, depending on the type of commodity. The channels represented by green solid lines depict formal trade occurring through official customs points. As depicted in Figure 5, sellers and buyers engaging in informal trade may also undertake transactions with each other.

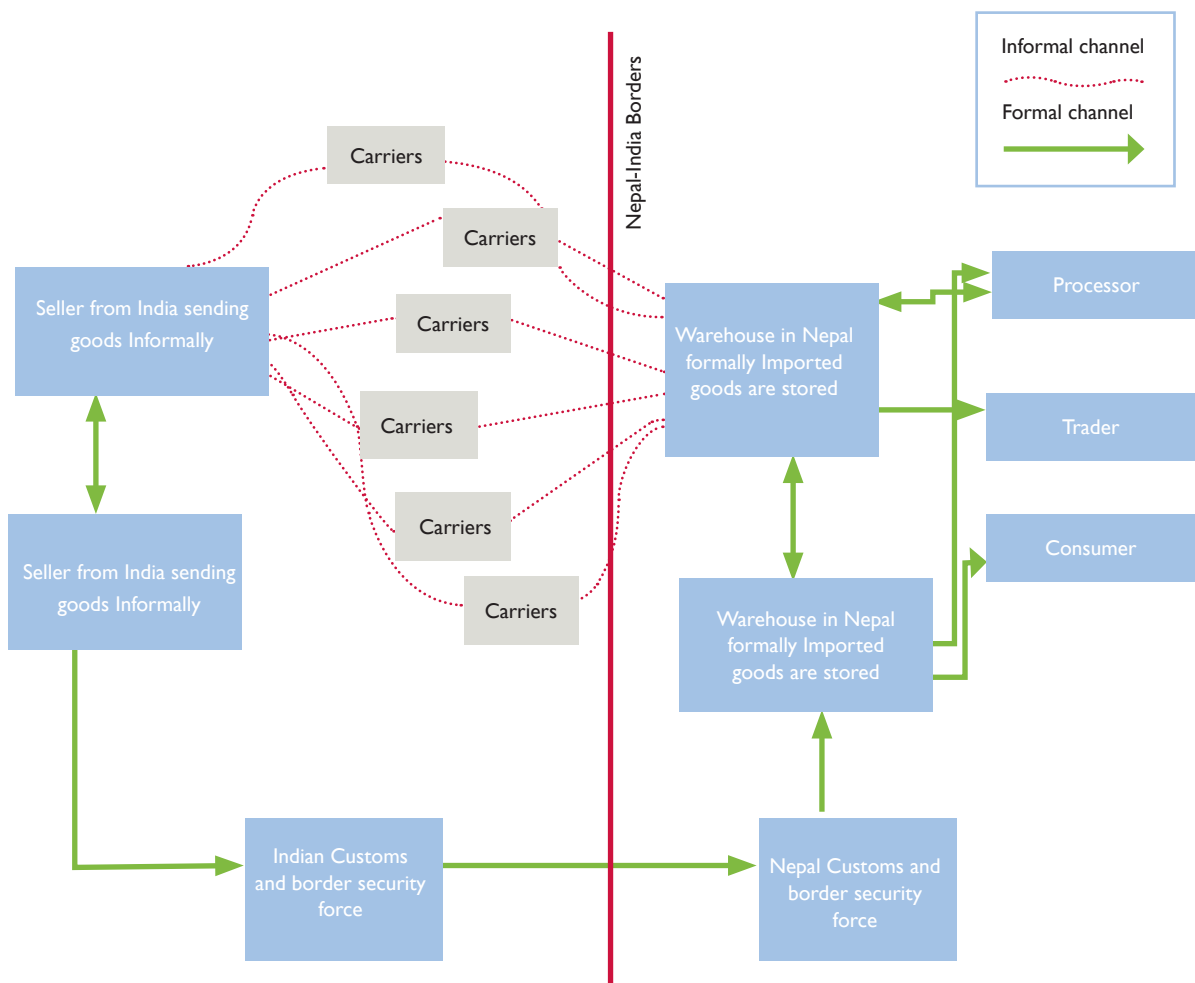
Carriers are organized and are handled by the heads that take orders from traders and arrange pickups and drops. In a way, carrying service providers are outsourced logistics service providers in the same manner as it happens in the formal trade. Carriers are individuals who use foot, bicycles, or motorcycles to

⁴³ Gazette Notification dated 29 June 2023 in Nepali <https://shorturl.at/bBKM4>

ferry goods. They get paid on a 'piece rate' basis, that is fare per kg for goods such as rice and sugar. For food products such as biscuits, and chip packets, they are paid on a per-piece basis. The interactions point out that items such as rice and sugar can fetch about NPR 4-5 (USD 0.04-0.05) per kg for the carriers. So that each trip brings them at least USD 1.16, if they are only carrying a 25-kg sack. These carriers can make as many as 10 trips in a day, depending on the distance between their pickup and drop spot. Most of the carriers are local area residents either from the Nepali side or Indian side of the border, and familiar with the terrains. The vehicles they use—bicycles and two-wheelers, are India registered as vehicles in Nepal are expensive given the high duties. If they are apprehended by security forces, carriers leave their cargo and generally flee without claiming the shipment.

Carriers also bring in some commodities for their consumption as there are both economies of scale and scope. These carriers use main checkpoints as well as smaller points near the main ones. At the checkpoints, carriers do have the incentive to claim carrying the goods for personal consumption. Moreover, since these carriers are locals, they are well-versed in the local geography and have mapped the routes that are out of notice of security forces. At some major crossings, the distance between the border and the customs office is more than 100 meters, like at Maheshpur in Kapilvastu where the Customs office is 800 meters away from the border; carriers avoid the main road after crossing the border.

Figure 5: Channels of informal trade.



Source: Authors' inputs from the field survey

This was evident in Nepalgunj too where carriers were taking side routes immediately after crossing the border so that they did not have to face the Customs authorities. Some even resort to paying duties at the traveler's counter at the major customs checkpoints for the first consignment in the morning. Then they use the same receipt to ferry an additional consignment of goods throughout the day. The set up seems to reflect that there is explicit or tacit collusion between traders or carriers and the border patrol authorities.

Movement of larger consignments of informal commodities also happens when the 'line is opened'. The term 'opening the line' or 'line opening' is a loose translation from Nepali which could mean the coast is clear. In this context, it refers to security forces on both sides of the border who would allow trucks of such goods to pass through at night. Traders, who implicitly pointed out having used these services, say that this happens in the cases of goods such as paddy and rice, onions, sugar. If something goes wrong, the risk of getting caught and the losses thereafter is higher for the traders. Even when drivers and helpers abandon the trucks, through the vehicle paperwork, owners could be traced, and cases filed against them

5.4.1. Network and price discovery

At the outset, informal trade operation appears to be seamless with goods crossing over the borders without being intercepted and having to pay additional duties or undergo any customs-related formalities. However, informal trade is also anchored by networks that help smooth the functioning of the linkages that connect buyers and sellers and get the consignments delivered in a similar fashion to formal trade. The coordination required to get the goods transported and to ensure that terms of their exchange are enforced perhaps are more compelling in informal transactions as legal recourse for redressal is absent in these transactions. Moreover, risks of getting carriers caught, seizure of consignment and fear of prosecution loom large for traders in these transactions. However, the advantage offered by a difference in prices between the markets, shortage of the commodities within Nepal, additional monetary

margin earned by avoiding customs and other duties and lack of a need to undergo custom formalities appear to make up for the risks and the additional charges to be paid for 'carrying' service and other informal payments.

Our discussions with various traders and officials provided valuable insights into the functioning of these networks and distribution systems. The consultations shed light that there is already an existing network of traders and middlemen that connect buyers and sellers. Then there exist the middlemen who get outsourced the tasks of carrying. Some traders also control such fleets of carriers themselves. The commodities collected at the Nepali side are then dispatched to processors, who will repackage them to be sold under different brand names, or to traders that sell the goods as is.

The enforcement of USD 0.93 cutoff for free entry of goods in Nepal was said to have discouraged households from making personal trips, but it increased the flow of carriers, according to the interviewees. The carriers utilized that opportunity to obtain customs clearance receipts and use the receipts for subsequent trips for easy entry. Informal traders were getting penalized for having a stock of goods for which they could not show any proof of purchase. They use the receipt after paying the fine (Box 2 for penalty details) as proof to get clearance if caught with new stock in the future.

The Customs Offices conduct auctions of the seized and confiscated items. Traders involved in informal trade participate in the auction and may buy the seized items. They use the proof of purchase obtained after buying the products in an auction to move their goods around the country. In July 2019, The Department of Revenue Investigation launched its Vehicle Consignment Tracking System (VCTS), which allows real-time tracking of the vehicles carrying the cargo.⁴⁴ The VCTS forms are submitted online by the customs clearing agents which have details about the consignment including invoices and all the necessary declarations, including customs clearance.

⁴⁴ Republica. 2019. "Govt enforces online consignment tracking system". Republica, 18 July 2019. <https://myrepublica.nagariknetwork.com/news/govt-enforces-online-consignment-tracking-system/>

While checking if the consignment in the vehicle could not produce sufficient proof, then they get charged by the Department of Revenue Investigation (DRI) for tax evasion. The auction papers are useful for the informal traders to move their consignments within Nepal. It is not only the authorities at the border—Sashastra Seema Bal (SSB) and the Indian Customs at the Indian side, but the Armed Police Force also (APF) and Nepali Customs—that

informal traders need to fear. They need to be careful while moving their goods domestically as a lack of documents and paperwork to prove that their consignment is formally purchased means they could be held and prosecuted by the Department of Revenue Investigation as well. According to a trader, the more layers of authorities that informal traders need to pass, the more the cost as more bribes need to be dispensed.

Box 2: Penalty for informal trading

According to Customs Act 2064 (2007), smuggling or trade through any other than the prescribed routes is subject to the following penalties.

- Forfeiture of such goods
- Fine equal to the value of such goods as assessed by the authorities.
- Prison sentence of two months to five years depending on the value of the consignment (person caught with goods in valuation of NPR 2 is liable for a prison sentence)
- The motor vehicle used to transport the goods will be forfeited; owner could be imprisoned for a term up to one year; driver involved knowingly will be fined USD 46.56 (NPR 5000) and imprisoned for up to one year.
- Any person who aids and abets the informal trade as if such person were the offender.
- Person hiding such goods will be liable for fine up to USD 93.13 (NPR 10,000)

According to the Revenue Leakage (Investigation and Control) Act 1995, if proven to have engaged in revenue leakage the penalties faced by culprit are as follows.

- Forfeiture of the goods
- Penalty equal to the value of the goods with interest
- Prison sentence of six months to five years depending on the value of the goods
- Accomplices also face half the penalties imposed on the main conspirator.

In cases besides outright bans on imports or exports and high duties, price differences for the agricultural commodities between Indian and Nepali markets appear as the most prominent driver of informal trade. The informal traders possess information on prevailing market prices, including wholesale rates, on both sides. There is seamless information exchange between the parties as these traders are also engaged in formal trading, allowing them to monitor prices closely. One reason cited for the easy access

to information by key informants is the social ties and networks established across borders over the years. The unrestricted movement of people across borders and shared socio-cultural landscape means families are dispersed across borders, facilitating the flow of information through the social ties formed.

Informal import means that traders do not have to pay any duties, such as customs, agriculture reform fees, excise duty and value-added tax. In addition,

informal imports do not have to go through the process of getting required plant quarantine and other SPS-related certifications, thus saving money (although fees are nominal) and time—at least three to four hours, in the case of vegetables and longer for other food products. They factor in the cost of transport and the payments that need to be made on the way and the price that they fix as the selling price may be enough for them to make a profit. Traders also factor in the risk associated with getting caught and the associated cost of fines and confiscation while fixing the selling price. Informally imported products are mixed with formally imported ones, thus, the final price paid by consumers also includes the cost of informal trade. According to the interviewees, payments of all transactions between the parties happen in cash—from buyer to seller and carriers and any other form of informal payment. The payments happen in Indian currency.

5.5. Dynamics of informal trade: Product-specific findings

Besides consumable agricultural food items, informal trade of agricultural inputs—seeds and fertilizers—as well as small equipment and machineries and their services were also reported to be taking place along the border. This product list for informal trade can never be exhaustive, driven by time specific price differentials. For example, in October, Nepal celebrates their two biggest festivals –Dashain and Tihar—around that time items such as sugar, oil, and dry fruits get informally exported to Nepal by both households and traders.⁴⁵

Although informal imports take place to a greater extent than informal exports from Nepal to India, some products also get exported from Nepal informally. These include certain varieties of vegetables that face certain barriers in formal trade, and seasonal items such as paddy when traders across the borders offer better rates. During the study period, products that were found to be prominently traded across borders through informal channels are discussed below. The product list is drawn based on primary consultations, secondary information, such as news reports, and observation at the border points. The following items were found to be frequently traded informally between Nepal and India. The analysis henceforth is focused on the modes and drivers of cross-border informal trade of these items.

5.5.1. Rice

In Nepal, rice is the most important staple food item with the highest acreage. In the last ten years, rice was cultivated in 47 percent of the country's total cultivated land while the share of rice production was about 50 percent of the total food grain production.⁴⁶ Despite rice being a major crop, commercial rice farming is limited as half of the production is for self-consumption.⁴⁷ Moreover, rice is also one of the most imported commodities in Nepal. Rice is an integral part of any discussion on food and livelihood security in Nepal as 30 percent of Nepali people's daily caloric intake is met through rice.⁴⁸ According to the Annual Household Survey 2016-17, Nepal's per capita consumption of coarse rice and fine rice is 68.9 kg and 43 kg, respectively.

⁴⁵ Republica. 2023. "Home Ministry directs its subordinate offices to stop illegal import of poultry and poultry products". República, 23 August, 2023. <https://myrepublica.nagariknetwork.com/news/home-ministry-directs-its-subordinate-offices-to-stop-illegal-import-of-poultry-and-poultry-products/>

⁴⁶ Ministry of Agriculture and Livestock Development. (2022). Agriculture Statistics 2020-21. Kathmandu: Ministry of Agriculture and Livestock Development, Government of Nepal.

⁴⁷ Joshi, K. , Upadhyay, S. , Chaudhary, P. , Shrestha, S. , Bhattarai, K. and Tripathi, B. (2020) The Rice Processing Industry in Nepal: Constraints and Opportunities. *Agricultural Sciences*, 11, 1060-1080. doi: 10.4236/as.2020.1111069.

⁴⁸ FAOSTAT, 2020

Table 4: Rice availability in Nepal based on production, recorded import, and export figures (all figures are in MT).

