

Current Trends and Status of Informal Cross-Border Trade in Eastern Nepal

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ABSTRACT

Cross-border trade is a defining feature of Nepal's border economy, particularly in the Nepal-India border. A large share of this trade operates informally outside official customs procedures and remains central to local livelihoods and the local economy. This study examines the current trends and status, nature, scale, modes of operation, and implications of informal cross-border trade in Eastern Nepal, drawing on primary survey data from 145 respondents in border-adjacent communities, as well as interviews, observations, and secondary sources. The research adopts a descriptive and analytical approach to explore socio-demographic characteristics, border-crossing patterns, traded goods, causes of informality, border-related challenges, and perceived income effects. The findings reveal that the local community's cross-border trade is predominantly small-scale and occasional, with most respondents reporting monthly trade values below NPR 50,000. In informal trade, household goods predominate, and nearly three-quarters of respondents reported engaging in or being exposed to trade without customs clearance. Informality is driven mainly by small trade volumes, high taxes, and complex customs procedures. While informal trade also contributes positively to income for some households, its overall impact on the respondents' livelihoods is mixed. The study concludes that simplified customs procedures, reduced taxes, and trader-friendly border governance are essential to promote inclusive and sustainable cross-border trade in Eastern Nepal.

Keywords: Cross-border trade; Informal economy; Nepal–India open border; Livelihoods; Border governance in eastern Nepal; Trend analysis.

INTRODUCTION

Cross-border trade plays a vital role in mobilising the economy, improving livelihoods, and expanding market access for border regions in developing countries such as Nepal. In South Asia, many countries share cultural ties, open or semi-open borders, and economic asymmetries that have fostered formal and informal trade flows. Nepal, which shares an open border with, is a notable example in which both countries permit the free movement of people and goods with only minimal restrictions. The open border supports local economic activity but also affects the expansion of informal cross-border trade, which is not recorded in official statistics.

Nepal's economy is highly dependent on trade with neighbouring country India to sustain livelihoods in the border regions. Cross-border exchanges have great significance. For landlocked economies such as Nepal, cross-border trade serves as an important mechanism for income generation, employment, and access to goods not readily available in the domestic market (Ahmed, 2017). While formal trade is well-regulated, a significant portion of commerce occurs through informal channels, circumventing official procedures, customs regulations, and taxation. Informal trade is influenced by multiple factors, including institutional inefficiencies, economic pressures, and governance challenges, which can vary across Nepal–India and Nepal–Bhutan border points (Ahmed, 2017; Pant & Maharjan, 2019). In regions with limited employment opportunities, small-scale cross-border traders often rely on cross-border trade to support their livelihoods, thereby contributing to household welfare and local economic circulation (UNESCAP, 2020).

The informal economy refers to economic activities that are neither regulated nor protected by formal legal and economic institutions, although they can be legitimate livelihood strategies (International Labour Organisation

[ILO], 2018). In the context of cross-border trade, informality often arises from the interaction of regulatory complexity, procedural barriers, and the high cost of formal compliance (Skinner, 2018). Studies in South Asia and sub-Saharan Africa show that small traders frequently use informal channels to avoid lengthy customs procedures, excessive documentation, and unpredictable fees at border points (Titeca & de Herdt, 2010; Braga, 2021). While participation in the informal economy may reduce immediate transaction costs, it also exposes traders to greater legal uncertainty, weaker access to formal credit, and limited social protection (Chen, 2012).

In Nepal, the eastern border with India is open, connecting to the two Indian states of West Bengal and Bihar. The eastern border hosts significant cross-border trade and strong historical socio-economic ties. Several Formal policies, such as the South Asian Free Trade Agreement (SAFTA), have emphasised the modernisation of customs and the facilitation of trade. However, micro-level studies of small traders remain limited (Pant & Maharjan, 2019). Evidence from past research indicates that procedural delays, informal payments, and limited access to trade infrastructure significantly affect trade behaviour at Nepal's borders (Gartaula et al., 2015). However, most existing literature has focused on the effects of border trade policy on macroeconomic indicators, with less attention to microeconomic indicators and ground-level informality.

This gap is localised, and the observed evidence limits policymakers' ability to design trade policies that address the needs of small and informal traders and strengthen formal compliance. Past research argues that understanding the motivations and constraints of informal traders is essential for designing effective border management strategies (Goreux & Robles, 2012). Without such specific insight, border governance reforms may unintentionally fortify informality rather than replacing it, underscoring the need for targeted policy interventions.

Against this background, the present study examines current trends of cross-border trade and the informal economy in eastern Nepal, with a primary focus on Jhapa District. The study investigates procedural, tax-related, and governance factors influencing small buyers and traders in informal markets. By generating small-buyer and small-trader-level empirical data from an active border region, this research contributes to the literature on informal economies. It provides evidence-based recommendations for improving trade facilitation and economic inclusion in Nepal, particularly along the Nepal-India open border, while emphasising the livelihoods of border community residents.

