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Policy Brief

U.S. Tariffs, Regional Competition, and Pakistan's Export Strategy in a Post-Free Trade Era

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Executive Summary

Since 1776, Adam Smith's theory of absolute advantage has remained central to modern economic thought on international trade. Over time, however, its universal validity has been increasingly contested due to recurring trade imbalances, asymmetrical distribution of gains across nations, and instances of deindustrialisation in economies that followed trade liberalisation. These developments have led many countries to adopt protectionist measures.

The United States, once the leading proponent of trade liberalisation, now imposes an average tariff rate of 19% on Pakistan's exports, slightly lower than Vietnam's and Bangladesh's 20%, but well below India's 50%. This Policy Brief analyses the impact of United States' tariff measures on Pakistan Economy.

For Pakistan, average tariff rates in the U.S. market are comparatively favourable relative to certain competing economies. However, structural cost disadvantages continue to undermine Pakistan's industrial competitiveness. Labour productivity remains constrained, and industrial electricity and gas prices significantly exceed the levels faced by most regional peers. The available evidence suggests that preferential tariff concessions and trade facilitation agreements, in the absence of complementary structural reforms, have not generated significant or sustained improvements in Pakistan's trade outcomes.

Nevertheless, contemporary trade developments also present strategic opportunities for Pakistan. India's basmati rice exports to the U.S. may fall by 50-80% due to higher tariffs. With comparatively lower tariffs and competitive pricing, Pakistan can increase its footprint in the U.S. rice market. In 2024, India supplied US $8.72 billion worth of medicines to the U.S., accounting for 40% of U.S. generic drug imports, another area where Pakistan can expand its exports. Similarly, by securing 10-15% of India's US $5.9 billion U.S. textile exports, Pakistan could generate an additional US $500-750 million in textile exports. However, without reforms in energy pricing, industrial efficiency, and export diversification, these gains may be short-lived, leaving Pakistan exposed to regional rivalry and global demand fluctuations.

Recommendation

Pakistan may conduct a comprehensive sectoral assessment using comparative advantage analysis, ROI evaluation, and value chain mapping to identify high-impact sectors for U.S. exports.

- **Introduction**

Since 1776, Adam Smith's theory of absolute advantage has remained central to modern economic thought on international trade. [1] The theory guided centuries of trade policy and economic integration, reinforcing the idea that international trade is not always a zero-sum game. It proposed that countries should specialise in goods where they hold a productive edge and trade for the rest. Smith's framework laid the theoretical foundation for global trade relations as well as contributed to a surge in cross-border trade relations in the centuries that followed. [2]

Subsequent scholars such as Heckscher (1919), Krugman (1981), and Melitz (2003) further expanded Smith's views on international trade. They stated that factors such as economies of scale, labour productivity, factor endowments, and product differentiation also play an important role in international trade. Moreover, they stated that strategic trade policies, whether aimed at liberalising or protectionism, can shape competitive outcomes between nations.[3]

Empirical evidence on international trade, however, suggests that only a limited number of countries have benefitted from international trade.[4] For many others, trade liberalisation has led to adverse outcomes such as widening trade imbalances, deindustrialisation, and increased exposure to external shocks. Such a situation, triggered protectionist responses, including the reimposition of high tariffs and the escalation of trade wars.

- **Context**

The United States, long considered a champion of free trade, is now grappling with the unintended consequences of its own trade liberalisation policies that it introduced globally. Recently, the U.S. has shifted toward protectionist measures, imposing tariffs on a wide range of imports to address trade imbalances, protect domestic industries, and safeguard strategic economic interests. These actions have triggered retaliatory tariffs from trading partners, disrupted global supply chains, increased consumer prices, and contributed to growing uncertainty in the global trading system.

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[1] Smith is regarded as the father of modern economics. In 1776, he presented his theory of absolute advantage in his seminal work *An Inquiry into the Nature and Causes of the Wealth of Nations* (WON). WON is considered one of the most influential books on Economy.

2 Smith (1776). An inquiry into the nature and causes of the wealth of nations. London

3 Krugman (1981). Intra-industry Specialisation and the Gains from Trade. Journal of Political Economy.
Melitz (2003). The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity.