Year	Production	Paddy imports	Paddy exports	Rice imports **	Rice exports **	Total rice Availability*
2016/17	5,230,327	163,302.23	0.47	426,608.1	1.32	4,202,150
2017/18	5,151,925	215,050.68	-	527,988.2	1.60	4,284,873
2018/19	5,610,011	235,167.97	10.68	533,936.8	1.22	4,625,556
2019/20	5,550,878	348,336.34	34.31	440,150.6	4.00	4,569,581
2020/21	5,621,710	698,061.73	-	597,262.9	14.00	5,021,117
2021/22	5,130,625	546,633.95	-	578,761.0	2.97	4,552,845
2022/23	5,486,482	557,752.58	0.20	233,975.4	0.09	4,464,940

Source: Trade data from Department of Customs databank; and production data from Agriculture Statistics of Ministry of Agriculture and Livestock Development, Government of Nepal.

Note: ⁴⁹**The available stock of rice is the sum of total milled rice (total paddy produced and imported minus paddy exported with an estimate of 30 percent loss of weight during processing) total imported rice, while the total exported quantity is deducted. ⁴⁹***Rice includes non-basmati, basmati, and brown rice.

An average Nepali household spends 27.9 percent of its annual expenses on cereals, which consist mostly of rice. According to an estimate, the annual demand for rice (including fine and coarse rice and beaten rice) in 2020 was 4.4 million tons and by 2025 will be 4.9 million tons.⁵⁰ Based on the official figures on production, processing loss estimates and recorded trade, the total available rice for consumption is presented in Table 4. As the table shows, as production shows a rising secular trend over the years, the recorded import figures do not follow a steady and predictable trend. Despite growing demand for rice for consumption and without any significant increase in domestic production, recorded import quantity has been on the decline in the past couple of years. The market did not observe a shocking rise in the retail price of rice in these years. This signals that the decline (or not so significant rise) in formal imports is probably being compensated by informal imports from India.

Nepal imports both rice and paddy in large amount (Table 4). If imported as rice that is after some milling/processing, then a greater share of value would accrue to the exporting country i.e., mostly India. Rice and paddy make up about 17 percent of the total agricultural imports of Nepal and 99 percent of these imports are sourced from India. Nepal imports paddy, rice (including Basmati), brown rice and broken rice for domestic consumption. In the last nine years, Nepal formally imported about 350,000 MT of rice annually on average (Figure 6). Almost all the import of paddy is from India as India made up nearly 98 percent of the total import.

According to the experts and traders consulted in this study, Nepal needs to import a large quantity of rice for consumption even though Nepal's annual production does not look too insufficient on paper, there is a definite mismatch between the varieties cultivated in Nepal and the varieties that are typically

⁴⁹ The loss estimate of 30 percent is based on Pandit, R., Devkota, D., Devkota, N.R., Bhattarai, P., & Shrestha, H.K. (2020). Dynamics of rice sub-sector in Nepal: Research investment, production, and supply chain. *Agricultural Science and Technology*, 12, 178-188; and Regmi, Nirmal & KC, Lesh Bahadur. (2017). "Rice Mills, Milling Processes and Current Status in Nepal." In *Rice Science and Technology in Nepal* (MN Paudel, DR Bhandari, MP Khanal, BK Joshi, P Acharya & KH Ghimire, eds). Kathmandu: Crop Development Directorate, Ministry of Agriculture Development.

⁵⁰ Kumar, P., Kumar, A., Joshi, P.K. 2019. "Food Demand System and Projections to 2035: Nepal". In: Thapa, G., Kumar, A., Joshi, P. (eds) *Agricultural Transformation in Nepal*. Springer, Singapore. https://doi.org/10.1007/978-981-32-9648-0_7

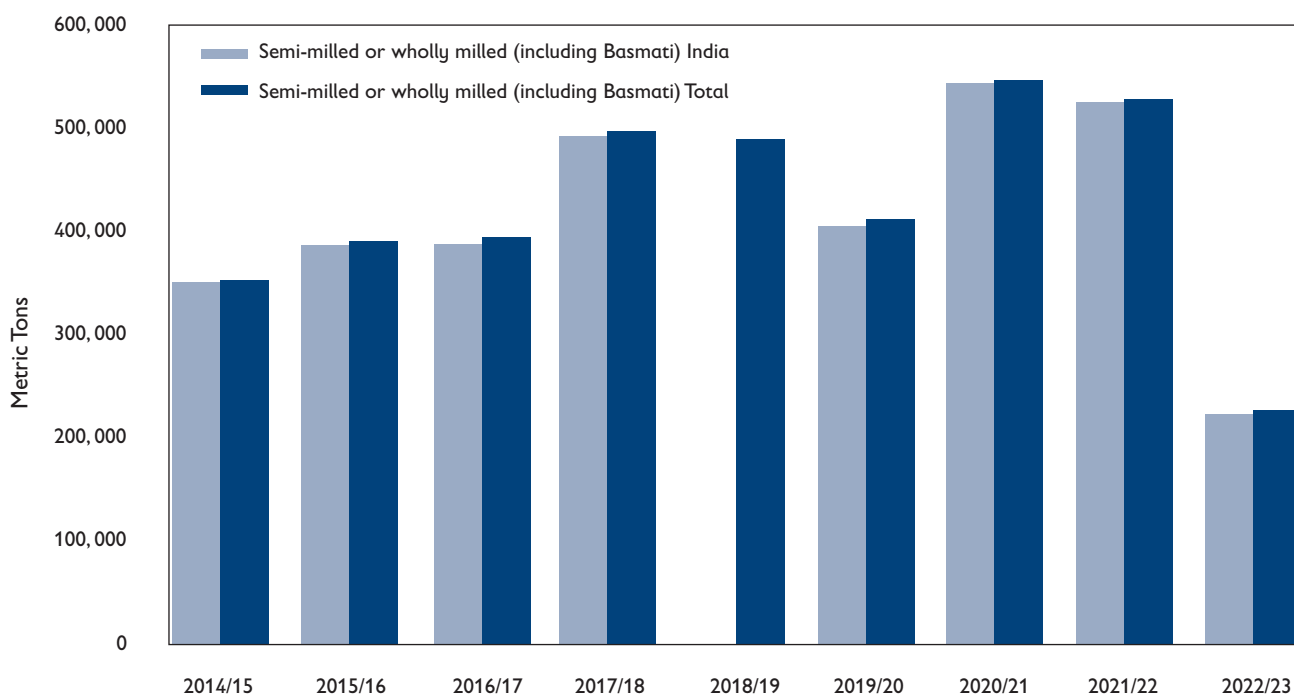
demand. The consumption of rice in Nepal is that of medium fine to fine rice variety while most of the production is of coarse variety. Domestic production of finer varieties is not sufficient to meet the demand. At present only 17 percent of the total paddy production is of finer variety.⁵¹ The Fifteen Development Plan of Nepal has envisioned increasing the cultivation of finer varieties to reach at least 35 percent of the total rice cultivation by 2024.⁵²

The coarse variety is used in preparing beaten rice (a type of flattened rice; it is made by parboiling rice, then drying it until it becomes brittle, and finally pounding it to make flat, light flakes which are eaten with vegetables in Nepal) or by distilleries in liquor preparation. According to the rice traders, the rice produced in Nepal and consumed should be considered as different products. The official paddy

cultivation statistics do not disaggregate the data on whether the cultivated variety is fine or coarse.

Nepal imports rice in negligible amounts from the rest of the world compared to imports from India. Over the years the largest type of rice imported from India is semi-milled or wholly milled rice whether polished (HS code 100630). In the year 2021-2022 alone 528.37 million MT was imported. However, the drastic fall in the formal import of rice is noticeable in 2022/23 upon the ban on rice exports by India. The total quantity of rice imported from India plunged to 222.7 million MT in 2022/23—nearly half the amount imported a year ago. This has been attributed to the 20 percent export duty imposed by India on non-basmati rice export in October 2022. The non-basmati rice export ban was imposed by India in July 2023, bringing imports to a halt.

Figure 6: Formal import of rice from India and the world.



Source: Nepal's custom data

⁵¹ Nabin Dhungana. 2023. "बढ्दो जनसंख्या, नपुग्दो उत्पादन : धानको सन्निक्कट संकटमा देश [Growing population, insufficient production: Country facing approaching paddy shortage]. Online Khabar, 13 November 2023. <https://www.onlinekhabar.com/2023/11/1396231>

⁵² National Planning Commission. 2020. "The Fifteenth Plan (Fiscal Year 2019/20 – 2023/24)." National Planning Commission. https://npc.gov.np/images/category/15th_plan_English_Version.pdf

KISAN. 2022. Assessment of Major Issues and Policy Recommendations in Rice Sub-sector. Kathmandu: USAID.

Some estimates suggest that 70 percent of the imported rice in Nepal is of fine, aromatic variety since their domestic production remains low.⁵⁴ According to the rice processors and traders consulted for the study, about 80 percent of paddy that they process for commercial sales is of Indian origin. All the processors interviewed point out that importing from India is the best option than the rice exporting countries in Southeast Asia. First, the varieties supplied by India match Nepali people's tastes and preferences while Southeast Asian varieties such as Jasmine rice and sticky rice are not commonly preferred. Moreover, the proximity of the markets in India is another advantage offered by Indian sellers as the processors and traders could easily make a day or two-day trip to their warehouses and check the varieties to negotiate and make deals.

The proximity also translates into lower transport costs. The proximity and ease of communication mean that traders in Nepal have easy access to information about the varieties and price movements in the Indian market translating into lower costs to trade. All the traders insisted on the ease of doing business with their Indian counterparts as another major factor owing to historical links and social and cultural ties. According to them, a phone call about the agreed price and quantity would suffice for the orders to get delivered within a couple of days. This ease means Nepali processors could maintain a smaller stock and bring down storage costs. According to paddy processors in Birgunj that run 6-tonne per hour machine, they only keep stocks to last a week.

Some traders and officials point out that these factors make India an ideal market to source rice from for Nepali processors and the potential monetary benefits of circumventing duties and documentation due to the ease of moving goods offered by the porous border, which enables informal trade of rice. Three-fourths of interviewees perceive that informal import of rice could be between 25 to 40 percent of the formal imports. Table 5 shows the amount of rice and paddy confiscated in FY 2022/23 by different customs offices that were informally traded. Data from Customs seizures at five major points reveal a stark contrast: only 13 metric tons

(MT) of paddy were confiscated compared to over 46 MT of rice in the fiscal year 2022/23. Customs officials admit that these figures could be a significantly smaller volume of informal trade that has come under the radar of authorities compared to the volume that actually occurs.

Table 5: Amount of rice confiscated by different customs offices.

2022/23 (in Kg)	Rice	Paddy
Birgunj	8040	13005
Bhairahawa	25710	28
Mechi	395	0
Suthauli	6785	0
Maheshpur	4200	0
Krishnanagar	934	0

Source: Field visit at various border custom offices

Both households and traders drive the informal trade of rice across borders. Households in the bordering towns and villages buy one or two sacks (25-kg sack) of rice from the markets across the borders. Border authorities (customs, and security forces on both sides) allow the households to transport such sacks. However, as discussed above, the sacks need to be unsealed from the original seal and tied up to ensure that the sacks are for household consumption not for resale. About two sacks are allowed to move through borders in this manner. Households use two-wheelers, bicycles, or rickshaws for this purpose. All the respondents opined that the major factor for informal imports by the households is the price on the Indian side is significantly lower than on the Nepali side.

According to the retailers on the Nepali side, they can save about USD 1.86 to 4.66 in a 25-kg sack depending on the variety. For example, in September 2023, a sack of 'jeera masino ghee rice' was being retailed for USD 0.58 at Joghani—the immediate market across the border in Biratnagar, the price of similar variety in Nepal was retailed at USD 0.75. In Nepalgunj in September 2023, the price of jeera masino rice was about USD 0.67 for a kg in the Nepali market (Table 6). Across the border in Rupaidiha, similar varieties could be bought for as low as USD 0.54. Similar differences were found in other border towns too.

⁵⁴ Choudhary, Dyutiman, Kamal Banskota, Narayan Prasad Khanal, Andrew James McDonald, Timothy J Krupnik, and Olaf Erenstein. 2022. "Rice Subsector Development and Farmer Efficiency in Nepal: Implications for Further Transformation and Food Security." *Frontiers in Sustainable Food System*. 5:740546. <https://doi.org/10.3389/fsufs.2021.740546>

Hence, even at retail rates, households could save between 18 to 22 percent.

Table 6 estimate is based on the figures provided by traders in Nepalgunj. According to traders from other areas, this approximation may not be accurate in terms of figures and prices but the cost of logistics—informal and formal—in terms of percentages are similar in other areas too. According to the key informants, the market price for that variety of rice in retail stores in Nepalgunj was around USD 0.67 to 0.70 per kg. The values in Table 6 show that there is a clear monetary advantage in arbitrage through informal imports.

Informal trade for commercial purposes takes place in a more organized form. As presented in the previous section, traders use carriers to transport rice from the Indian side to Nepal. Each carrier charges about USD 0.47 to 0.93 per sack depending on the distance. Besides that, interviewees expressed some organized forms of informal trade when larger consignments are passed through borders. A miller in Nepalgunj said that even border points near Bhairahawa are used to bring rice informally from India. This requires making informal payments to the authorities manning the border for smooth logistics. Interviewees pointed out that all sizes of processors—small, medium, and large—including big-name brands in Nepal, are involved in buying imported rice informally.

As the volume of formal rice imports as shown in the Customs data has gone down, the volume of informal imports of rice is expected to have increased in the past year after India imposed a 20 percent export duty on non-basmati rice in September 2022. India exempted the duty on export to Nepal but only for the consignments that pass through Raxaul-Birgunj, Joghani-Biratnagar and Sonauli-Bhairahawa customs (Box 3). This made imports from other places such as Nepalgunj expensive, fueling informal imports. Although the Indian government included Nepalgunj among the eligible customs points for rice export in April 2023, the traders interviewed at Jhapa and Nepalgunj signaled that the area has seen a rise in

informal trade after India imposed the export duties. For Indian sellers, selling rice formally to Nepal even in normal circumstances would require approval from the Directorate General of Foreign Trade, New Delhi.⁵⁵ Hence the sellers/exporters that have not obtained the permit are not able to send their consignment to Nepal through formal routes as Indian Customs will not allow clearance. Hence, such sellers also seek informal routes.

Table 6: Approximation of the price difference in formal and informal trade based on the figures shared by the interviewees.