LITERATURE REVIEW

The informal economy is increasingly recognized not as a marginal or illegal sector, but as a structural manifestation of institutional gaps and limited employment opportunities in developing economies (Chen, 2012; ILO, 2018). Within this context, Informal Cross-Border Trade (ICBT) encompasses transactions occurring outside official channels or involving "quasi-formal" practices, such as under-declaration and the avoidance of customs documentation (Lesser & Moisé-Leeman, 2009). Theoretically, this phenomenon is best understood through the lenses of Institutional Theory and Transaction Cost Theory. North (1990) posits that economic behavior is a rational response to the interplay between formal rules and informal norms; when formal institutions are inefficient or predatory, informal practices emerge as a survival strategy. Furthermore, transaction cost perspectives suggest that traders opt for informal channels to minimize the prohibitive time, effort, and monetary costs associated with regulatory compliance (Coase, 1937; Williamson, 1985).

Empirical research identifies a triad of procedural, fiscal, and governance-related drivers that sustain ICBT. Procedural complexities—characterized by excessive documentation and unpredictable delays—disproportionately burden small-scale traders who lack the capital and specialized knowledge to navigate formal customs (Moisé & Sorescu, 2013). This burden often outweighs the impact of actual tax rates; however, when customs valuations and administrative fees are perceived as arbitrary or excessive, they further incentivize the splitting of consignments and the use of informal crossings (Lesser & Moisé-Leeman, 2009; Rajkarnikar, n.d.). These factors are compounded by weak governance at border points. The literature emphasizes that a lack of accountability and the prevalence of discretionary enforcement create an environment where traders perceive formal compliance as riskier than informality due to potential harassment or the requirement of informal payments (Chen, 2012; Thapa et al., 2023).

In the specific context of the Nepal–India border, these dynamics are reinforced by unique socio-economic linkages and infrastructure bottlenecks. While the Government of Nepal has initiated customs modernization, implementation remains inconsistent across subnational regions (Department of Customs, 2021; World Bank, 2018). Inadequate border infrastructure—such as a lack of inspection areas and warehouses—increases transaction costs and reinforces informal trade as a more efficient alternative for household goods and essential commodities (Thapa et al., 2023; Gartaula et al., 2015). Crucially, ICBT in this region is a bilateral phenomenon; Indian-side constraints, including complex documentation and unofficial fees, mirror Nepalese institutional gaps, forcing traders to navigate a cross-border ecosystem of informality to maintain their livelihoods (Taneja & Pohit, 2002; Singh, n.d.).

Despite these insights, a significant gap remains in localized, trader-level quantitative research. Much of the existing literature is either macro-centric or focused on national policy frameworks, leaving district-specific dynamics—particularly in high-intensity trade hubs like Jhapa—largely unexplored. There is a lack of baseline data regarding the demographic patterns, occupational status, and specific adaptive strategies of informal traders at the local level. This study addresses these deficiencies by adopting a triangulation approach that integrates primary survey data with secondary evidence (Chen, 2012; Pant & Maharjan, 2019). By shifting the focus from policy documents to the lived experiences and perceptions of traders in the Jhapa District, this research provides the granular evidence necessary to inform targeted, sustainable interventions for formalizing cross-border trade.

Key Contributions

This study contributes to the understanding of informal cross-border trade by linking survey data from traders with existing theories and policy discussions.

First, the study provides rank-based, micro-level evidence on the drivers of informal cross-border trade in eastern Nepal. It identifies and ranks key challenges faced by traders, such as procedural barriers, tax and fee burdens, governance practices, and infrastructure issues. This goes beyond simple descriptions and offers a structured assessment of which challenges are most important in practice. It meets calls for evidence that reflects traders' concerns rather than policy assumptions.

Second, the study refines current explanations of informality by demonstrating that procedural barriers are the most significant constraint on informal trading behaviour, as evidenced by the top-ranked results. While earlier studies discuss institutional weaknesses in general terms, this finding supports the idea that administrative complexity and delays are more important than just financial factors in influencing informality at border points.

Third, the study distinguishes taxation and fee-related burdens as secondary yet important drivers of informal trade. Ranking tax-related challenges below procedural barriers but above infrastructure issues provides a clearer understanding of how traders evaluate financial risks against administrative and time-related issues when choosing between formal and informal trade.

Fourth, the findings contribute to governance-focused research by indicating that border-level governance practices, such as the consistency of enforcement and institutional behaviour, are important determinants of informality. This supports theories suggesting that informality is shaped not just by formal regulations, but also by how these rules are applied and perceived by traders at specific border sites.

Fifth, the study contributes to the infrastructure literature by showing that, although infrastructure challenges are relevant, they are perceived as less urgent drivers of informality than procedural and governance-related factors. This ranking insight clarifies the relative impact of physical versus institutional challenges on sustaining informal cross-border trade.

Finally, by connecting trader-ranked challenges with existing theories, the study provides a methodological contribution to research on the informal economy. It demonstrates how simple ranking surveys can yield policy-relevant insights into behaviours that are hard to capture using official data. This approach strengthens the basis for designing targeted trade facilitation and border governance reforms to reduce informality while supporting small-scale traders.