4 Matthias Busse, Stanley Kojo Dary, Jan Wüstenfeld, Trade liberalisation and manufacturing employment in developing countries, Structural Change and Economic Dynamics, Volume 70, 2024.

- **Pak-U.S. Trade and the Regional Tariffs**

The U.S. is Pakistan's largest export partner. In 2024, Pakistan exported US$5.47 billion worth of goods to the U.S. This accounted for 17% of Pakistan's total exports to the U.S. With a deficit of $3.37 billion, Pakistan imports from the U.S. reached to $2.14 billion in 2024. Over the past decade (2015-2024), Pakistan's exports to the U.S. grew steadily, increasing from $3.91 billion in 2015 to $5.47 billion in 2024 (see Figure 1).

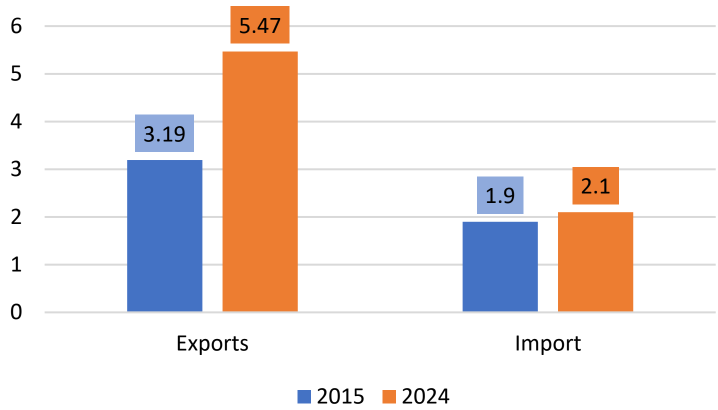

Figure 1: Pakistan-US Bilateral Trade (ITC, 2025)

Due to the significant trade deficit with Pakistan, as well as with its other trade partners, the U.S. applied an average tariff rate of 19% on Pakistan. Other regional peers have likewise faced comparatively higher tariffs, such as Vietnam (20%), India (50%), and Bangladesh (20%).

Some economists argue that lower tariffs give Pakistan a comparative advantage in maintaining competitiveness while preserving space for domestic industry development. Others contend that due to Pakistan's high production costs and meagre export base even these moderate tariffs may not be sufficient to put Pakistan at a better place against its regional competitors.

This study aims to comparatively explore this evolving landscape of global trade particularly the impact of tariffs on Pakistan vis a vis its regional peers. The findings of this Policy Brief highlight that tariff reduction standalone would not have any transformative impact. If that had been the case, EU GSP+ would have increased Pakistan's T&A (textile and apparel) exports.

The Brief moreover shows that the current trade conditions are not entirely unfavourable for Pakistan. With regional competitors facing higher tariffs, Pakistan has an opportunity to leverage lower tariffs. By addressing domestic bottlenecks in productivity, governance, and industrial capacity, Pakistan could unlock new prospects for export growth and industrial upgrading.

- **Analysis**

This study follows a comparative analytical framework to assess the implications of tariff structures on trade performance, with a particular focus on Pakistan and its regional peers. Using multiple indicators, it explores the broader trade ecosystem that shapes both trade and industrial outcomes. The analysis incorporates factors such as export ecosystems, energy tariffs, industrial capacity, fiscal frameworks, and productivity dynamics. For the analysis, a set of regional players, India, Bangladesh, Sri Lanka, Uzbekistan, and Vietnam, has been selected based on similarities in economic structure, geographic proximity, and trade relations.

- **Data Sources and Results**

This section presents empirical evidence regarding the implications of the U.S. tariffs. It compares economic structure of Pakistan and its regional peers. The analysis is based on data from the World Bank's WITS and WDI databases, ITC data, UNCTAD, as well as Pakistan's national statistical bureaus and sectoral reports.