Jeera Masino rice	Formal channel	Informal channel
Price NPR per kg	52 [0.48]	52 [0.48]
Customs and other duties (11.5 percent) NPR per kg	5.98 [0.06]	0 [0.0]
Logistics (transportation and other service payments) NPR per kg	16 [0.15]	10 [0.09]
Final price	73.98 [0.69]	62 [0.58]

Source: Field visit

Note: Third bracket denotes values in USD.

In Nepal, rice processors and mills are known to be importing rice from India and repackaging it for sale domestically instead of processing paddy—either imported or locally sourced. Repackaging of rice imported from India is more profitable for the processors than operating mills as they can make profits without incurring the costs of managing the milling operation.⁵⁶ A former rice mill operator in Kohalpur, near Nepalgunj, pointed out that he did not have the inclination and lacked the network needed for the repackaging, and he could not compete with the millers that engage in repackaging, so he shut his milling business down. Repackaged rice sold under their brand names mix informally and formally imported rice.

The finer quality non-basmati long grain rice is sold in the urban areas at prices as high as USD 1.25 for a kg. According to traders, buying rate for both formal and informally traded rice is similar but avoiding formal customs crossings would save them at least

⁵⁵ Directorate General of Foreign Trade. 2018. Export Policy - ITC(HS) 2018. [https://content.dgft.gov.in/Website/dgftprod/1702ad48-120b-446e-a044-1b66e0ff8c51/Schedule%20%20-%20Export%20Policy%20New%20\(1\)%20\(1\).pdf](https://content.dgft.gov.in/Website/dgftprod/1702ad48-120b-446e-a044-1b66e0ff8c51/Schedule%20%20-%20Export%20Policy%20New%20(1)%20(1).pdf)

⁵⁶ Joshi, K. , Upadhyay, S. , Chaudhary, P. , Shrestha, S. , Bhattarai, K. and Tripathi, B. (2020) The Rice Processing Industry in Nepal: Constraints and Opportunities. *Agricultural Sciences*, 11, 1060-1080. doi: 10.4236/as.2020.1111069.

11.5 percent (Agriculture Reform Fee of 9 percent and Advance Income Tax of 2.5 percent) compared to formal imports.⁵⁷ Further, repackaging tasks requires a smaller workforce and minimal operational cost compared to running a full-fledged paddy processing unit.

Note that informal import of rice is not limited to finer varieties. Processors also bring medium fine varieties from India. Some traders shared that some of the processors also buy rice that is being distributed under India's National Food Security Act, 2013 through public distribution system at subsidized rates (INR 2 per kg for rice equivalent to NPR 3.2 per kg) meant for extremely poor households to Nepal

through informal channels. This export is likely to be augmented further as cereals in the public distribution system (PDS) in India have now been made free thus elevating the arbitrage opportunities.

The researchers during the field visit in Nepalgunj in November 2023 found that the rice being packaged at one of the mills contained tiny granules of iron. The Government of India has started to distribute fortified rice since April 2022 through its public distribution system. Rice containing iron granules in Nepali mills does suggest that the subsidized rice makes way to Nepal through its porous border. Those rice, which are coarse variety, are sold to hilly areas of Karnali and Sudurpaschim districts for about USD 0.47 per kg.

Box 3: India's protection measures in rice and paddy exports

Agricultural products are the most protected commodities where countries have been imposing outright bans or imposing quotas. India used export prohibition in the late 2000s as the world witnessed inflationary pressures on food prices. In the last couple of years, India started imposing similar restrictions on food products starting with wheat in 2021. Following the drought and to check the inflated domestic prices, India started slowly imposing restrictions on rice and paddy exports.

India's prohibitions on rice and paddy export (year wise)

- 8 September 2022 - Export of broken rice (HS 10064000) was prohibited⁵⁸
- 8 September 2022 - Twenty percent export duty on paddy husked (brown rice), and semi-milled or wholly milled rice.⁵⁹
- 31 October 2022 - Twenty percent export duty on paddy husked (brown rice), and semi-milled or wholly milled rice exempted for Nepal; 600,000 MT quota for Nepal was imposed; but only applicable for the exports undertaken from Raxaul, Joghani and Sonauli Customs Points⁶⁰
- 23 April 2023 - Notification added Nepalgunj in the list of crossings eligible under this provision.
- 20 July 2023 - India prohibited the export of non-basmati white rice (semi-milled or wholly milled rice, whether polished or glazed: other) (HS 10063090)⁶¹
- 18 October 2023 - India allows export of 95,000 MT of rice to Nepal.⁶²

⁵⁷ Department of Customs. 2024. Ekikrit Bhansar Mahashul 2080/81 [Integrated Tariff Rate 2023/24]. In Nepali. Kathmandu: Department of Customs, Ministry of Finance, Government of Nepal. <https://shorturl.at/cflwY>

⁵⁸ Directorate General of Foreign Trade. Notification No. 31/2015-2020 dated 8 September 2022. <https://content.dgft.gov.in/Website/dgftprod/e51d35f2-910e-48ac-9e5e-32cbac228402/Noti%2031.pdf>

⁵⁹ Central Bureau of Indirect Tax and Customs, Government of India. Notification No 49/2022 dated 9 September 2022. <http://www.salestaxindia.com/DEMO/TreeMenu.aspx?menu=208504>

⁶⁰ Central Bureau of Indirect Tax and Customs, Government of India. Notification No 55/2022 dated 31 October 2022. <https://taxinformation.cbic.gov.in/view-pdf/1009539/ENG/Notifications>

⁶¹ Directorate General of Foreign Trade. Notification No. 20/2023 dated 20 July 2023 https://apeda.gov.in/apedawebsite/DGFT_notificationfile/Notification_20_07_2023.pdf

⁶² Directorate General of Foreign Trade. Notification No. 37/2023 dated 18 October 2023 <https://content.dgft.gov.in/Website/dgftprod/4c606476-77fb-458a-926f-59b00cd1d77a/DGFT%20Notification%20No.%2037-2023%20dated%2018.10.2023-English.pdf>

India's export ban on non-basmati rice imposed in July 2023 has also increased informal imports. Immediately after the ban was announced, traders and households alike were trying to stock up on as much rice as they could through informal channels, according to the traders and retailers at the border. As informal trade did not face much hurdle, the rush to procure rice seemed to have subsided by September 2023. Despite the export ban, the Nepali market across the border had been selling Indian-brand rice in the original packaging. However, there has not been a dramatic rise in the prices—signaling informal imports have been able to cool the markets successfully in Nepal.

5.5.2 Fertilizer

The shortage of chemical fertilizer in Nepal has started to become a persistent issue in agriculture. Nepal's dependence on the informal import of chemical fertilizers from across the border is well-acknowledged even by government authorities.⁶³ Even the Agriculture Development Strategy 2015-2035 of the Government of Nepal accounts that 75 percent of the total chemical fertilizer supply is fulfilled by informal imports.⁶⁴ According to 2012 estimates, Nepal's chemical fertilizer consumption requirement is about 600,000 to 800,000 MT per year.⁶⁵ The other estimate reports that the demand could be about 700,000 MT⁶⁶ while the Nepal Fertilizer Entrepreneurs' Association estimation is that Nepal need about 550,000 MT every year⁶⁷. The last 12-year data shows that Nepal has never crossed 400,000 MT including all three major varieties of chemical fertilizers (Table 7). There are estimates that

suggest annual formal import can meet about only 60 percent of total demand (Table 8).⁶⁸

Table 7: Recorded import of major chemical fertilizers in Nepal (In MT).

Year	Urea	Diammonium Phosphate (DAP)	Potash	Total AICL & STCL
2010/11	85,191	22,001	2,821	110,013
2011/12	97,957	43,146	3,711	144,813
2012/13	108,553	65,722	2,688	176,963
2013/14	145,622	81,520	5,046	232,189
2014/15	190,163	101,797	6,716	298,677
2015/16	213,063	107,121	7,336	327,520
2016/17	205,425	114,802	7,991	328,217
2017/18	235,304	105,619	7,811	348,734
2018/19	215,733	120,893	7,377	344,004
2019/20	224,700	160,298	9,597	394,595
2020/21	225,180	140,982	12,990	379,152
2021/22	143,482	77,720	6,633	227,836

Source: MoALD Agriculture Statistics

In Nepal, there is no restriction for the private sector to import urea, DAP, or potash, yet the country struggles with timely supply of fertilizers. Although the private sector can import fertilizers to sell in the market, only government-supplied fertilizers are sold at subsidized rates. Nepal provided fertilizer subsidies to farmers since 1973 and the purchase was done through the government company, but the fertilizer market was deregulated completely by 1999, allowing the private sector to enter the fertilizer import and distribution market.⁶⁹ However, the government reintroduced fertilizer subsidy in 2009.⁷⁰ Government outsources procurement and distribution of chemical fertilizer

⁶³ Gautam, Shrinivas, Dyutiman Choudhary, and Dil Bhaadur Rahut. 2022. "Behavior of Private Retailers in a Regulated Input Market: An Empirical Analysis of the Fertilizer Subsidy Policy in Nepal". *Asian Development Review*, Vol. 39, No. 2, pp. 175–199. DOI: 10.1142/S0116110522500135 USAID and EAT. 2014. *Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth across South Asia*. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

⁶⁴ Ministry of Agriculture Development. 2014. *Agriculture Development Strategy (ADS) 2015 to 2035*. Kathmandu: Ministry of Agriculture Development.

⁶⁵ Hoyum R.A. 2012. *Nepal Fertilizer and Plant Nutrient Assessment*. USAID.

USAID. 2014. *Regional trade in seed, fertilizer, and strategic grains: A Review of the Legal, Regulatory, and Institutional Constraints to Growth Across South Asia*. https://cuts-citee.org/pdf/EAT_SouthAsia_Report_041514_web.pdf

⁶⁶ Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." *South Asia Watch on Trade, Economics and Environment (SAWTEE)*. No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

⁶⁷ Based on the consultation undertaken with the Association's representative in March 2024.

⁶⁸ Gautam, Shrinivas & Gaihre, Yam & Acharya, Ganga & Dongol, Prabin & Choudhary, Dyutiman. 2022. "Fertilizer demand-supply gap and avenues for policy revisits in Nepal". *SAARC Journal of Agriculture*, 2022, Vol 20, Issue 2: 223-234. 10.3329/sja.v20i2.63583.

⁶⁹ Takeshima, Hiroyuki. 2019. "Use of Chemical Fertilizers in Nepal—Issues and Implications" In Thapa, G., Kumar, A., Joshi, P. (eds) *Agricultural Transformation in Nepal*. Springer, Singapore. https://doi.org/10.1007/978-981-32-9648-0_7

⁷⁰ Takeshima, Hiroyuki. 2019. "Use of Chemical Fertilizers in Nepal—Issues and Implications" In Thapa, G., Kumar, A., Joshi, P. (eds) *Agricultural Transformation in Nepal*. Springer, Singapore. https://doi.org/10.1007/978-981-32-9648-0_7

to two government entities—Agriculture Inputs Company Ltd (AICL) and Salt Trading Corporation (STC), and stocks are sold at subsidized prices which the government supports from its coffers directly.

The stocks of fertilizers imported by the two state agencies were then stored at their warehouses across the country and then distributed to farmers through agriculture cooperatives. In 2020, the government issued new regulations with regard to fertilizer distribution—Subsidized Chemical Fertilizer Distribution Management Regulations, 2077—which allowed private companies to be the link between the farmers and the AICL and STC.⁷¹ There are about 8247 dealers including private sector agrovets and agriculture cooperatives that deal in fertilizers.⁷² These last-mile sellers can charge 2 to 10 percent as service charges depending on the remoteness of the area over the prices fixed by the government. The delayed public procurement process is the reason for fertilizers not reaching farmers on time.

At present, the government has fixed price for a kg of urea at USD 0.23 and a kg of DAP is priced at USD 0.47.⁷³ This is a new price revised by the government in March 2023 to reduce the financial burden on the government. Depending on the procurement price, which fluctuates, the government could be subsidizing 60 to 80 percent of the price paid by the farmers.⁷⁴ The private sector importers cannot import urea and DAP at the market rate from the world market and then sell at a 60-80 percent higher rate than the government. This has left Nepal's fertilizer supply dependent on subsidized fertilizers, which is usually not available on time, or the informally imported fertilizers from India. This is also acknowledged by the Agriculture Development Strategy 2015-2035.

Informal import of fertilizer also happens through the channels mentioned in the previous section as farming households as well as traders are engaged in bringing urea and DAP from the Indian market. Informal procurement from India has twin advantages—one, timely availability and two, the price of fertilizers in India is cheaper than in Nepal because of heavy subsidization in India particularly of urea. The Subsidized Chemical Fertilizer Distribution Management Regulations, 2017 mentions that the price of fertilizers will be cognizant of the price of fertilizers in the Indian border markets while determining selling price in Nepal. Consultation with fertilizer dealers and farmers in the border areas reveals that agro-vet retailers in the Indian border towns are selling subsidized urea for about USD 0.08 per kg and USD 0.4 per kg for subsidized DAP. If farmers cross borders and buy fertilizer for themselves then the prices would be about the same as charged to Indian farmers. Commercial informal traders that get fertilizers transported to Nepal through carriers sell them at a higher price. In some border villages, 70 to 80 percent of their total fertilizer requirement is from Indian markets.⁷⁵

In the years when the government procurement is delayed, 17 districts in Terai region which borders India, see informal imports as high as 200,000 MT, according to the representative of fertilizer entrepreneurs' association. Even in normal years, the informal import could be as much as 100,000 MT. One of the fertilizer dealers from Dang, who was interviewed, confessed about procuring informally imported urea from Kailali district and selling them in Dang in 2022. According to the dealer, the informal depot from which they ordered the fertilizer was near the border and was quite large. There it must

⁷¹ Ministry of Agriculture and Livestock development. 2020. Subsidized Fertilizer Distribution Management Directive 2077. https://www.kscl.gov.np/files/Act/Mal_Bitaran_Nirdesika.pdf

⁷² Vista, Shree & Devkota, Sabina & Shrestha, Shova & Rawal, Nabin & Paneru, Prakash & Timilsina, Sandip. 2022. FERTILIZERS IN NEPAL. National Soil Science Research Centre, Nepal Agricultural Research Council.

⁷³ <https://kathmandupost.com/money/2023/03/13/nepal-hikes-chemical-fertiliser-prices-to-curb-subsidies>

⁷⁴ Vista, Shree & Devkota, Sabina & Shrestha, Shova & Rawal, Nabin & Paneru, Prakash & Timilsina, Sandip. 2022. FERTILIZERS IN NEPAL. National Soil Science Research Centre, Nepal Agricultural Research Council.