RESEARCH METHODOLOGY

A purposive sampling strategy was employed due to the absence of a comprehensive sampling frame for informal cross-border traders. Respondents were identified through a combination of snowball sampling and key informant referrals. Initial contacts were established at local markets, border-area tea shops, and community gathering points in the Kakarbhitta border region. These initial respondents then referred other eligible participants. Eligibility criteria included: (a) residence in a border-adjacent community within Jhapa District, (b) engagement in cross-border purchase of goods from India for personal use or resale in Nepal within the past 12 months, and (c) willingness to participate voluntarily. No monetary incentives were provided. Of 168 individuals approached, 145 agreed to participate (response rate: 86.3%). The sample size was determined based on practical feasibility and the exploratory nature of the study, as no prior power analysis could be conducted without estimates of effect sizes.

RESULTS

Socio-demographic Profile of Respondents

Table 1 Gender-wise profile of respondents

Gender	No.	Percentage
Female	32	22.07
Male	113	77.93
Grand Total	145	

In Table 1, we presented the gender compositions of respondents included in the research survey. Of the 145 respondents, 113 were male, and 32 were female. It shows that males constitute the majority of respondents (77.93%), and females constitute only 22.07%.

The dominance of male respondents suggests that cross-border trading activities in the surveyed area are male-dominated. This gender distribution reflects the broader socioeconomic context of cross-border trade in Nepal, in which males are more engaged than females.

Table 2 Age group-wise profile of respondents

Age Group	Count	Percentage
26–40	101	69.66
41–55	6	4.14
Below 25	38	26.21
Grand Total	145	

Table 2 presents the age-group-wise profile of the respondents, indicating that the majority are in the active working age group. The majority of respondents are of the age group (26–40), which is 69.99%, followed by below 25 age group 26.21 % and the age group (41–55) have only 4.14%.

Overall age distribution suggests that cross-border trading activity is primarily driven by the early- to mid-working-age population in the study area, with limited participation among older age groups.

Table 3 Education level-wise profile of respondents

Education level	Count	Percentage
Above Bachelor	54	37.5
Bachelor	72	50
Secondary	19	12.5
Grand Total	145	

Table 3 represents the educational attainment of respondents. The result indicates that the majority of respondents hold Bachelor’s degrees (72; 50.0%). Respondents with a Bachelor’s degree or higher are 54 (37.5%), and those at the secondary level are 19 (12.5%). It shows a high level of educational attainment among the samples.

Overall, the findings suggest that cross-border trading in the study areas is associated with a higher proportion of well-educated individuals.

Table 4 Profession-wise profile of respondents

Profession	Count	Percentage
Job	73	50.34
Self employed	2	1.38
Student	48	33.10
Trader	16	11.03
Transporter	2	1.38
Unemployed	4	2.76
Grand Total	145	

Table 4 presents the respondents' professional profiles. The result indicates that jobholders are the largest group of respondents, accounting for 73 (50.34%). This was followed by students, with 48 (33.10%) participants, indicating substantial participation among individuals engaged in education. Among respondents, 16 traders (11.03%) were included in the survey; unemployed individuals accounted for 4 (2.76%), and self-employed individuals and transporters accounted for 2 each.

Overall, the occupational profile indicates that the research captured diverse perceptions of occupations, with a notable representation of salaried workers and students.

Nature of Cross-Border Trading Activities

Table 5 Frequency of border crossing

Frequency of border crossing	count	percentage
Daily	2	1.38

Monthly	13	8.97
Occasionally	120	82.76
Weekly	10	6.90
Grand Total	145	

Table 5 represents the frequency of cross-border trading or related activities. The findings indicate that the majority of respondents travel occasionally (120; 82.76%). This shows cross-border trading is occasional for informal traders rather than regular. A smaller proportion of respondents reported monthly border crossings (13; 8.97%), whereas weekly crossings were reported by 10 (6.90%) and daily crossings by 2 (1.38%).

Overall, the findings suggest that cross-border trading among respondents is mainly occasional, with very few individuals engaging in weekly, monthly, or daily trading.

Table 6 Types of goods purchased

Types of products	Count	Percentage
Agricultural products	18	9.84
Clothes	4	2.19
Household goods	131	71.58
IT related	2	1.09
Vehicle parts	28	15.30
Grand Total	183	

“Respondents were allowed to report more than one type of product traded; therefore, the total responses exceed the number of respondents.”

Table 6 represents the type of products traded across the border. Most traders engaged in cross-border trade in household goods, with 131 respondents (71.58%), indicating its dominance. Similarly, the second most traded goods are vehicle parts, with 28 respondents (15.30%). Agricultural products account for 18 (9.84%), clothing for 4 (2.19%), and IT-related products for 2 (1.09%).

Overall, most small-scale cross-border traders trade household goods, whereas very few trade agricultural goods or other goods.

Table 7 Average Monthly transactions

Average Monthly Transactions	Count	Percentage
50K–100K	8	5.52
Above 500K	2	1.38
Below 50K	135	93.10
Grand Total	145	

Table 7 shows the average monthly transactions across the border of the respondents. Among 145 respondents, 135 (93.10%) reported average monthly transactions below 50 K. Very few counted to 50k - 100k, i.e. 8 (5.52%) and above 50k, i.e. 2 (1.38%).