- **Comparative Macroeconomic Snapshot**

Pakistan's corporate tax rate (29%) is among the highest in the region, second only to Sri Lanka (30%), potentially limiting investment incentives. Its policy rate (11%) is the highest, reflecting tighter monetary conditions compared to Vietnam (4.5%) and Indonesia (5.25%). Pakistan's minimum wage ($130.50) is above India and Bangladesh. It remains lower than Vietnam and Indonesia.

Pakistan benefits from a relatively low reciprocal U.S. tariff (19% vs India's 50%), presenting a trade advantage that needs utilisation. However, tight fiscal space, high taxes, and a debt-to-GDP ratio of 79% pose challenges.

Table 1: Comparative Macroeconomic Indicators

Indicator	**Pakistan**	**India**	**Bangladesh**	**Vietnam**	**Sri Lanka**	**Indonesia**
Corporate Tax Rate	29%	25%	27%	20%	30%	22%
Policy Rate	11.00%	5.50%	10.00%	4.50%	7.75%	5.25%
Minimum Wage	$130.50	$61.8	$102.20	$189.70	$58.00	$330.10
Reciprocal U.S. Tariffs	19%	50%	20%	20%	20%	19%
Debt (%GDP)	79%	80%	39%	36%	119%	39%

Source: WDI, WITS, ITC, IMF, Finance Division (2025)

- **Labour Productivity**

According to Smith (1776), labour is the primary factor in generating an exportable surplus. Higher labour productivity enables production beyond domestic consumption needs, allowing the surplus to be exported. The following figure compares regional labour productivity levels.

The following Figure 2 depicts long-term productivity levels for Bangladesh, China, India, Sri Lanka, Pakistan, and Uzbekistan. China starting from just $3,280 in 1991 reach $45,494 by 2024 (a 13-fold increase). India also shows significant growth, moving from $6,609 in 1991 to $24,468 in 2024. Notably, Bangladesh overtakes Pakistan in the mid-2000s, rising from $6,553 to $19,977. Sri Lanka despite its political and debt crises, grows consistently, peaking in 2021-2022 before a dip, likely reflecting the post-COVID debt shock.