⁷⁵ Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." South Asia Watch on Trade, Economics and Environment (SAWTEE). No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

have stocked nearly '10 large trucks worth of fertilizers, which were collected from carriers that transported fertilizers in one sack at a time. This was shared, according to the dealer, to ensure that the quality of fertilizer has not been compromised. The dealer bought two small truckloads of urea from Kailali crossing Bardiya, Banke and entered Dang on the East-West Highway and was not intercepted by any security forces. Back then, the dealer had bought urea at USD 0.24 per kg rate and sold it at USD 0.43 per kg in Dang, a big margin of profit (Table 8).

According to some key informants, even when fertilizer is available domestically, farmers in Nepal

usually must resort to buying fertilizers from black market as the dealers alleged that official stocks run out quickly. The fertilizers that the dealers sell could be collected from Nepali government-supplied formal stock or informally imported ones. According to dealers, using individual carriers to informally bring fertilizer from India is easier as there is less resistance for individuals from the border patrol forces on the Indian side and Nepali side. However, such informally imported fertilizers are susceptible to quality compromises as carriers must unseal the pack to prove that they are for their farming consumption not for sale.

Table 8: Estimation of difference in rates of formally distributed fertilizers and informally imported fertilizers.

Type of Fertilizer	Nepal's rate	Selling rate including 10 percent commission of dealers	Indian rate (approximate value as reported by informants)	Selling rate of informal imports
Urea	25 [0.23]	27.5 [0.26]	10 [0.09]	25-30** [0.23-28]
DAP	50 [0.47]	55 [0.51]	43 [0.40]	50-55** [0.47-0.51]

5.5.3 Seeds

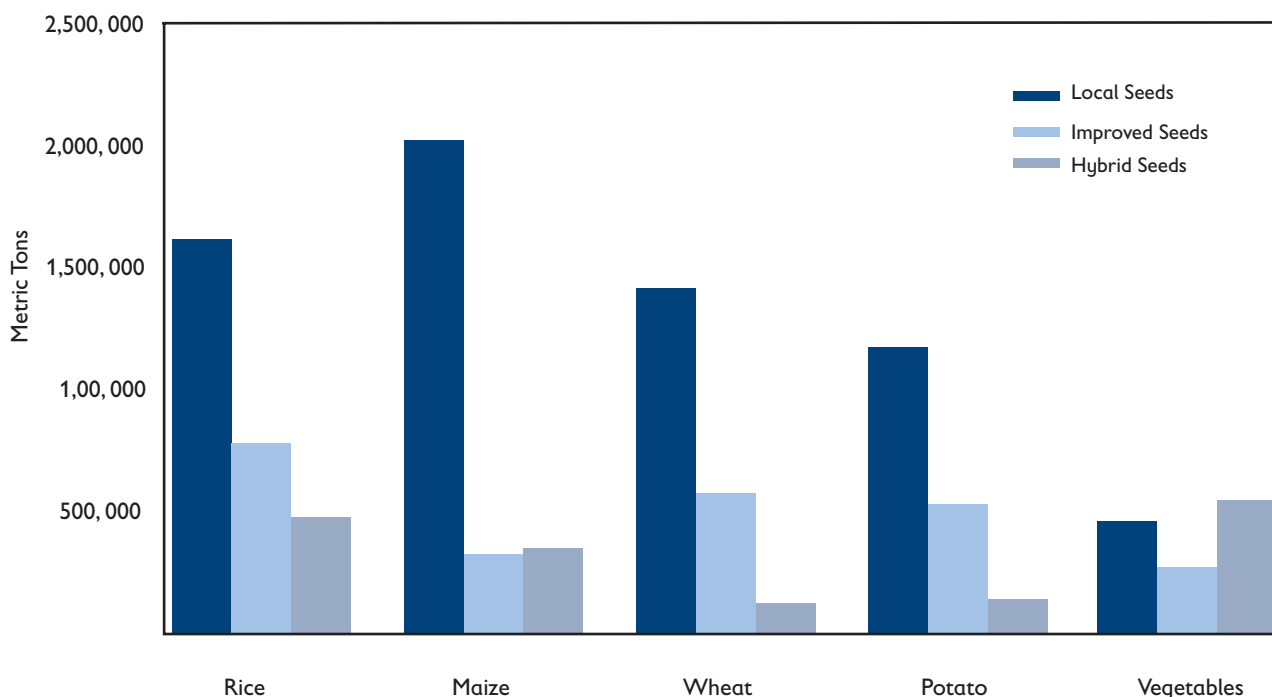
Indian markets across the borders are an important source of seeds for Nepali farmers. Agrovets stand prominently among grocery stores and readymade garment outlets, signaling agricultural inputs being a major attraction for buyers visiting from the Nepali side. Seeds are one of the highly regulated commodities in Nepal, considering their implications on the agricultural system. Imported seeds need to be free from any pests, pathogens, or invasive species that could harm local crops, ecosystems, or public health. The quality and purity of seeds entering Nepal need to be maintained to ensure that farmers have access to seeds that are reliable, productive, and adapted to local conditions.

Hence, seed import is allowed only for the approved and certified varieties. According to the Seeds Act 1988 (last amendment in 2022), only import and export of certified seeds are legally allowed. However, it takes

almost three to four years for a seed variety to get certified, according to seed entrepreneurs consulted for the key informant interview. The delays in getting the variety approved and certified for formal import and sales in Nepal while the availability of new and improved varieties across the porous border, make informal import of seeds an obvious choice for the farmers, most of the key informant's interviews have opined.

Farmers choose seed varieties that are high yielding, require minimal maintenance and deliver on selling price of the product in the market based on consumption traits. If these requirements are fulfilled by the domestically available seeds, formal or informal imports would not ensue. However, if farmers are aware or perceive that some varieties could yield similar results but are only available across the border, then they would pick that variety (Figure 7).

Figure 7: Types of seeds used for different crops.



Source: Agriculture Sample Census 2021/22, National Statistics Office

Box 4: Diesel uses in agriculture

Diesel is an important power source in farm mechanization and crucial in non-farm activities such as the transportation of farm produce or food products between villages and city areas. The use of agricultural machinery and farm equipment is on an increasing trend in Nepal. As per the National Sample Census of Agriculture 2021-22, it was found that of all agricultural holdings, almost 40 percent had used tractors in their fields, 28.5 percent used threshers, 16.7 percent used pump-sets and 11.4 percent used power tillers. For holdings that were above 1ha, the use of tractors was prevalent in 48 percent, reaching up to 72 percent for those holdings above 5 ha land. Such machinery often requires the use of diesel as a power source.⁷⁶ While the government's energy policies have subsidized the use of electricity or other renewable sources such as solar power, the high and unaffordable price of petroleum as well as shortages in availability have been cited as impediments to farm mechanization in Nepal.⁷⁷ Evidence from other countries in South Asia viz. Bangladesh and Southeast Asia i.e., Thailand shows that trade and trade policy have a big role to play in farm mechanization and scaling it. The tariff rates of agricultural machineries in Bangladesh (1.5%), Nepal (1.4%) and Thailand (2.6%) are significantly lower than of India (7.5 %).

⁷⁶ Biggs, Stephen and Justice, Scott. 2015. "Rural and Agricultural Mechanization: A History of the Spread of Small Engines in Selected Asian". IFPRI Discussion Paper 1443.

⁷⁷ Gauchan, Devendra and Shreemat Shrestha. 2017 "Agricultural and Rural Mechanisation in Nepal: Status, Issues and Options for Future". In Rural Mechanization: A Driver in Agricultural Change and Rural Development, eds. Mandal S. M.A., S.D. Biggs and S.E. Justice (Dhaka, Bangladesh: Institute for Inclusive Finance and Development (InM), 2017), xp276.

Especially after the economic blockade in 2015, Nepal experienced an increase in informal imports of petroleum from India. Hannan (2018) describes the functioning of the informal network carrying petrol in motorcycles' fuel tanks as well as in jars by women from their fieldwork in Eastern Nepal in 2016.⁷⁸ Such activities were reported to be quite lucrative with a margin of INR 10 (USD 0.15) per liter of petrol supplied informally from the Indian market.

Due to high duties being charged by the Indian government as well as fluctuations in international market prices of crude oil, there have also been instances where it was observed that petroleum was being informally traded from the Nepal side to the India side in 2021.⁷⁹ In February 2021, Nepal had lower prices of petroleum products compared to India; there was observed to be a price differential of USD 0.43 per liter in petrol and USD 0.38 per liter in diesel opening opportunities for oil smuggling. However, at present price of diesel per liter in border areas are at USD 1.44 per liter while the Indian side is selling a liter for about USD 1.42 per liter. The consultation during field visits during the period between August and November 2023, did not point to diesel as a major commodity being informally traded as minimal price difference between the two markets did not give rise to arbitrage opportunities for the traders.

This tendency was markedly observed in the Nepali border area in a survey undertaken in 2017, which showed that farmers in Dhanusha were cultivating the Sona Mansuli variety of paddy even though the variety was banned for its high susceptibility to certain diseases.⁸⁰ Farmers would cross the Nepali border and buy a couple of sacks of paddy seed and sow it as it provided better yield and fetched relatively higher prices. Farmers are acutely aware about the Indian side selling any improved varieties, thanks to social ties between the communities across borders which has made knowledge sharing easy.

Hence, if it suits their preference and requirements, farmers will use that seed, no matter whether the variety has been approved or not by Nepali authorities. This underlines one of the motivations for this study i.e. domestic policy offsets and ineffectiveness because of informal trading possibilities. This is not a one-way exchange as in 2017 the same study found that Indian farmers in Bihar were crossing the border to buy two varieties of wheat seeds—Gautam and NL297—in a similar fashion from Nepal as they were not formally available in the Indian side.⁸¹

In the informal import of seeds, farmers themselves cross the border to buy their preferred varieties from the Indian side. They carry about half a quintal on bicycles and do more trips when necessary. If using a motorcycle, they can fetch about a quintal in one go. Vegetable seed packets of one kilo or less are easy to bring back without any major friction.⁸² Seeds are high-value, low-volume items. So, there are many importers who import seeds in sacks by placing them in the middle of other items in the trucks. In some cases, seeds are imported as cereal which draws higher customs duty but less scrutiny from the regulatory authorities.⁸³ Nepal is the same and the same inputs and farming technology are used, hence, the varieties that are suitable 100 meters from the border could be suitable for the land 100 meters within the border.

In terms of informal imports of seeds, key informants point out that the price of the seeds is less of a determinant than availability and preference. Farmers at the border downplay the risk of informal import and any damage caused by uncertified seeds saying that the environment across the border in India

⁷⁸ Hannan, A. 2018. "Geography of Informal Trade, Commodity Flows and Livelihoods in Indo-Nepal Border (A case of Dhulabari, Bagdogra and Siliguri Corridor)." *Business Management & Compliance* 1(2) (July-December 2018): 7-29.

⁷⁹ Prasain, Krishna. "Huge price differential triggers cross-border fuel smuggling." *The Kathmandu Post*, February 27, 2021. [<https://kathmandupost.com/money/2021/02/27/huge-price-differential-triggers-cross-border-fuel-smuggling>]

⁸⁰ Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." *South Asia Watch on Trade, Economics and Environment (SAWTEE)*. No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

⁸¹ CUTS International. 2018. *Linkages and Impacts of Cross-border Informal Trade in Agricultural Inputs in Eastern South Asia*. Jaipur: CUTS International. https://cuts-citee.org/pdf/Research_Report_on_Linkages_and_Impacts_of_Cross-border_Informal_Trade_in_Agricultural_Inputs_in_Eastern_South_Asia.pdf

⁸² Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." *South Asia Watch on Trade, Economics and Environment (SAWTEE)*. No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

⁸³ Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." *South Asia Watch on Trade, Economics and Environment (SAWTEE)*. No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

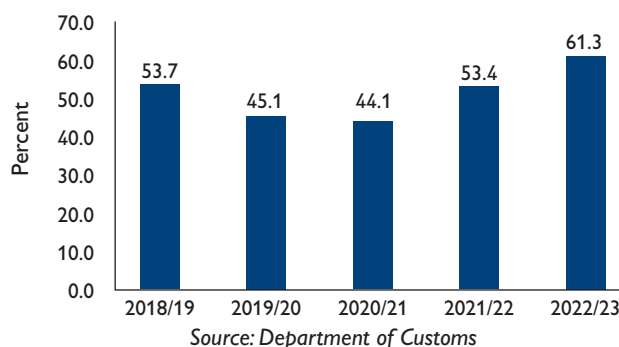
and Representatives from the Seed Entrepreneurs Association of Nepal (SEAN) point out the delay in getting the seed varieties certified for persistent informal trade of varieties that could be produced domestically as well. To get cereal crops' seed varieties registered at least two seasons trial is required. This would translate into three to four years of completing the whole process, by which time, new varieties would be developed and the seed industry in Nepal could not keep up with that. They point out that risk in terms of informal import is not only of pests and unsuitability of seeds to Nepali climate and soil profile but also farmers not being fully knowledgeable about handling the varieties like they would have been in the case of certified varieties.

5.5.4 Vegetables

Annual vegetable production in Nepal was estimated to be about 4.1 million MT in fiscal year 2021/22 while Nepal's total import in that period was 834 million MT. Of the total formal imports, 74 percent in terms of volume is from India. India is the largest vegetables trading partner of Nepal as the figure demonstrates. At the same time, vegetables are also equally traded through informal channels (Figure 8).

Informal imports of vegetables from India to Nepal seems to happen on a small scale, which especially caters to local markets. Traders cite that the main reason for informal trade is to avoid any procedural necessities such as laboratory testing and other formalities. For example, bringing vegetables through customs would require the supplier in India to contact a Nepali importer and those importers need to have been registered with EXIM Code at the Department of Commerce. To obtain the EXIM Code, importers need to deposit USD 2800. Hence, with the fixed cost, traders who want to sell small consignments resort to informal routes, which are aplenty scattered across the border area, to bring vegetables to Nepal. Since prices in Nepal are about 10-15 percent higher than some Indian vegetable vendors may want to cross the border and sell their products for higher profitability. This sort of informal trade happens on bicycles and motorcycles.

Figure 8: Share of India in Nepal's global vegetable imports.



Moreover, when a larger scale of consignment is exchanged, it is to circumvent border taxes of 14 percent for green vegetables. The tax incidence is higher in vegetables such as potatoes, onions, and garlic—at 24.67 percent following the imposition of an additional 13 percent Value Added Tax imposed on the import of potatoes, onions, and garlic (mid-July 2023—beginning of the fiscal year 2023/24). Key informants consulted point out that this has surged the informal imports of potatoes and onions. This sort of informal trade happens in an organized pattern compared to small traders transporting small quantities on two-wheelers.