Based on these data, we found that the majority of small informal cross-border traders have monthly transactions below 50k.

Table 8 Ranking of Constraints Influencing Informal Cross-Border Trade

Rank	Constraint	Responses	Percentage
1	Customs and regulatory barriers	186	128.28
2	Economic and tax burden	156	107.59
3	Corruption and informal payments	68	46.9
4	Market competition	59	40.69
5	Awareness and information gap	44	30.34
6	Infrastructure constraints	35	24.14
7	Other factors	16	11.03

Note: Respondents could select multiple constraints. The frequency column indicates the number of times constraints within each category were selected. The percentage is calculated as $(\text{frequency} / \text{total respondents}) \times 100$, and values exceed 100% because respondents selected multiple constraints within the same category. Respondents could select multiple constraints. The frequency column indicates the number of times constraints within each category were selected. The percentage is calculated as $(\text{frequency} / \text{total respondents}) \times 100$, and values exceed 100% because respondents selected multiple constraints within the same category.

The ranking is derived from response frequency, with higher frequencies indicating greater perceived influence of a given constraint on engagement in informal trade. As shown in the table, customs and regulatory barriers rank as the most significant constraint, followed by economic and tax-related burdens, highlighting the dominant role of regulatory complexity and cost pressures in shaping informal cross-border trading practices. Governance-related issues, such as corruption and informal payments, also constitute a notable constraint, while factors such as market competition, lack of awareness, and infrastructure limitations are relatively less influential. Overall, the results indicate that structural and institutional barriers play a more decisive role in driving informal cross-border trade than individual or market-based factors.

Table 9 Impact of cross-border trade on Income

Impact of cross-border trade on Income	Count	Percentage
Increases income	55	37.93
No effect	68	46.90
Reduces income	22	15.17
Grand Total	145	

Table 9 presents the impact of cross-border trade on respondents' income. 68 respondents report no effect on their income due to cross-border trade, 55 report an increase, and 22 report a decrease.

Overall, the data show that approximately 46.90% of people don't experience changes in income due to cross-border trade, 27.93% experience increased income, and 15.17% experience reduced income.

Table 10 Opportunities from cross-broder trade

Opportunities of cross-border trade	Count	Percentage
Bigger market	17	11.72
Business partnerships	10	6.90
Cheaper goods	112	77.24
Employment	6	4.14
Grand Total	145	

Table 10 presents the cross-border trade opportunities that benefited the respondents. 112 respondents (77.24%) identify opportunities for cheaper goods, 17 respondents (11.72%) identify a larger market, 10 respondents (6.90%) identify business partnerships, and 7 respondents (4.14%) identify employment opportunities.

Overall, the data indicate that most people have benefited from informal cross-border trade, owing to lower prices.

Table 11 Cooperative/Microfinance Membership and Support Provided

Variable	Frequency	Percentage
Membership in Cooperative / Microfinance		
– Yes	103	71
– No	42	29
Type of support provided by cooperative / microfinance (multiple responses allowed, n = 103)		
– Helped in savings	49	47.6
– Networking or advice	6	5.8
– No support received	48	46.6
– Provided a loan or credit	26	25.2
Total responses	129	

Note. Respondents could select multiple types of support. Percentages for support are calculated relative to the 103 members. The total frequency exceeds 103 because multiple responses were allowed.

Table 11 shows whether respondents are members of cooperatives/microfinance institutions and whether they received any support from these organisations. Among 145 respondents, 103 (71%) are members of cooperatives/microfinance institutions, and 42 (29%) are not.

Similarly, among 103 respondents with membership, 47.6% received assistance with savings, 46.6% received no support, 25.2% received a loan/credit, and 5.8% received networking or advice from cooperatives or microfinance institutions.

Overall, the data show that the majority of small informal traders are affiliated with cooperatives/microfinance institutions for savings and loan/credit support.

Table 12 Activities to be done to ensure fair trade

What should be done to ensure fair trade?	Count	Percentage
Awareness for traders	40	13.79
Improve border infrastructure	45	15.52
Promote cooperatives	28	9.66
Reduce taxes	82	28.28
Simplify the customs process	95	32.76
Grand Total	290	

Note: Multiple choices allowed in n=145

Table 12 shows the activities to be done to ensure fair trade in eastern Nepal. We found 95 respondents (32.76%) said to simplify the customs process, 82 respondents (28.28%) said to reduce taxes, 45 respondents (15.52%) said to improve border infrastructure, 40 respondents (13.79%) said to provide awareness to traders, and 28 respondents (9.66%) said to promote cooperative institutions.

The above data indicate that the majority of informal traders want a simplified customs process and low tax rates to facilitate fair and formal trade through formal channels.

DISCUSSIONS

This section interprets the empirical findings within the existing theoretical framework and the contextual realities of cross-border trade in eastern Nepal. The discussion is structured around the ranking of constraints and the key findings presented in the Results section to ensure analytical coherence and thematic consistency.