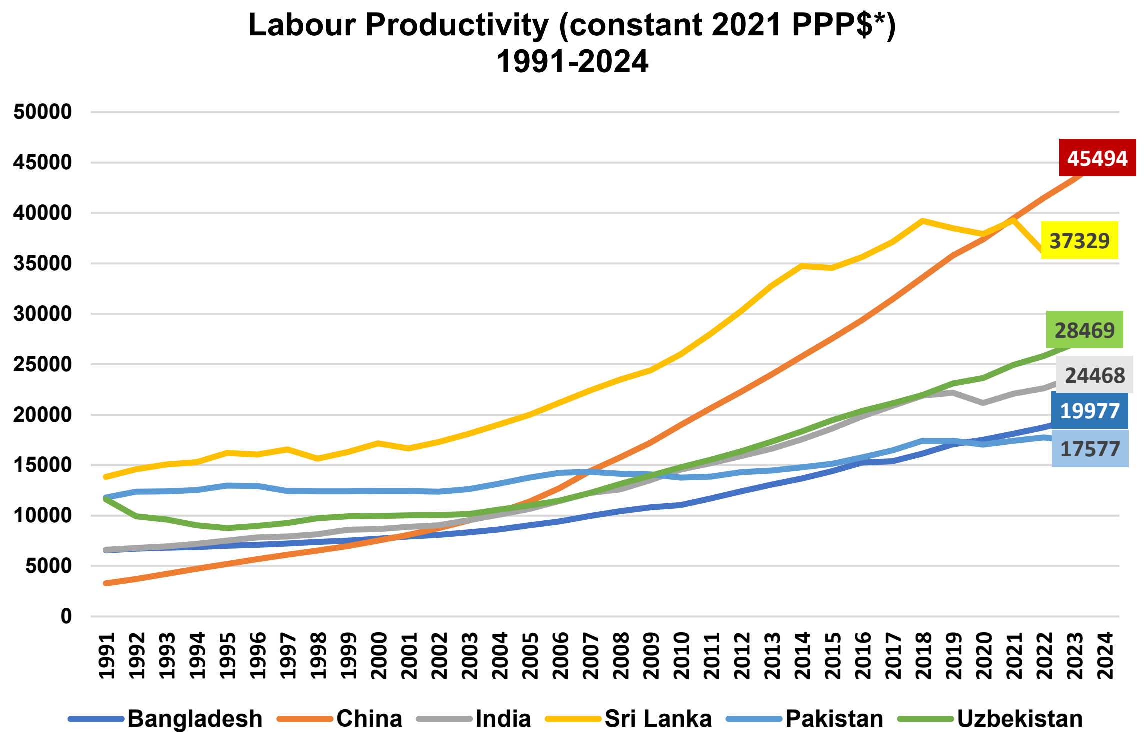

Figure 2: Labour Productivity (*WDI, 2025)*

**In purchasing power parity terms, adjusted for inflation and fixed at 2021 prices*

Pakistan's labour productivity trend shows persistent stagnation. In contrast, countries began at a similar level, have shown steady growth. Pakistan and Uzbekistan both started with labour productivity levels of around $13,000 in the 1990s. Today, Pakistan stands at about $17,000, while Uzbekistan has crossed $28,000.

Over the past two decades, Pakistan has benefited from major tariff reductions through agreements with China and the EU. Figure 2, however, shows that annual labour productivity growth averaged just 1.5%, compared to 5.7% in India, 3.9% in Bangladesh, and 8.5% in China. This shows that lower tariffs merely improve productivity gains.

- **Comparison of Pakistan and Regional Gas and Electricity Tariffs**

Pakistan's electricity tariff remains highest in the region. The industrial tariff remains at U.S.D 0.15 per kWh, almost double that in Vietnam and 40% higher than Bangladesh and India. Across the region, Sri Lanka and Uzbekistan have the lowest electricity tariffs for their industry.

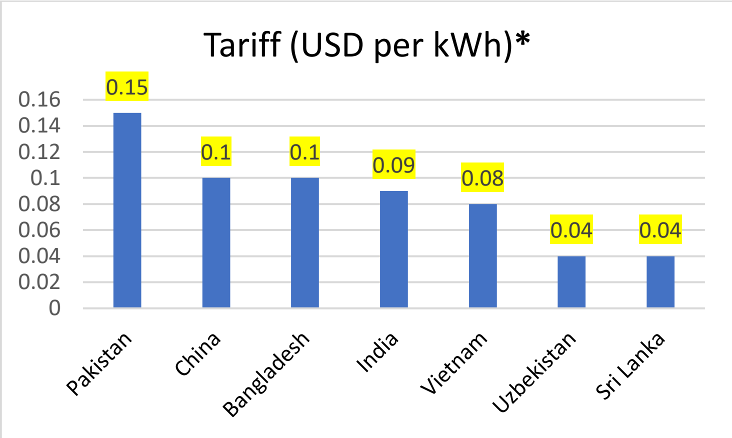

Figure 3: **Pakistan and Regional Electricity Tariffs (APTMA, 2023)**

**Note: "Tariff (USD per kWh)" means the cost charged for one kilowatt-hour of electricity.*

The following Table 2 shows Pakistan's top exports and the overall (total) exports to the U.S. between 2021 and 2024. It shows that Textile-related items dominate the export basket. In 2022, the overall exports to the U.S. were US$6.28 billion.

Table 2: Pakistan's top Exports to the U.S (in 000 US$).

Years	Clothing	textile articles/rags	Cloth, not knitted	Cotton	Leather	Mattresses, cushions	All products
2021	1955615	1895463	1085093	192824	170566	88743	6094814
2022	2030382	1779019	1240731	194777	191966	111893	6275021
2023	1423879	1465349	1001134	166683	158832	113117	5046317
2024	1615595	1578855	1143141	177282	171082	155544	5614623

Source: ITC (2025)

- **Pakistan's Textile Industry Gas Tariff: Regional Comparison**

This segment discusses Pakistan's textile industry (top exporting sector to the U.S.) gas tariffs as well as provide regional comparison.