India first imposed an export duty of 40 percent on onions following a domestic rise in prices in August and banned exports in December as the export duty and minimum export price failed to arrest the prices domestically. In October 2023, the Indian government fixed the minimum export price of US\$800 per ton to arrest domestic prices by curbing exports. The export duty and minimum export price did affect prices in Nepali markets pushing the price for a kg of onion to USD 1.86 in November from about USD 0.57 per kg in August. However, the ban did not affect the prices to persist for long as informal trade flourished and cooled the markets. According to Indian media reports, less used border crossings in rural areas were being uniquely used to transport onions on two-wheelers and e-rickshaws. In the two weeks since India's ban, Nepali security forces had seized 37.3 tons of onions that were informally imported without proper invoice.

⁸⁴ Hindustan Team. 2023. "Open smuggling of onion in India-Nepal border." Hindustan, December 12, 2023. <https://www.livehindustan.com/bihar/motihari/story-onion-smuggling-is-rampant-from-india-nepal-border-9056098.html>

⁸⁵ Post Report. 2024. "Onion smuggling thrives after Indian export ban." The Kathmandu Post, January 8, 2024. <https://kathmandupost.com/money/2024/01/08/onion-smuggling-thrives-after-indian-export-ban>

5.5.5 Informal export from Nepal

Although Nepal's informal trade with India is heavily import-oriented with more imports than exports, however, instances of exports from Nepal that circumvent border crossings also do happen. But these happen in response to temporary supply or price shocks induced by policy interventions. Hence, these exports happen in short bursts. For example, in July 2023, prices of tomatoes increased to as high as INR 260 per kg in India, traders started sourcing tomatoes from Nepal where prices had gone down to USD 0.29 per kg (INR 18.75).⁸⁶ The informal export to India was formalized once the Department of Agriculture and Farmers Welfare issued a notification specifying the tests that tomatoes coming from Nepal need to provide certificates for. Consultations at Bhairahawa and Birgunj, which took place in August 2023, at the peak of tomato shortage called attention to the informal export of tomatoes that was happening at the time.⁸⁷ According to traders in Bhairahawa, tomatoes were being sent off through minor routes on motorcycles to be sold on the Indian side from places that were nearly 100 kms away from the border.

In agricultural products such as vegetables, India does not apply customs duties so the motivation to informally export and take the associated risks is limited for traders. However, receiving plant quarantine certificates would require a wait of another two to three hours. Also, the sporadic price shocks create immediate arbitrage opportunities that tend to get exploited through informal trade in both directions. According to the traders and farmers, instead of waiting, they choose to send it off via the minor routes when the volume is smaller. Traders also point out that the Indian side is a bit rigid in allowing the export of a new variety of vegetables. The traders in Kakarvitta said that Indian customs did not allow the export of chayote from that point citing that it is

not in the approved list. The traders say that they are not even aware of such a list existing.

However, in items such as areca nuts or betel nuts, informal exports from eastern Nepal to India is quite prevalent. Betel nut imports and their informal exports have been a contentious issue in Nepal. Unlike other agricultural products that are informally exported due to surplus production in Nepal and the Indian market offering better prices, betel nut's informal trade happens solely to exploit the advantage offered by the open border to push the item that faces in formal exchange a high import tariff by the Indian government. Nepal's annual production of betel nut is about 14,000 tons and annual consumption is estimated to be about 5000 tons, yet Nepal annually imports a large quantity of betel nuts formally that is recorded.⁸⁸ In FY 2022/23, Nepal imported areca nuts of 8138 tons, in the previous year the volume was almost 19,000 tons. The imported areca nuts are known to be sent off to India through informal routes and sold to traders.⁸⁹ India has fixed 100 percent duty on areca nuts imports; hence, traders find the informal route through Nepal cheaper akin to what is happening in formal trade in case of edible oil.⁹⁰ In the eastern part of Nepal, Biratnagar and Jhapa, mention of informal trade with India would elicit the example of betel nuts as a thriving instance of informal export from Nepal.

The eastern side of Nepal is the hub of areca nuts production and informal export happens from that area—around Kakarvitta-Panitanki customs point. Carriers on bicycles and motorcycles take about 10 kg of areca nuts undetected to India through different routes around Kakarvitta, each consignment earning about USD 18.63. According to some reports, the price in the Indian market is about USD 1.86 more than the local price in Nepal, further fueling the informal trade.⁹¹ Consultations pointed out that the

⁸⁶ Sharma, Suparna. 2023. "India's wild price swings for tomatoes make and lose fortunes". Al Jazeera, 3 August 2023. <https://www.aljazeera.com/economy/2023/8/3/caught-between-drought-and-deluge-tomato-prices-in-india-crash-and-soar>

⁸⁷ Dhungana, Nabin. 2023. Nepal exports 670 tonnes of tomatoes in 2 weeks. Online Khabar, 22 August 2023. <https://english.onlinekhabar.com/nepal-tomatoes-export-india.html>

⁸⁸ <https://moald.gov.np/wp-content/uploads/2023/08/Statistical-Information-on-Nepalese-Agriculture-2078-79-2021-22.pdf>

⁸⁹ Poudel, Dilip. 2023. "Imports of betel nuts smuggled into India are open when foreign exchange is falling." Nagarik Daily, March 10, 2022. <https://nagariknews.nagariknetwork.com/economy/764261-1646966510.html>

⁹⁰ Central Board of Indirect Taxes and Customs. 2022. "Chapter 8: Edible fruit and nuts; peel of citrus fruit or melons." Central Board of Indirect Taxes and Customs, Section II: 120-125. https://old.cbic.gov.in/resources/htdocs-cbec/customs/cst2023-010523_new/chap-8.pdf

⁹¹ Poudel, Dilip. 2021. "Billions scam in betel nut business." Nagarik Daily, November 16, 2021. <https://nagariknews.nagariknetwork.com/economy/668041-1637109481.html>

informal trade of betel nuts happens in organized forms with the involvement of prominent figures in business. They are the ones who import most of the betel nuts from countries like Indonesia and Malaysia. They store those imported stocks in warehouses near the border and employ carriers to take them across the border in smaller batches.

5.6. Drivers of informal trade

Informal cross-border trade of agricultural products takes place due to different economic and social factors. These factors could be structural, hence difficult to bring changes through superficial interventions in one or two areas, while some products get traded informally due to some policy-induced drivers for a span of time. Despite risks associated with being involved in informal trade, criminal prosecution, jail sentence and hefty financial penalties (for both the traders and carriers) informal trade is taking place. This signals that the benefits from informal trade are greater than the risks and expected costs.

This section highlights the factors that seem to be driving informal trade based on the findings from the exercises undertaken in this study. The products examined in the previous section demonstrate that drivers could be price differences, caused by tariffs and/or differences in production cost (such as sugar); availability, caused by prohibition (rice) or supply constraints (chemical fertilizers); regulatory

compliance (fresh vegetables); and relaxed monitoring at the border crossings. Moreover, informal trade could be a source of employment and livelihood for the carriers and couriers and the abundance of such carriers could also further encourage the informal movement of goods across the border. This section groups the drivers mentioned in the earlier section to provide an overview. These drivers could be broadly categorized under the following headings.

5.6.1 Tariffs and duties

Nepal-India Treaty of Trade exempts primary goods from any customs duties, hence, imports of agricultural products such as rice and vegetables from India do not attract any customs duty.⁹² However, Nepal charges the Agriculture Reform Fee on these imports from India. Other countries (even those in SAARC) are levied customs duty.⁹³ Fresh vegetables attract 14 percent duties (Table 9).

The government of Nepal applies five types of duties—customs, excise, agriculture reform fee, advance income tax and value-added tax—on imports. Total tax incidence on imports could be as high as 49.44 percent, as is the case of cashew nuts. Sugar is an example of a highly taxed commodity, which is also one of the highly imported items informally in Nepal from India. The tax incidence on sugar was higher before the revision of the customs duty at the end of the fiscal year 2022/23 to 30 percent from 40 percent.

Table 9: Tariffs and duties applicable on the imports from India.

HS Code	Commodities	Customs (%)	Excise (%)	Agriculture Reform Fee (%)	Advanced Income Tax (%)	VAT(%)	Total(%)
10063090	Rice non-basmati			9	2.5		11.5
10063010	Rice basmati			9	2.5		11.5
17011490	Sugar	30				13	46.9
12092900	Seeds			9			9.0
08013100	Cashew	15	15			13	49.4
07019000	Potatoes			9	1.5	13	24.8
07031000	Onions			9	1.5	13	24.7
07049000	Green vegetables			9	5		14.0

Source: Department of Customs, Government of Nepal

⁹² Cite Nepal-India Treaty on Trade

⁹³ Department of Customs. 2024. Ekikrit Bhansar Mahashul 2080/81 [Integrated Tariff Rate 2023/24]. In Nepali. Kathmandu: Department of Customs, Ministry of Finance, Government of Nepal. <https://shorturl.at/cflwY>

Since duties are applied at the customs point, advance income tax and VAT also make up a substantial payment for the importers; circumventing customs will save money for importers. This also translates into lowered prices for consumers in many cases. According to a trader in Biratnagar, if informal imports of sugar did not happen in Nepal, Nepali consumers would be paying at least 20 percent higher retail price.

Among spices such as cinnamon, cumin, and pepper, duties are as high as 37 percent on top of their already high prices. These items (some traders also called them high value) could be transported in small batches from across the border. Even for vegetables that are easily available across the border, smaller traders' resort to using unofficial routes. However, this is more practiced by smaller traders. In the case of non-basmati rice, India imposed a 20 percent export duty on exports. Export to Nepal through any other points except for Raxaul (Birgunj), Jogbani (Biratnagar) and Sonauli (Bhairahawa) was exempted from export duty as per the notification issued on 31 October 2022. In addition to 11.5 percent duties (including agriculture reform fee and advance income tax), the additional 20 percent levy increased the total burden of tax on importers importing from other customs points. The duty imposed on exports by India is attributed to the plunge in formal imports in the fiscal year 2022/23. In addition to duties, customs and clearing agents estimate that transportation and payments to customs and clearing agents on both sides of the border would add to about INR 10,000 (USD 149) depending on the distance between the origin in India and the destination in Nepal.

Note that informal imports would not require any additional payments. Large consignments of informal imports are possible when payments are made to loosen up security. And when carriers who ferry nearly a quintal of rice in entirety on a bicycle or motorcycle, they are paid about USD 1.49 for each sack of rice; so, the transport cost will be about NPR 6.5 per kg of rice. For example, in the case of rice itself, if traders in Nepalgunj buy a quintal for INR 4500 then the charge will be INR 400, which is 9 percent and marginally lower than the duties charged

at the Nepal border. The Indian imposition of export duty further made informal imports lucrative for the traders from areas other than Birgunj, Biratnagar, Bhairahawa and Nepalgunj. The duties add at least 31.5 percent and the traders must make payments to customs and clearing agents on both sides of the border.

5.6.2 Non-tariff barriers

Besides the need to circumvent official border points to circumvent duties and other regulatory prohibitions, traders seek informal channels to ferry their goods to avoid non-tariff barriers, in the form of laboratory certificates and other regulatory requirements.

Now paddy and rice export to Nepal from India is prohibited, but earlier that export was heavily regulated. Cereal and lentil export from India to Nepal through land borders required exporters to receive export permits for the applied quota from the Directorate General of Foreign Trade (DGFT) office in New Delhi. Exporters could only export up to the level approved by the DGFT even when they had capacity i.e. a system of tariff rate quotas (TRQ). Thus, export to Nepal is regulated to an extent. The 600,000 MT paddy quota applied to Nepal for a year in October 2023 ran out in August 2023, so the Nepali importers were not eligible to receive duty-free paddy.

According to paddy importers, they cannot import paddy by paying the duty of 20 percent since the DGFT does not approve the export of paddy to Nepal. Hence, if exporters are not approved by the DGFT they also tend to export informally. Moreover, even when the Indian government exempted export duty on the export of 600,000 MT of paddy to Nepal, only three customs points: Raxaul-Birgunj, Jogbani-Biratnagar and Sonauli-Bhairahawa, were allowed to transport zero-tariff paddy. This prevented traders in other areas, for example, around Kakarvitta, being compelled to import from Biratnagar. According to interviewees in the area, this could have prompted informal imports.

⁹⁴ Source: Ministry of Finance (Department of Revenue);

<https://taxinformation.cbic.gov.in/view-pdf/1009539/ENG/Notifications>

In Nepal, traders have identified that the reference price set by the Department of Customs as a hindrance to formal trade. They argue that these reference prices or shadow prices often deviate significantly from actual market prices, which are inherently dynamic due to fluctuations and negotiation-driven determinations. However, customs occasionally adopt an inflexible approach, rejecting any deviations, leading to complications. The latest reference price list issued in August 2023, sugar's reference price per kilo was INR 30 which was lower than the market price. Traders reported that there were similar discrepancies in the valuation of some vegetables and fruits. According to a vegetable trader, the reference price of INR 70 per kg of lemons was higher than the prevailing market price.

Since prices of such agricultural commodities fluctuate at high frequency and the transaction price also depends on the order size, the reference price creates difficulties. Customs officials said that reference price is merely indicative of the price of the imported commodities and used only when the invoice price variation is suspiciously higher or lower. Yet, traders point out that reference prices are a deterrent when it comes to moving goods through formal trade channels. In other categories of goods as well, the systems of reference prices have been encouraging mis-invoicing so that traders' fake invoices match the reference price due to the fear of penalty, leading to resorting to informal channels to make payments (if reference price is lower than the market price) or to get refund (if reference price is higher than the actual market price).⁹⁵

As discussed above, seeds are another highly important agricultural commodity traded informally due to non-tariff barriers, according to seed

entrepreneurs and farmers. Since importing a new variety of seeds takes as long as three years to go through the formal approval process, informal imports of such unregistered trade have flourished. This has also given rise to mis-invoicing where seeds are reported as cereals to circumvent regulatory obligations. Even potato seeds were reported to be imported as potatoes meant for final consumption to avoid regulatory testing.⁹⁶

5.6.3 Price differentials

Higher tariffs and duties add up to the already existing price difference between the markets in both countries. The differences owing to cost, and easy mobility between the borders, is a tempting factor for the households residing in the bordering areas near Indian border markets.