Socio-Demographic Characteristics and Informal Trade Participation

The dominance of male respondents and individuals in the economically active age group reflects the gendered and labour-intensive nature of cross-border trading in eastern Nepal. From the institutional perspective, embedded social norms and role expectations disproportionately positioned men as economic actors in mobility-intensive activities such as border trading. Limited female participation is also linked to constraints related to household responsibilities, safety concerns, and restricted access.

The high level of educational attainment among respondents challenges assumptions that informal trade is primarily driven by low-skilled or uneducated actors. These findings also support the arguments within institutional theory that informality is often a rational response to institutional inefficiencies rather than a consequence of limited human capital. Educated individuals may also choose informal channels due to imposition of excessive procedural and financial burdens that outweigh perceived benefits.

Nature of Trading Activities and Scale of Informality

The dominance of occasional border crossings and low monthly transaction volumes indicates that a large portion of informal cross-border trade is small-scale and supplementary. This pattern aligns with transaction cost theory, which posits that actors seek to minimise costs associated with market participation. For small traders dealing in limited volumes, the fixed cost for formal compliance - such as documentation, delays and fees are disproportionately high relative to expected returns, which makes informality a cost-minimising strategy.

The concentration of trade in household goods and vehicle parts reflects the demand-driven informality. These goods are characterised by frequent cross-border price differences and low perishability, which enable traders to exploit arbitrage opportunities without incurring complex logistics costs. In the context of Nepal-India porous borders and long-standing informal exchange networks, such practices are facilitated, reinforcing the persistence of informal trade even among legally permissible commodities.

Procedural and Regulatory Barriers as Primary Drivers of Informality

In informal cross-border trade, customs and regulatory barriers also emerged as a significant constraint. This finding is consistent with institutional theory, which emphasises that weak, complex or inconsistently enforced formal rules incentivise actors to operate outside official systems. In eastern Nepal, traders encounter complex customs procedures, extensive paperwork requirements, and discretionary enforcement practices at border points.

These procedural barriers increase uncertainty and time costs, thereby making formal trade channels less attractive, particularly for small-scale traders. As a result, informal routes are an adaptive mechanism for bypassing institutional rigidities rather than an inherently illicit choice. This constraint suggests that informality is structurally induced rather than behaviorally motivated.

Economic and Tax Burdens

The high rankings of economic and tax-related constraints underscore the role of cost structures in shaping trading behaviour. From a cost perspective, high tariffs, multiple fees and unofficial charges raise the effective cost of formal trade participation. For traders operating on narrow profit margins, these costs erode their competitiveness and promote informal practices.

In Nepal-India borders, differential tax regimes and inconsistent valuation practices further increase cost uncertainty. A trader may find informal trade as a rational response to an uneven playing field, when compliance doesn't guarantee predictability or fairness. These findings reinforce the argument that reducing formal-sector costs is essential to encouraging voluntary formalisation.

Governance Practices, Corruption, and Informal Payments

Governance-related constraints, including corruption and informal payments, constitute a critical institutional failure that influences informal trade. Within institutional theory, such practices weaken the legitimacy of formal rules and erode trust in regulatory authorities. When traders feel that compliance does not protect them from informal payments, the incentive to remain in the formal system will diminish.

In the border areas of eastern Nepal, informal payments are often viewed as an implicit cost of formal engagement, which lies between formal and informal trade. This normalisation of corruption contributes to a self-reinforcing cycle in which informality becomes both a cause and a consequence of weak governance structures.

Market Competition, Awareness Gaps, and Infrastructure Constraints

Market competition, awareness gaps, and infrastructure deficiencies were ranked second, but were analytically important constraints. Competitive pressure from large traders and established networks may marginalise small traders and push them toward informal channels with lower entry barriers.

Similarly, information asymmetries regarding customs rules and regulations, as well as the requirements of formal trade, increase the perceived risk associated with formalisation. Poor infrastructure, such as inadequate storage facilities, transportation bottlenecks, and limited digital systems at border points, further increases transaction costs and reinforces informal practices. These findings suggest that informality is sustained not only by regulatory failures but also by structural and informational constraints.

Income Effects and Perceived Benefits of Informal Trade

The respondents reported mixed income effects indicate that informal cross-border trade does not uniformly enhance economic well-being. Access to cheaper goods and cross-border price differential offers short-term benefits, but the absence of scale, legal protection and institutional growth limits income growth potential. This finding aligns with theoretical perspectives that view informality as a survival-oriented or risk-hedging strategy rather than a pathway to sustained economic advancement.

Role of Cooperatives and Microfinance Institutions

The high rate of cooperative and microfinance membership shows the importance of semi-formal institutions in supporting traders operating outside formal trade systems. From an institutional substitution perspective, cooperatives partially compensate the gaps in formal financial access by providing savings and limited credit facilities. However, the great portion of members also reported no tangible support, which suggests misalignment between institutional offerings and trader needs.

This gap highlights the need to strengthen cooperative capacity and align financial products with the realities of cross-border trading, particularly for small-scale traders in border regions.

Policy Implications for Fair Trade and Formalisation

Respondents emphasise that simplifying customs procedures and reducing taxes primarily reinforce the central role of institutional reform in promoting fair and formal trade. The findings suggest that awareness programs and infrastructure improvements are important but insufficient without addressing core procedural and cost-related barriers. Promoting cooperatives as intermediaries between traders and formal institutions may offer a contextually appropriate path for gradual formalisation in Nepal-India border regions.