Nepali agriculture, due to various constraints, is regarded as high-cost production due to issues inter alia, such as limited infrastructure for irrigation, low adoption of modern technology, lack of improved seeds, insufficient agricultural logistical infrastructure.⁹⁷ The amount of support received by farmers is comparatively small in relation to neighboring farmers in India. In comparison, the Indian agricultural landscape is relatively better with better infrastructure, established market linkages, and use of modern technology. At the same time, support provided by the government makes up for about one-fifth of their farm income.⁹⁸

India spends about 2 to 2.25 percent of its GDP on farm subsidies in the forms of fertilizer subsidies, credit subsidies, crop insurance and price support through its central and state government. Nepal's such expenditure was only about 0.44 percent of its comparatively small

⁹⁵ Pageni, Rudra. 2023. एक्सप्लेनर : बिलमा हुने गोलमालको कथा [Story of under invoicing]. Himal Khabar 24 December 2023 <https://www.himalkhabar.com/news/139387>

⁹⁶ Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." South Asia Watch on Trade, Economics and Environment (SAWTEE). No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

⁹⁷ Ministry of Agriculture Development. 2014. Agriculture Development Strategy (ADS) 2015 to 2035. Kathmandu: Ministry of Agriculture Development.

⁹⁸ Ramaswami, Bharat. 2019. Agricultural Subsidies: Study Prepared for XV Finance Commission. https://fincomindia.nic.in/archive/writereaddata/html_en_files/fincom15/StudyReports/Agricultural%20subsidies.pdf

GDP in 2021/22 (Table 10).⁹⁹ The amount distributed as a subsidy; 60 percent (NPR 154.6 million) was allocated for chemical fertilizer procurement only. Moreover, in Nepal's case, only 7 percent of the total landholdings report to have received any kind of subsidy.¹⁰⁰

For instance, the total cost of production in neighboring state of Bihar which itself is comparatively a poor state of India per hectare was about INR 45,000 (USD 670.52) in 2017 while the average cost of production in Nepal is between USD 884.71 and USD 1005.77 based on the size of land holding.^{101 102} These estimates suggest that the cost of production in Nepal is about 30 percent higher than the nearest neighboring Indian state. The differences make agriculture products in India cheaper than in Nepal. In addition to expensive transport costs and inefficient market linkages, agricultural goods from farm to table become expensive. Since similar commodities are available in the Indian market at lower rates, households as well as traders, resort to informal imports.

Moreover, India's food subsidy program, through its National Food Security Act (NFSA) 2013, sells rice at INR 3 per kg and wheat at INR 2 per kg to extremely poor households under its public distribution system (PDS) and since last year these cereals have been distributed for free. Those food stocks are also suspected to have made their way to Nepal through informal channels particularly from neighboring states like Bihar where NFSA has been offloading more grains than demanded, like rice in the case of Bihar or wheat in the case of West Bengal.¹⁰³ As discussed above, the presence of PDS rice in Nepalese mills could be traced through the presence of iron fortification in the rice which has been uniquely mandated (since April 2022) in all public programs in India, including its PDS.

Table 10: Expenditure by MoALD in subsidies.

Year	Expenditure by MoALD in subsidies (in NPR billion and USD in Million)	Expenditure on fertilizer procurement (in NPR billion and USD in Million)
2021/22	21.8 (203 USD)	16.6 (155 USD)
2020/21	19.6 (183 USD)	12.6 (117 USD)
2019/20	13.6 (127 USD)	10.5 (98 USD)
2018/19	12.29 (115 USD)	8.38 (78 USD)

Source: Different editions of Reports of Auditor General of Nepal¹⁰⁴

As demonstrated in the case of rice and sugar, these items are already cheaper in the Indian market, and informal imports to Nepal mean other duties can be circumvented. The traders can sell the products at domestic retail prices, expanding their profit margins. Even with 5 percent GST (imposed by India at retail purchase) for branded rice and sugar, their prices remain low.

A 25-kg sack of rice in India is USD 1.86 to 4.66 cheaper in India than in Nepal. Similarly, a kg of sugar was priced at about USD 0.70 in November at Rupaidiha in India and sold at USD 1.02 for a kg at retail outlets across the border in Nepalgunj. The major factor for informal imports by households was that the price on the Indian side was much lower. Traders also seem to be following a similar rationale and taking risks. This phenomenon is more prominent in food items such as packaged snacks like chips, crackers, soft drinks, and candies, which are cheaper in India, and get informally imported and sold at retail stores.

Moreover, price difference factors spur informal exports from Nepal as well. According to a few

⁹⁹ According to Report of Auditor General, Nepal spent NPR 21.8 billion was distributed by Ministry of Agriculture and Livestock Development in FY 2021/22 and the GDP of Nepal that year was NPR 4,933 billion.

¹⁰⁰ National Sample Census of Agriculture 2020/21

¹⁰¹ Singh, K.M. and Ahmad, Nasim and Pandey, Vagish Vandana and Kumari, Tulika and Singh, Ritambhara. 2021. Growth Performance and Profitability of Rice Production in India: An Assertive Analysis. MPRA Paper No. 110635 https://mpra.ub.uni-muenchen.de/110635/1/MPRA_paper_110635.pdf

¹⁰² Choudhary, Dyutiman, Kamal Banskota, Narayan Prasad Khanal, Andrew James McDonald, Timothy J. Krupnik, and Olaf Erenstein. 2022. "Rice Subsector Development and Farmer Efficiency in Nepal: Implications for Further Transformation and Food Security." *Frontiers in Sustainable Food System*. 5:740546. <https://doi/10.3389/fsufs.2021.740546>

¹⁰³ KISAN. 2022. Assessment of Major Issues and Policy Recommendations in Rice Sub-sector. Kathmandu: USAID.

¹⁰⁴ This figure does not include interest rate subsidy on selected agricultural loans.

traders, in the certain pockets of Karnali province, Nepali farmers sold their harvest to Indian traders that would get informally transported to India as they were offering about NPR 2 (USD 0.02) more than the domestic traders. Moreover, the MSP for paddy announced by the government was USD 0.30 per kg for coarse rice and USD 0.32 for finer variety and although this is supposed to be the minimum support price, in practice it acts as the ceiling.

5.6.4 Prohibitions and shortages

India's decision to halt export or to impose export duty is one of the major driving factors for informal trade. In the past three years, India has imposed prohibition on the export of staple items such as rice, paddy, wheat, sugar, and onions. According to traders, when India imposes a ban on formal exports, imports through informal routes have been increasing. When the Indian government banned the export of non-basmati rice in July 2023 the price of rice saw an upward spike in Nepal, but its supply has remained undisrupted.¹⁰⁵ Despite the formal ban on rice exports, retail shops in border towns still had stocks of packaged Indian brands of rice being sold at the markets on the Indian and Nepali sides with marginal price differences.

Similarly, India's ban on sugar and onion exports in the third quarter of 2023 was reflected immediately in Nepali markets. Prices of these items saw an upward shift and the incidence of informal imports went up. According to traders at Rupaidiha across Nepalgunj, after Nepal experienced a shortage of sugar in October 2023, the frequency of households going to the Indian side to procure sugar increased—the time being the festive season when sugar consumption is highest. Both instances triggered the run across the border. Similarly, despite India's ban on onion export, onion prices in Nepal peaked and then started to dip without any policy change. The informal traders wanted to take advantage of the price rise in Nepal and were channeling onions through informal exports to Nepal.¹⁰⁶

The chronic shortage of chemical fertilizers in Nepal also has left farmers dependent on informal imports of fertilizers from India during plantation season. Since the process of procuring fertilizer in Nepal through its state-owned trading companies takes a long time, distribution hardly occurs within the stipulated timelines.

The open border and ease of undertaking informal trade at the border render many such trade prohibition policies less effective. For example, the Government of Nepal prohibited the import of potato chips and other similar snacks between April and December 2022 to arrest its dwindling foreign reserve, but informal trade of these items still supplied them to the bordering towns in Nepal. According to the interviewees, the frequency of informal imports increases whenever there is a ban or rumors about the ban.

5.6.5 Lax border patrol

Strong border patrol authorities would prevent a large scale of informal trade happening across the border. In July 2023, the Nepal government decided to strictly enforce its rule of only allowing goods below the valuation of USD 0.93 through border crossings.¹⁰⁷ The USD 0.93 value was assessed based on the maximum retail price printed on the labels or the reference price determined by the Department of Customs. The rule already existed in the Customs Act 2064 but barely enforced. But the budget announcement for fiscal year 2023/24 stated that this rule will be strictly implemented directing the Customs administration and security forces. The rule was implemented for about a month at customs points such as Bairahawa but the enforcement had become relaxed around the festive season in October. According to Customs officials, they still have a level of scrutiny towards people who cross the Nepali border with shopping bags. Based on the size of the purchase and if the parcels appear to be for commercial sale, they charge applicable customs. With the possibilities

¹⁰⁵ Directorate General of Foreign Trade. 2023. "Notification No. 20/2023." Gazette of India Extraordinary, Part-II, Section-3, Sub-section (ii), July 20, 2023. https://apeda.gov.in/apedawebiste/DGFT_notificationfile/Notification_20_07_2023.pdf

¹⁰⁶ Post Report. 2024. "Onion price drops on hassle-free imports despite India's export ban." The Kathmandu Post, January 22, 2024. <https://kathmandupost.com/money/2024/01/22/onion-price-drops-on-hassle-free-imports-despite-india-s-export-ban>

¹⁰⁷ Shah, Deo Narayan, Madhav Dhungana, and Manoj Poudel. 2023. "Border shoppers moan at end of duty-free system." The Kathmandu Post, July 19, 2023. <https://kathmandupost.com/money/2023/07/19/border-shoppers-moan-at-end-of-duty-free-system>

of such leakages the border measures have tended to be lax and tight border security may not be possible unless incurring prohibitive costs.

At present, as per the Customs Act 2064, if a person is caught undertaking informal trade - the consignment of goods gets forfeited with a fine equal to the value of the forfeited goods, and the person transporting gets a prison term depending on the value of such informal consignments while the motor vehicle used for transportation is seized. In FY 21/22, the Department of Customs raised USD 27.9 million through auctions of such seized goods. They have recorded 10,282 cases of such informal imports. The customs administration admits that the numbers of cases that they apprehend are few compared to the actual informal trade that is happening.

In terms of large commercial informal trade that happens when the 'lines are opened', stricter leadership (at the security forces and district administration levels) could help curb that, according to well-informed sources the study team consulted at the border areas. This was demonstrated during the COVID-19 lockdowns when the implementation of prohibition orders saw informal trade plunging.

5.6.6 Socio-economic causes

Informal trade offers a livelihood to the population living near the border areas to ferry goods across the border as carriers or in other similar roles. As per the latest update on the minimum wage rate set by the federal government, the hourly wage for formal employment should be at least USD 0.83, and for part-time workers around USD 0.88 per hour. Consultations revealed that transporting a 25-kg bag of rice would yield at least USD 0.93, at varying rates depending on the severity of shortages, urgency, and the level of border enforcement. Carriers can transport approximately a quintal of goods on bicycles in one trip. They are trained to evade security forces and instructed on steps to take if apprehended.

Informal traders have developed efficient mechanisms to transfer goods across the border. While men use bicycles and old motorcycles to transport goods, women do the same on foot. Unless better income and employment opportunities are created to build their capacity, it would be difficult to shift them to alternative livelihoods. Easy availability of such couriers at relatively low rates has also helped informal trade flourish in the border areas.

¹⁰⁸ Department of Customs. 2023. "Annual Progress Report of FY 2022/23." Department of Customs. <https://customs.gov.np/storage/DoC/2080-81/Miscellaneous/Barsik%20Pragati%20Bibaran%202079-80.pdf>

¹⁰⁹ Government of Nepal, Gazette Notification dated 31 August 2023. Available here: <https://moless.gov.np/np/post/show/548>

6

SUMMARY OF THE PRODUCTS AND THEIR DRIVERS

6.1. Informal imports

Products	Nature of informal trade	Drivers of informal trade
Rice	<ul style="list-style-type: none"> All the respondents placed rice as one of the highly informally imported items. Studies undertaken on informal trade have placed rice at the top of the commodities informally traded between Nepal and India.¹¹⁰ India's export duty on rice imposed in September 2022 has further fueled the informal trade and export ban in July 2023 of non-basmati rice. 	<ul style="list-style-type: none"> Evasion of tariff and duties Variation in prices Ban on export
Vegetables: potatoes and onions	<ul style="list-style-type: none"> Vegetables are one of the major imported products from India to Nepal. Studies cite that informal trade of vegetable imports happen frequently between borders.¹¹¹ Studies have cases of Nepali vegetables being exported to India informally to circumvent SPS regulations.¹¹² Nepal imposed 13 percent VAT on import of potatoes, onions, and garlic at the Customs, which is attributed for surge in informal imports of these vegetables.¹¹³ India imposed export ban of onions in December 2023 after imposing 40 percent export duty in October 2023.¹¹⁴ 	<ul style="list-style-type: none"> Evasion of tariff and duties Variation in prices Ban on exports. Avoidance of non-tariff requirements—phytosanitary certificates
Seeds	<ul style="list-style-type: none"> Farmers in Nepal informally import seeds of varieties not available locally—especially hybrid seeds of vegetables. 	<ul style="list-style-type: none"> Restricted import Avoidance of non-tariff requirements
Chemical fertilizers (Urea and Diammonium Phosphate)	<ul style="list-style-type: none"> Persistent chemical fertilizer shortage domestically has left farmers dependent on informal imports from India. Price per kg is cheaper in Indian side. 	<ul style="list-style-type: none"> Shortage in domestic market Variation in prices
Others: Cumin, cashews, poultry etc.	<ul style="list-style-type: none"> These products see a surge in informal imports prompted by price differences between the markets. Restrictive tariff on certain items such as cashew nuts, traders resort to discrepancies about reference price fixed by the Department of Customs Informal imports of certain products witness seasonal spikes during festive seasons. 	<ul style="list-style-type: none"> Avoidance of non-tariff requirements Reference price fixed by Department of Customs does not match with the market price, hence, issues with valuation at the customs declaration. Avoidance of tariff and duties

¹¹⁰ Karmacharya, B.K. 2010. "A Study on Cross-border Informal Trade between Nepal and India on Selected Agricultural Commodities." National Council for Development Research, Kathmandu.

¹¹¹ SAWTEE. 2017. Export Potential of Fresh Vegetables to India and Other Countries. Kathmandu: South Asia Watch on Trade, Economics and Environment. <https://sawtee.org/publications/Policy-Brief-33.pdf> Adhikari, B. and A. Pokhrel. 2020. "Analysis on Production, Import, and Export of Vegetable Sub-Sector in Nepal". Journal of the Institute of Agriculture and Animal Science 36: 53-62.

¹¹² https://necs.org.np/wp-content/uploads/2022/03/02_Identifying-Trade-Deficit-Reduction-Strategies-for-Fresh-Vegetables-in-Nepal.pdf Singh, Dikshya. 2018. "Nepal-India informal trade in agricultural inputs Evidence from a small-scale survey." South Asia Watch on Trade, Economics and Environment (SAWTEE). No.2, 2018. <https://sawtee.org/publications/Research-Brief-7.pdf>

¹¹³ Republica. 2023. "VAT on potato and onion fuels smuggling and market price increase". Republica, 23 June 2023. <https://myrepublica.nagariknetwork.com/news/vat-on-potato-and-onion-fuels-smuggling-and-market-price-increase/>

¹¹⁴ Directorate General of Foreign Trade Notification No 49/2023 <https://content.dgft.gov.in/Website/dgftprod/7a0297d6-4c65-4129-8008-97dd3b5a7c28/Notification%20No%2049-2023-English.pdf>

6.2. Informal exports

Products	Nature of informal trade	Drivers of informal trade
Vegetables	<ul style="list-style-type: none"> Vegetables such as tomatoes, chayote, certain varieties of chilly are informally exported to India to circumvent SPS-related requirements. 	<ul style="list-style-type: none"> Variation in prices Avoidance of non-tariff requirements—phytosanitary certificates
Paddy	<ul style="list-style-type: none"> If price offered in India is higher, farmers in some bordering villages sell them to Indian traders. 	<ul style="list-style-type: none"> Variation in prices
Betel nuts	<ul style="list-style-type: none"> Betel nuts (or acacia nuts) export to India has been a contentious issue from a long time. Nepali exporters are suspected to be exporting third-country betel nuts as Nepali product to India. Since betel nuts are scrutinized more instances of informal export of betel nuts are reported frequently. 	<ul style="list-style-type: none"> Benefits from avoiding tariff imposed by India

7

WOMEN'S INVOLVEMENT AS CARRIERS

Throughout the literature on informal trade in the South Asian region, it was noted that women were involved in the lowest value chains of trade.¹¹⁵ A report estimated that 82 percent of working women in India were involved in the informal sector and, in Nepal, 90.5 percent of the women engaged in informal employment.¹¹⁶ The literature on the informal sector in South Asia stated that women often resorted to informal trading due to lack of opportunities, lower participation in the economy, lack of empowerment, and lack of gender friendly institutions and infrastructure in trade in South Asia.¹¹⁸ The female labor force participation rate (FLFP) is only 27.9 percent compared to 55 percent of the male labor force participation rate. The disparity is even bigger in India where the FLFP is 28.3 percent compared to 76.1 percent for its male counterpart.¹¹⁹

As most women are involved at the lower level of the value chain, even in informal trade, most women in the border areas are often employed as carriers. It was noted during the field visit that people with disabilities were also employed as carriers. Carrying is often regarded as an act of informally concealing items for use for household goods and then selling them to the traders without paying the required duties. The clemency shown by border patrols towards women also encouraged traders to employ

them as carriers.¹²⁰

During the field visit to various border cities, it was noted that carrying is seen by women as a full-time profession and mostly women are employed as carriers by the traders. Daily essential items such as sugar, dry fruits and spices which are high-value goods and levied with high duties were found to be carried by women from India to Nepal. They often made five to ten trips to and from the border markets within a day to bring these goods, concealing them as items for household consumption, which are exempted from import duties in Nepal.

Many customs patrol officials stated that it was difficult to convict them of smuggling as it was mostly stated that the goods were only for household consumption and not trade. The women who are employed as carriers live very close to the border and often belong to poor families with little to no formal education. Most traders hire large groups of such women to work as carriers and they often work with groups of women. It was found that children were also used to carry goods, especially small toys, garments, and ready-made snack items from India to Nepal. The carriers made anywhere from USD 4.66 to 23.3 per day smuggling goods, which is considered decent income for people in Nepal.¹²¹

¹¹⁵ Singla, Nikita. 2023. Women Are Missing from India's Border Trade. The Asia Foundation <https://asiafoundation.org/2023/07/12/women-are-missing-from-indias-border-trade/>

Livani, T., & Solotaroff, J. Promoting Women's Participation in Cross-border Trade in South Asia. 2019. ANTYAJAA: Indian Journal of Women and Social Change, 4(1), 9-32. <https://doi.org/10.1177/2455632719832208>

¹¹⁶ The Diplomat. India Must Protect the 150 Million Women in the Informal Sector. The Diplomat 23 March 2023 <https://thediplomat.com/2023/03/india-must-protect-the-150-million-women-in-the-informal-sector/#:~:text=As%20per%20a%202018%20International,street%20vending%20and%20so%20on.>

¹¹⁷ Central Bureau of Statistics. 2019. Report on the Nepal Labour Force Survey 2017/18. Kathmandu: Central Bureau of Statistics, Government of Nepal. https://nepalindata.com/media/resources/items/20/bNLFS-III_Final-Report.pdf

¹¹⁸ The World Bank. 2023. Women in Trade: A spotlight on Eastern South Asia. <https://documents1.worldbank.org/curated/en/810701611321529668/pdf/Women-in-Trade-A-Spotlight-on-Eastern-South-Asia.pdf>

¹¹⁹ Human Development Report 2023-24 UNDP <https://www.undp.org/nepal/publications/human-development-report-2023-24>

¹²⁰ Women highly active in informal trade with India: Sawtee report, 2017 https://sawtee.org/media_coverage/kathmandupost-2017-5-3.pdf

¹²¹ Based in the field observation.

Some customs officials in the bordering cities even stated that when the informal carriers are caught by the border patrols, the traders who have employed them come and pay their dues and free them from prosecution. It was also noted that the risk of getting caught was mostly incurred by the women carriers rather than the traders who employ them.

We noted that people with disabilities with disability cycles were also heavily involved in informal trade. They attached carts with their cycles to carry larger quantities of goods from the border, also concealed as household consumption goods. Customs officials stated that it was very hard to punish people with disabilities engaging in informal trade as it was their only source of income for their families which has put them into high demand as carriers.

The carriers of goods engaged in informal trade between Nepal and India used both formal channels (big and small customs points) and easy entry points with no border patrol due to the porous border. The presence of small borders and porous points has made it easy for carriers to carry out their operation. The modes of transportation used were often foot by women, cycles by some women and disabled-friendly

cycles/carts by people with disability. Motorbikes were usually used by comparatively large carriers.

To curb the growing informality in the bordering cities which has affected the businesses this side of the border.¹²² The Nepal government in the last fiscal year had tightened the border area where any goods above USD 0.93 were taxed by the customs officials. Although this reduced informal trading it also significantly reduced formal trade. According to the customs officials, it was estimated that the number of footfalls dropped from 500 to 50 daily due to the tight regulations and patrolling. This also significantly reduced the revenue collected by the Nepali customs offices. The tightening of the border was met with hostility from both sides of the border. The locals of the bordering cities in Nepal also reported that this regulation increased the price of goods by the local business as the competition from the Indian traders was significantly reduced.¹²³ Stricter measures seemed to have reduced trade and government revenue overall, therefore other alternatives such as facilitating gender-friendly trade, quasi-formal trade, creating better trade infrastructure and institutions and also empowering women in trade to manage informality seem to be better alternatives.

¹²² Kharbarhub. 2023. अवैध व्यापारले सीमा क्षेत्रमा नेपाली उद्योगी व्यवसायी संकटमा [Nepali businesses at border areas suffer due to illegal trade]. Kharbarhub, 3 March 2023. <https://kharbarhub.com/2023/04/481982/>

Halo Khabar. 2023. अवैध व्यापार नियन्त्रण गर्न गृहमन्त्रीलाई चेम्बरको आग्रह [Chambers requests home minister to control illegal trade]. Halo Khabar, 4 January 2023. https://halokhabar.com/news-details/12419/UCrzddx-YIDNqSjzR-bCTvdg?view_as=subscriber

¹²³ Post Report. 2023. Border shoppers moan at end of duty-free system. The Kathmandu Post 19 July 2023. <https://kathmandupost.com/money/2023/07/19/border-shoppers-moan-at-end-of-duty-free-system>

8

DISCUSSION

8.1. Discussion

Informal trade of agricultural products between Nepal and India has prevented consumers from experiencing shortages to an extent and helped create income for a certain groups of people, but it is considered as one of the reasons for eroding the productive capacity of domestic farmers and processors. Rampant informal import of cereals, and vegetables due to lower prices has made Nepali local production uncompetitive, with farmers struggling to find a market and acceptable rates for their products. In addition, goods transported outside regulation might also bring sanitary and phytosanitary issues and may prove to be hazardous. In addition, the government loses out on revenue when customs are bypassed. In the case of re-export through the informal channel of goods imported from other countries, as in the case of betel nuts, the country may also lose out on foreign currency.

Some stylized facts emerge from this study. At the outset, the informal trade of agricultural food commodities, including inputs, has increased access to those products. The products that could not be exported from India due to formal export ban (rice, onions) or products requiring added permits (sugar) are being accessed by the consumers in Nepal. The benefits of getting access to erstwhile banned commodities are further enhanced by the fact that products from India that cross the border through informal channels are cheaper than formally imported ones. A trader has expressed that informal trade has been instrumental in keeping prices of essential items such as rice and sugar low and, therefore, has helped keep inflation under control. This statement could appear to be true at face value but whether that really is a case needs to consider the implicit cost of informal trade borne by the state in the foregone revenue, increased investment in border patrol forces, stifling of domestic production and distribution nexus and

offsetting of policies and reducing their effectiveness.

Even if the statement as such is true lower prices across the border do not always translate into lower prices for the consumers, as in the case of chemical fertilizers. There is a significant issue of price transmission that depends on the market structure. Except for the farmers who go and procure their own supplies from the Indian market themselves, other farmers are charged almost at par with the domestic price. As pointed out by the fertilizer supplier in Dang, they were selling urea at an added premium price to cover incurred costs and generate profit.

Moreover, one of the most concerning aspects of the informal trade of agricultural products is the impact on domestic production. The rice processing industry in Nepal may be a victim of informal imports of rice. According to an estimate, one-third of Nepal's rice mills had to shut down as they could not compete with processors that were selling repackaged informally imported rice.¹²⁴ This sentiment was echoed by rice millers interviewed for the study as they find remaining competitive a challenge. For processors buying paddy at the prevalent rate in the domestic market and incurring processing expenses and then trying to sell at a price that could compete with informally imported rice does not leave enough margins. This tendency affects the whole supply chain as the traders seek to reduce the buying price of paddy. This further discourages farmers from switching to commercial farming of paddy from coarse varieties to finer rice cultivation if there were no guarantee that they would fetch a good price from the traders.

Informal imports of agricultural products also render government policy ineffective as policy intent does not get realized while the government ends up losing any revenue. This is evident in the case of items such as sugar where high tariffs were imposed to discourage

¹²⁴ Joshi, K., Upadhyay, S., Chaudhary, P., Shrestha, S., Bhattarai, K. and Tripathi, B. (2020) The Rice Processing Industry in Nepal: Constraints and Opportunities. *Agricultural Sciences*, 11, 1060-1080. doi: 10.4236/as.2020.1111069.

imports and to boost domestic industries. Rampant informal imports from across the border defeated the policy. Similarly, the imposition of 13 percent VAT on imports of potatoes, onions and garlic was intended to provide a competitive advantage in terms of price to domestic farmers. However, the provision is suspected to have fueled informal trade as cargoes get diverted to informal channels to avoid additional 13 percent duty, findings from the field suggest.

Not only has rampant informal trade made fiscal measures to boost agriculture productivity ineffective, it also has set in a sort of policy complacency. This is more evident in the case of chemical fertilizers. The amount of chemical fertilizer estimated as requirement for Nepal (500,000 to 750,000 MT) is nearly 20 to 50 percent less than the actual volume procured every year. In addition, the procurement process gets delayed despite the farming calendar being certain. Since informal imports from India do help in meeting the deficit and shortages, there may be lack of urgency and policy lag to solve the chemical fertilizer crisis that affects the agriculture sector every year in Nepal.

One of the drivers of informal trade is the opportunity such channels provide to avoid regulatory requirements, especially plant quarantine-related phytosanitary tests and certificates. The regulatory requirements are often recognized as a non-tariff

barrier as they are costly and time-consuming. These regulations are in place to prevent any harm to plant, animal, and human health due to pests, pesticides and other factors that could be present in the agricultural food commodities being brought to Nepal. Informal trade renders the attempt to block pest movement through phytosanitary control that is imposed on formal trade ineffective. In the case of seeds, such informal import that does not adhere to certification requirements could have a major impact on farm productivity and even on the ecosystem. Moreover, there is no quality guarantee on the items imported too.

Informal trade is being carried out by vulnerable people on the ground. These people take up the role of carriers to earn a livelihood. The informal trade encourages more people to get involved in such activities that by law are prohibited and treated as criminal offenses. Carriers are always at risk of being apprehended and are at the mercy of their employer to bail them out. With unwritten work contracts informal trade is beset with significant asymmetry in bargaining power against those engaging in low end jobs. Even if not arrested they are susceptible to harassment at the border. Moreover, it is evident that informal trade is enabled by paying bribes to the border patrol forces and other authorities involved, informal trade has emerged as a governance issue and creates hindrance in curbing corruption.



WAY FORWARD

Informal trade is considered as 'a wicked problem'. In the realm of planning and policy, a wicked problem denotes a challenge that proves exceedingly difficult or even impossible to resolve due to factors such as incomplete, contradictory, and fluctuating requirements. This term describes an issue or dilemma that defies easy fixes, lacking a singular solution, with "wicked" connoting a formidable resistance to resolution. Informal trade has helped meet Nepal's food demand while making available essential inputs such as fertilizers and seeds when needed. However, these activities foil the policy intent by making them ineffective. Given the open border with India, the elimination of informal trade does not seem possible and given the circumstance, it may not be desirable. However, allowing the free flow of informal trade or eliminating tariffs and non-tariff requirements may also not be possible as government revenue depends upon imports. There might be middle ground in quasi-formal trade as is being implemented in several cases including Bangladesh-India trade.

The most important and potent force for reallocating trade towards formal channels would entail derisking trade that is embedded in policy certainty (both at and within border). Investing in formal trade requires key infrastructure and institutions. If policies remain less predictable, there will always be a spur towards informal trade. Given these circumstances, some policy recommendations that could help manage and tackle the possible problems by informal trade in agricultural food products are listed below.