Theoretical Integration and Synthesis

This subsection integrates the empirical findings of the study with established theoretical frameworks to provide a deeper analytical understanding of informal cross-border trade dynamics in eastern Nepal.

The finding that customs and regulatory barriers are the most significant constraints aligns strongly with insights from Douglass C. North's Institutional Theory. This theory posits that when formal institutional structures impose high compliance costs, economic actors are incentivized to operate outside formal systems. In the context of the Nepal-India border, complex customs procedures, documentation requirements, and inconsistent enforcement increase the cost of formal trade participation. As a result, small traders rationally opt for informal channels that reduce time, uncertainty, and administrative burden.

Similarly, the prominence of economic and tax-related constraints supports the logic of Transaction Cost Theory, originally developed by Ronald Coase and further expanded by Oliver Williamson. According to this framework, individuals and firms seek to minimize transaction costs associated with economic exchange. High tariffs, unofficial payments, and procedural inefficiencies increase the overall cost of formal trade transactions. For small-scale traders operating with narrow profit margins, avoiding these costs through informal trade becomes an economically rational strategy. Thus, informality is not merely a deviation from the system but a calculated response to inefficiencies within it.

The persistence of informal trade despite respondents' involvement in cooperatives and microfinance institutions can be interpreted through the concept of institutional substitution, as discussed by Martha Chen. This perspective suggests that when formal institutions fail to adequately serve economic actors, alternative or semi-formal institutions emerge to fill the gap. In this study, cooperatives and informal financial networks provide partial support in terms of credit access and risk-sharing. However, they do not fully address structural barriers such as customs complexity or regulatory burden, thereby allowing informal trade practices to persist alongside semi-formal institutional engagement.

Furthermore, the findings highlight the role of governance and enforcement inconsistencies, which reinforce informal economic behavior. Weak institutional coordination, lack of transparency, and discretionary practices at border points contribute to uncertainty in formal trade processes. This observation further strengthens the relevance of Institutional Theory, as it emphasizes the importance of predictable and efficient rules in shaping economic behavior.

Overall, the integration of these theoretical perspectives suggests that informal cross-border trade in Jhapa is not simply a result of non-compliance, but rather a systemic outcome of institutional inefficiencies, high transaction costs, and incomplete institutional support structures. Addressing informality, therefore, requires not only stricter enforcement but also meaningful reforms aimed at reducing compliance costs, simplifying procedures, and strengthening institutional effectiveness. By aligning policy interventions with these theoretical insights, it becomes possible to design more inclusive and efficient border management strategies that encourage formal participation while supporting the livelihoods of small-scale traders.

POLICY IMPLICATIONS AND RECOMMENDATIONS

The findings of this study show that informal cross-border trade in eastern Nepal is primarily driven by structural and institutional constraints rather than deliberate non-compliance. Consequently, policy responses should focus on reducing procedural complexity, transaction costs, and governance failures while strengthening supportive institutions that facilitate gradual formalisation. This section outlines key policy implications followed by targeted recommendations.

Policy Implications

At present, customs and regulatory barriers impose disproportionately high compliance costs on small-scale traders. Formal trade procedures appear misaligned with the scale, capacity, and transaction volumes of informal traders operating in Nepal-India border regions. Informality is likely to persist as a rational economic choice without procedural differentiation based on trader size.

Second, the significance of economic and tax-related burdens underscores the need to reassess tariff structures and fee regimes for small consignments. High and unpredictable costs undermine incentives to use formal channels and erode trust in state institutions. This suggests that formalisation efforts must prioritise cost transparency and affordability.

Third, governance-related issues, including corruption and informal payments, indicate institutional weaknesses that erode the credibility of formal trade systems. When traders perceive discretionary enforcement and rent-seeking behaviour, formalisation loses legitimacy. Addressing informality, therefore, requires governance reform alongside technical improvements.

Fourth, the role of cooperatives and microfinance institutions underscores the importance of intermediaries in supporting traders. However, the limited effectiveness of these institutions in providing meaningful trade-related support suggests a missed opportunity to leverage them as bridges between informal traders and formal regulatory systems.

Finally, respondents' emphasis on simplifying customs procedures and reducing taxes underscores that awareness-raising alone is insufficient. Structural reforms must precede or accompany informational interventions to achieve sustainable outcomes.

Policy Recommendations

Simplification of Customs Procedures for Small-Scale Traders

Custom procedures at Nepal-India border points should be simplified by introducing simplified or fast-track clearance mechanisms for small-scale and low-volume traders. This should reduce documentation requirements,

standardise the valuation of frequently traded goods, and simplify the declaration process. Such measures would reduce transaction costs and reliance on informal routes.

Rationalisation of Tax and Fee Structures

Tax and fee regimes applicable to small consignments should be reviewed to ensure proportionality and predictability. Introducing lower tax slabs or flat-rate (lump-sum) duties for small traders could improve compliance while maintaining revenue. Transparent display of official fees at border points would further reduce uncertainty and opportunities for informal payments.

Strengthening Governance and Reducing Informal Payments

To address corruption and discretionary practices, border management systems should be strengthened through greater digitisation, monitoring, and accountability mechanisms. Expanding electronic documentation and payment systems can limit face-to-face interactions that facilitate informal payments. Clear grievance redress mechanisms for traders would also enhance trust in formal institutions.

Enhancing Border Infrastructure and Trade Facilitation

Investment in border infrastructure—such as storage facilities, transport connectivity, and digital customs platforms—should be prioritised to reduce delays and logistical bottlenecks. Improved infrastructure would lower time-related transaction costs and make formal trade channels more efficient and attractive, particularly for traders dealing in household goods and vehicle parts.

Leveraging Cooperatives and Microfinance Institutions

Cooperatives and microfinance institutions should be strategically integrated into cross-border trade policy frameworks. Beyond savings and credit, these institutions could provide trade-related financial products, compliance assistance, and information dissemination. Capacity-building initiatives for cooperatives would enable them to function as intermediaries that facilitate the gradual formalisation.

Targeted Awareness and Capacity-Building Programs

Awareness programs should be designed to complement institutional reforms rather than substitute for them. Training initiatives focusing on customs procedures, tax obligations, and formal trade benefits should be delivered through cooperatives, local trader associations, and border-area community organisations to ensure accessibility and relevance.

Overall Policy Direction

Taken together, these recommendations suggest that informal cross-border trade in eastern Nepal should not be addressed through punitive enforcement alone. Instead, a facilitative, incentive-based approach that reduces institutional barriers, enhances governance quality, and strengthens intermediary institutions is more likely to encourage voluntary formalisation. Such an approach aligns with the realities of Nepal–India and Nepal–Bhutan border economies, where informality functions as an adaptive response to institutional constraints rather than as outright illegality.

CONCLUSION

This study examined the nature, drivers, and implications of informal cross-border trade in eastern Nepal, with particular reference to the Nepal–India border regions. Using primary survey data from 145 respondents, the research analysed socio-demographic characteristics, trading patterns, constraints that influence informality, perceived income effects, institutional support mechanisms, and traders' perspectives on measures required to ensure fair trade. The findings contribute to a deeper understanding of informal cross-border trade as an institutional and structural phenomenon rather than merely an outcome of individual non-compliance.

The socio-demographic profile of respondents indicates that informal cross-border trade is predominantly undertaken by males within the economically active age group, many of whom possess relatively high levels of education. This challenges conventional assumptions that informal trade is primarily driven by uneducated or marginal actors. Instead, the evidence suggests that informed and economically active individuals consciously engage in informal trade as a rational response to institutional inefficiencies and high transaction costs associated with formal trade channels.

The nature of trading activities further indicates that informal cross-border trade in the study area is largely small-scale and occasional, characterised by low transaction volumes and a concentration on household goods and vehicle parts. Such patterns indicate that informality primarily functions as a supplementary or survival-oriented economic strategy rather than as a pathway to large-scale commercial expansion. The predominance of low-value transactions explains why many traders perceive formal procedures as disproportionately burdensome relative to their potential returns.

A key contribution of this study is the ranking of constraints that influence informal cross-border trade. Customs and regulatory barriers emerged as the most significant factor, followed by economic and tax-related burdens and governance issues such as corruption and informal payments. These findings underscore the central role of institutional failures—procedural complexity, cost uncertainty, and weak governance—in sustaining informality. Market competition, awareness gaps, and infrastructure constraints, while relevant, play a secondary role. Overall, the results confirm that informal cross-border trade in eastern Nepal is primarily institutionally induced rather than preference-driven.

The income-related findings indicate mixed outcomes from informal cross-border trade. While some respondents reported increased income due to access to cheaper goods and cross-border price differentials, a substantial proportion experienced no income effect or even income reductions. This suggests that informal trade offers short-term economic coping mechanisms but limited prospects for sustained income growth, largely due to the absence of scale, legal protection, and institutional support.

The analysis of cooperative and microfinance participation highlights the importance of intermediary institutions in border economies. Although a majority of respondents are members of cooperatives or microfinance institutions, the level of effective trade-related support remains limited. This indicates untapped potential for these institutions to facilitate access to finance and information, and to support the gradual formalisation, if appropriately strengthened and aligned with the needs of cross-border traders.

Finally, traders' recommendations for ensuring fair trade—particularly the emphasis on simplifying customs procedures and reducing taxes—reinforce the central conclusion of this study: informal cross-border trade persists not because traders reject formal systems, but because existing systems are inaccessible, costly, and inefficient for small-scale actors.

In conclusion, informal cross-border trade in eastern Nepal should be understood as an adaptive response to structural and institutional constraints within the formal trade regime. Policies aimed solely at enforcement or suppression are unlikely to succeed. Instead, a facilitative approach that simplifies procedures, rationalises costs, strengthens governance, improves infrastructure, and leverages cooperatives as intermediary institutions offers a more sustainable pathway toward fair trade and gradual formalisation. By addressing the root institutional causes of informality, policymakers can better integrate small traders into the formal economy while preserving livelihoods and promoting inclusive cross-border economic development.