- More accurate and comprehensive research and data are needed commodity-wise as the nature and drivers of informal trade vary depending on a commodity and situation. Being aware of the nature and drivers could help anticipate the response to the policy changes and assess how effective the interventions could be.
- Rationalize regulatory barriers where possible to remove the incentive to circumvent formal trade channels and institute quasi formal trade with some regulatory and quality control.
- Bring in trade and domestic policy certainty as unpredictability in policy leads to informal trading over formal trading.
- Harmonize the sanitary and phytosanitary requirements between the two countries and mutually recognize the certificates issued by one country's regulatory body for faster and hassle-free movement of agricultural food products.
- In case of seeds, Nepal and India could harmonize their seed certification system so that seeds certified by one country get automatically certified in another country.
- Implement trade facilitation measures to ensure seamless movement of products so that traders would not seek informal channels to move their goods faster.
- Provision should be made to allow farmers to directly sell their fresh produce, green vegetables, across the border up to a certain quantity without an easier to navigate regulatory requirement. This would provide a market for the surplus produce to benefit farmers.
- Nepal government may need to revise the rule under which people crossing customs points from India are allowed to bring goods worth USD 0.93 value without imposition of any duties.
- Rationalize tariffs and other duties of the products that are most informally imported.
- A comprehensive assessment of the supply chain of major informally traded agricultural food products such as rice and seeds need to be undertaken to understand the reasons and implications of informal trade in the whole agro-processing ecosystem. This would help design policy interventions accordingly.
- Fertilizer procurement needs to be undertaken on time and to ensure smooth distribution.
- In case of export bans imposed by India, Nepal needs to negotiate promptly with Indian authorities to ensure supply to Nepal is not disrupted.

ANNEXURE

IFPRI–USAID Project 2023–24: Survey Questionnaire

Informal Cross Border Agricultural Trade between Nepal and India

Introductory Information

Good morning/Good afternoon. My name is _____. I am from _____ (City, Country) and work with _____ (organization). We are working on gathering, assessing, and analyzing evidence and developing key thematic areas for revisions to the Nepal Global Food Security Strategy (GFSS) Country Plan. We are conducting these In-depth interviews with key stakeholders like you who have been an integral part of the GFSS country plan for Nepal. The purpose of our research is to identify new potential elements to be included in an updated Country Plan. Your ideas can help us plan better and strengthen the document that is being revised. The information you share will help us in assessing accordingly and will help in providing inputs to update Nepal's existing plan.

This interaction usually takes around 30–45 minutes to complete. The information provided by you will be kept strictly confidential and will not be shared with anybody else.

_____ Observer/reporter's will be writing down some of the things that we will be talking about so we can remember them later. Hope this is okay with you. We are the only ones who will know your names, we will not use any names in our reports.

I greatly appreciate for your valuable time from your tight schedule to meet me to answer my questions.

Protocol and Consent

The IFPRI team and South Asia Watch on Trade, Economics and Environment (SAWTEE) team starts the in-person qualitative-cum-quantitative survey of the stakeholders such as local traders in border areas, wholesalers (exporter and importer), local/community leaders from the area/block/division, a representative from a female group, expert elicitation (senior citizen), head of the trader's union, market leaders, teachers, security personnel (police and border security forces), transporter, custom house agents, and local people by visiting the India–Nepal borders and ports. For each stakeholder, the IFPRI and SAWTEE team will make 2–3 attempts, at least 3 hours apart. At least two attempts need to be made in the morning and at least two in the afternoon/evening. The IFPRI and SAWTEE team will log each attempt, noting why the qualitative interview could not be completed. If the stakeholders cannot be reached after 3 attempts, it will be dropped from the study for a particular border point/port.

When a IFPRI and SAWTEE team successfully approach to the stakeholders, IFPRI and SAWTEE team will be wearing a mask and will maintain 2–6 meters distance from the stakeholders. The consent portion of the survey questionnaire will be read out loud to the respondent. The consent form addresses all major elements of informed consent, including that participation is completely voluntary and that participants are welcome to stop participating at any time. IFPRI and SAWTEE team will be trained to understand the purpose and content

of informed consent, to read the informed consent statement to respondents, and to answer respondents' questions about the survey or informed consent. The consent form also explains that every effort will be made to ensure that any information respondents share with the research team is kept private and confidential. IFPRI and SAWTEE team will explain that the interview will take approximately 30–45 minutes. Respondents will also be notified that if they consent to participate, they may be contacted to participate in similar follow-up surveys (if any in future). While the survey does not present any risks to the participants, some participants may become upset when reflecting upon the impacts of Coronavirus. Participants will be notified of this before they agree to participate in the survey. Participants will also be notified that while their participation in this study may not benefit them directly, the information provided may help the government evaluate the trade policies and help in the design of policy. Only respondents who provide informed consent will be asked questions or measured. The respondents will indicate consent orally, which will be documented by the IFPRI and SAWTEE team.

Questions in the survey are related to answer the broad objectives of the study. Your participation is highly appreciated. If you have questions about the research in general or about your role in the study, about your rights as a participant in this study you may contact the IFPRI Institutional Review Board (att. Olivette Burton – IRB coordinator) that protects the rights of study participants. You can contact the IRB at Tel: +001 202-862-5600 or ifpri-irb@cgiar.org. Do you have any questions about this interview/research?

Do you have any query about the survey or what I have said?

Are you willing to participate in this survey? (1 – Yes, 2 – No)

If no, then skip the interview (Please go to another member from the list)

If yes, then please start the interview

Note for the interviewer – The following is a guide. Further try to ask all the questions below in the order given, but it is more important to maintain the flow of discussion. Suggested probes have been included.

The response group should include:

1. Knowledgeable persons
2. Formal Traders
3. Retired officials from Customs/Border Security
4. Transporters (truck agencies and drivers)
5. Informal goods carriers
6. Agents organizing informal trade
7. CHAs and Forwarders

Time period in consideration: April 2022 to March 2023

India–Nepal Border Points

S. No.	India–Nepal Border Points		Tick the relevant option
	India Side	Nepal Side	
1)	Banbasa in Champawat district, Uttarakhand	Kanchanpur District, Sudurpashchim Province	
2)	Rupaidiha in Bahraich district, Uttar Pradesh	Nepalganj in Banke District	
3)	Sonauli in Maharajganj district, Uttar Pradesh	Belahia, Siddharthanagar in Rupandehi District	
4)	Raxaul in East Champaran district, Bihar	Birgunj (also known as the 'Gateway of Nepal')	
5)	Bhitthamore in Sitamarhi district, Bihar	Malibara, Jaleswar in Mahottari District	
6)	Jogbani in Araria district, Bihar	Biratnagar, Nepal	
7)	Panitanki in Darjeeling district, West Bengal	Kakarbhitta, Nepal	
8)	Custom Ports	Custom Ports	

I. Informal Exports

1. About traders and trade

I.1. What is the number of Indian and Nepalese carriers engaged in informal export through this location/market and since when they are engaged in these activities? (Provide range)

I.2. Do carriers and agents undertake both informal export and import and how are contract enforced and failures managed? Explain.

I.3. What is the number of agents organized in informal export at this location/market? (Provide range)

I.4. How the trade has changed after due to the following:

- NFSA
- Nepal Blockade 2015
- GST
- Covid – Lockdown
- Russia–Ukraine

I.5. What is the proportion of Indian and Nepali carriers?

Origin	Proportion of carriers (%)
Indian	
Nepali	
	100%

I.6. How many large informal exporters/agents are there in this location? (Provide range)

I.7. What items (agricultural commodities and agricultural inputs) are informally exported from this location?

Items	Values (INR or Nepali Rupee)

1.8. Which are perishable items (fresh vegetables, meat, fish)? What special care is taken to move such goods?

1.9. How was informal export impacted after COVID-19 and Russia–Ukraine War?

2. Reasons for not exporting formally:

S.No.	Reasons	Rank in order: 1 to 9, 1 = most important
1.	High duties/tariff in India	
2.	Delays at formal border post	
3.	Perishable nature of items	
4.	Ban on goods exported from India to Nepal	
5.	Difficulty in meeting India's regulations and standards	
6.	Not Registered for EXIM Code	
7.	Complicated procedures and documentation	
8.	Lack of awareness about export policies	
9.	Difficulty in getting credit guarantees from bank officials	
10.	Difficulty in making payments through banks	
11.	Others? (Please specify)	

3. Modalities of Informal trade:

3.1. Route

3.1.1. Which is the route used? (Tick the relevant option)

Riverine	
Land	

3.1.2. Which mode of transport do you use to cross the border? (Tick the relevant option)

Foot	
Cycle	
Motor transport	
Others (Please specify)	

3.1.3. Do these routes change frequently? If so, is it because of (Tick the relevant option)

New route is cheaper	
Less security forces	
Better link between suppliers and markets	

3.1.4. How much time does it take to cross the border with informal consignment? (In hours)

3.1.5. How has road and rail connectivity improvement impacted informal trade?

3.2. Risk

3.3.2. How is information obtained on commodities and quantities to be exported? (Tick the relevant options)

Formal channels	
Personal trips	
Distribution networks	
Official media	
Enforcement agencies	
Trade fairs	
Use of phone calls (WhatsApp/messenger apps)	
Others (Please specify)	

3.2.1. In every 100 trade deals, what are the chances of goods being seized?

< 3 times	
3–5 times	
5 to 10 times	
10 to 20 times	
> 20 times	

3.2.2. How is the penalty determined? (Tick the relevant option)

Basis of value	
Uniform rate	

3.3. Information network

3.3.1. How are goods sourced?

State in India	Proportion (%)
Uttar Pradesh	
Bihar	
West Bengal	
Uttarakhand	
Others (Please specify)	
	100%

3.4. Fencing and boundaries

3.4.1. How effective is the fencing (border patrols) in the area?

3.4.2. How has fencing along the Indo–Nepal border impacted informal export? Has informal export increased or decreased since then?

3.4.3. Once the enclaves were formally exchanged between India and Nepal has it made any difference to informal export?

4. Price discovery

4.1. How are prices for agriculture items determined for informal trading?

4.2. Do they follow prices in formal markets?

4.3. Does formal market follow informal market pricing?

5. Governance structure

5.1. Do formal and informal agencies work together?

(For example, on the Indo–Bhutan border at Gelephu there is an informal market where security agencies provide security to the informal traders. Also, informal traders have an association which takes the responsibility for smooth functioning of the market)

5.2. Is there any informal association of traders/carriers/agents who trade informally? What is their role and how do they function?

6. Distribution of Informally Exported Goods

6.1. What proportion of exported goods are third country goods?

Third Country Name	Proportion (%)
India	
China	
Bhutan	
Others	
	100%

6.2. Who are the exported goods sold to?

	Proportion (%)
Agents	
Wholesalers	
Directly to markets	
	100%

II. Informal Import

1. About traders and trade

I.1. What is the number of Indian and Nepalese carriers engaged in informal import through this location/market and since when they are engaged in these activities? (Provide range)

I.2. Do carriers and agents undertake both informal export and import and how are contract enforced and failures managed? Explain.

I.3. What is the number of agents organized in informal import at this location/market? (Provide range)

I.4. How the trade has changed after due to the following:

- a. NFSA
- b. Nepal Blockade 2015
- c. GST
- d. Covid – Lockdown
- e. Russia–Ukraine

I.5. What is the proportion of Indian and Nepali carriers?

Origin	Proportion of carriers (%)
Indian	
Nepali	
	100%

I.6. How many large informal importers/agents are there in this location? (Provide range)

I.7. What items (agricultural commodities and agricultural inputs) are imported from this location?

Items	Values (INR or Nepali Rupee)

I.8. Which are perishable items (fresh vegetables, meat, fish)? What special care is taken to move such goods?

I.9. How was informal import impacted after COVID-19 and Russia–Ukraine War?

2. Reasons for not importing formally:

S.No.	Reason	Rank in order 1 to 9, 1=most important	
1.	High duties/tariff in Nepal		
2.	Delays at formal border post		
3.	Perishable nature of items		
4.	Ban on goods exported from Nepal to India		
5.	Difficulty in meeting Nepal's regulations and standards		
6.	Not Registered for EXIM Code		
7.	Complicated procedures and documentation		
8.	Lack of awareness about export policies		
9.	Difficulty in getting credit guarantees from bank officials		
10.	Difficulty in making payments through banks		
11.	Others? (Please specify)		

3. Modalities of Informal trade:

3.1. Route

3.1.1. Which is the route used? (Tick the relevant option)

Riverine	
Land	

3.1.2. Which mode of transport do you use to cross the border? (Tick the relevant option)

Foot	
Cycle	
Motor transport	
Others (Please specify)	

3.1.3. Do these routes change frequently? If so, is it because of (Tick the relevant option)

New route is cheaper	
Less security forces	
Better link between suppliers and markets	

3.1.4. How much time does it take to cross the border? (In hours)

3.1.5. How has road and rail connectivity improvement impacted informal import?

3.2. Risk

3.2.1 In every 100 trade deals, what are the chances of goods being seized?

< 3 times	
3–5 times	
5 to 10 times	
10 to 20 times	
> 20 times	

3.2.2. How is the penalty determined? (Tick the relevant option)

Basis of value	
Uniform rate	

State in India	Proportion (%)
Uttar Pradesh	
Bihar	
West Bengal	
Uttarakhand	
Others (Please specify)	
	100%

3.3.2 How is information obtained on commodities and quantities to be imported? (Tick the relevant options)

Formal channels	
Personal trips	
Distribution networks	
Official media	
Enforcement agencies	
Trade fairs	
Use of phone calls (WhatsApp/messenger apps)	
Others (Please specify)	

3.4. Fencing and boundaries

3.4.1. How effective is the fencing (border patrols) in the area?

3.4.2. How has fencing along the Indo–Nepal border impacted informal import? Has informal import increased or decreased since then?

3.4.3. Once the enclaves were formally exchanged between India and Nepal has it made any difference to informal import?

4. Price discovery

- 4.1. How are prices for agriculture items determined for informal trading?
- 4.2. Do they follow prices in formal markets?
- 4.3. Does formal market follow informal market pricing?

5. Governance structure

- 5.1. Do formal and informal agencies work together?

(For example, on the Indo–Bhutan border at Gelephu there is an informal market where security agencies provide security to the informal traders. Also, informal traders have an association which takes the responsibility for smooth functioning of the market)

- 5.2. Is there any informal association of traders/carriers/agents who trade informally? What is their role and how do they function?

6. Distribution of Informally Imported Goods

- 6.1. What proportion of imported goods are third country goods?

Third Country Name	Proportion (%)
Nepal	
China	
Bhutan	
Others	
	100%

- 6.2. Who are the imported goods sold to?

	Proportion (%)
Agents	
Wholesalers	
Directly to markets	
	100%



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