Delimitations, Limitations and Directions for Future Research

Delimitations

1. Geographical Scope

This study focuses exclusively on informal cross-border trade in eastern Nepal, particularly along the Nepal–India and Nepal–Bhutan borders. Other border regions of Nepal are excluded due to potential differences in trade dynamics, regulatory practices, and border infrastructure.

2. Population and Sample

The study is limited to 145 respondents involved in informal trade, including traders, jobholders, and students. High-volume commercial traders, formal institutional traders, and Indian traders were intentionally excluded. Indian-side trade issues are incorporated through secondary literature, not primary data collection.

3. Timeframe

The data represent cross-border trading patterns at the time of the survey. Seasonal or temporal variations in trade frequency, commodity types, and transaction values were not systematically captured.

4. Type of Trade Studied

Only informal small-scale trade activities were included, primarily involving household goods, vehicle parts, and agricultural products. Formal registered trade, large-scale exports/imports, and digital cross-border trade were excluded.

5. Methodological Delimitation

The study employs a triangulated approach, combining survey data, qualitative interviews, and document analysis for literature review. However, primary data were collected only in Nepal, and Indian-side constraints are addressed through secondary sources.

Limitations of the Study

1. Sample Size and Generalizability

The study's sample of 145 respondents limits generalizability. Findings may not represent all informal traders along the Nepal–India or Nepal–Bhutan borders, particularly in other regions or larger trade networks.

2. Self-Reported Data

The survey relies on respondents' self-reported information, which may be subject to recall bias or social desirability bias, especially when reporting income, transaction amounts, or engagement in informal trade.

3. Cross-Border Policy Variability

Although Indian-side issues are discussed, the study did not collect primary data from Indian traders or border officials. Therefore, conclusions regarding Indian policies are based solely on secondary literature, which may not fully capture current local practices or enforcement variability.

4. Temporal Limitations

Data were collected at a single point in time. Cross-border trade patterns are subject to seasonal fluctuations, policy changes, and macroeconomic shifts, which may not be reflected in the study.

5. Excluded Factors

Certain influencing factors, such as social networks, informal agreements, or trader-specific strategies, were not systematically measured. These could affect informal trade patterns but are beyond the scope of this study.

Despite providing important insights into informal cross-border trade in eastern Nepal, this study has several limitations that should be acknowledged when interpreting the findings.

First, the study relies on a cross-sectional survey design, capturing respondents' perceptions and experiences at a single point in time. As informal cross-border trade is influenced by seasonal demand, policy changes, and fluctuations in border enforcement, the findings may not fully reflect temporal variations in trading behaviour.

Second, the sample size is limited to 145 respondents from selected border areas in eastern Nepal. While this sample provides valuable context-specific insights, it may limit the generalizability of the findings to other border regions of Nepal or to different cross-border trade corridors with distinct institutional and economic characteristics.

Third, the use of self-reported data introduces the possibility of response bias. Given the informal and sometimes sensitive nature of cross-border trade, respondents may have underreported or overstated certain behaviours, income effects, or constraints due to fear of disclosure or social desirability considerations.

Fourth, the analysis primarily employs descriptive statistics and ranking methods. Although this approach is appropriate for exploratory analysis and policy-oriented interpretation, it does not establish causal relationships between institutional factors and informal trade engagement. As a result, the findings should be interpreted as indicative associations rather than definitive causal links.

Finally, the study focuses primarily on traders' perspectives and does not incorporate the views of other key stakeholders, including customs officials, border security personnel, and policymakers. The absence of these perspectives limits the ability to fully assess institutional dynamics from both the supply and regulatory sides of cross-border trade.

Directions for Future Research

Building on the limitations identified above, several avenues for future research emerge.

Future studies could adopt longitudinal research designs to capture changes in informal cross-border trade over time, particularly in response to policy reforms, infrastructure development, or shifts in border management practices. Such approaches would provide deeper insights into the dynamics of formalisation and institutional adaptation.

Expanding the geographic scope to include other Nepal–India border regions, as well as comparisons with the western and southern border corridors, would enhance the generalizability of the findings and enable regional comparisons of institutional effectiveness.

Further research could employ mixed-methods approaches, combining quantitative surveys with in-depth interviews or focus group discussions. Qualitative insights would help uncover nuanced motivations, negotiation practices, and informal norms that shape cross-border trade behaviour but are difficult to capture through structured questionnaires alone.

Future studies may also utilise econometric or structural modelling techniques to examine the causal impact of specific institutional variables—such as customs delays, tax rates, or governance quality—on traders' decisions to operate informally. This would strengthen the empirical basis for targeted policy interventions.

Additionally, research focusing on the role of cooperatives and microfinance institutions in facilitating trade formalisation warrants deeper exploration. Evaluating institutional capacity, governance structures, and financial product design could inform strategies to enhance their effectiveness as intermediaries between informal traders and formal trade systems.

Finally, incorporating perspectives from customs authorities, policymakers, and border administrators would provide a more holistic understanding of cross-border trade dynamics and institutional constraints. Such multi-stakeholder analyses could support the design of more balanced and implementable policy reforms.

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