Pakistan textile industry faces highest gas/LNG tariff in the region denting its competitiveness. Pakistan's textile industry was paying U.S.D 6.5 per MMBtu and will be paying U.S.D 9 per MMBtu in FY23. This rate is almost 3.5 times higher than what

Uzbek textile firms are paying and 1.5 times higher than Bangladesh's industrial tariff (Figure 3).

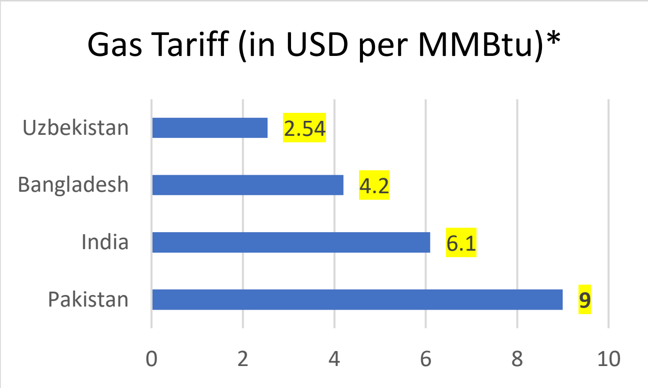

***Figure 3:* Textile Industry Regional Gas Tariffs (APTMA, 2023)**

**Note: MMBtu means per million British thermal units. A standard for measuring natural gas.*

Pakistan's textile industry is paying higher price for gas that is a major source of energy in each segment. About 75% of the industry is using gas to generate electricity, and at such tariffs, the cost of electricity remains higher than all major competitors. Recently, following the disconnection of industrial captive power plants, the government approved a 6.6% increase in prescribed natural gas prices to meet about Rs 890 billion in revenue requirements for the companies during 2025-26. Such increases in tariffs significantly hamper export competitiveness of Pakistan's top exporting sectors.

Regional peers have utilised export incentives and labour-intensive manufacturing without depending much on tariffs. Uncertainty in trade and energy pricing policies also limits long-term investment, energy pricing (higher industrial energy tariffs than neighbours), policy reversals (e.g., repeated tariff adjustments without long-term clarity), underutilised infrastructure (e.g., coal, LNG, and oil assets left idle or inefficient) have also impact.

- **Findings**

Pakistan nonetheless maintains a notable trade relationship with the U.S. That is its largest export destination. However, it is important to recognise that the global trade landscape is dynamic. Relying solely on direct exports to a single developed market may not help in addressing the economic issues of Pakistan.

Countries like Vietnam and Bangladesh have developed export ecosystems that are underpinned by streamlined logistics, integrated industrial supply chains, and consistent policy support. Despite a comparative decrease in tariff rates, Pakistan may not enjoy a strong competitive edge relative to its regional peers. Even in the case of India, despite higher tariffs imposed on India, India's broader and more diversified export base, lower input costs, higher productivity levels, and greater fiscal space (India provides multiple export-related subsidies to its industries) make it also an important regional competitor.

Moreover, while discussing tariffs, it is essential to explore the role of indirect/informal trade channels. A considerable volume of Indian goods, particularly pharmaceuticals and chemicals, enters the Pakistani market through third countries such as the UAE and Afghanistan. These goods are often re-routed via bonded warehouses and re-labelled before reaching their final destination. Estimates suggest that such indirect exports from India to Pakistan amount to nearly $10 billion annually. This is how businesses adapt to trade restrictions and circumvent direct barriers, especially when comparative cost advantages are significant. Hence, the probability of Indian goods exported to the U.S. via other countries can not neglected.

Taken together, Pakistan needs a broader regional competitiveness strategy beyond focusing on tariff alone, and consider the full spectrum of trade dynamics and strategically filling the gaps (in case) left by the regional competitors.

- **On Energy Transition and Oil Prospects**

Some analysts argue that a potential offshore oil discovery could transform Pakistan into a future energy exporter and attract U.S. investment in the hydrocarbon sector. Energy is also part of the tariff deal under discussion, with the idea that greater market access could be paired with U.S. participation in Pakistan's oil and gas exploration. This creates optimism that untapped fossil fuel reserves might deliver an economic windfall and enhance Pakistan's leverage in trade negotiations. However, such projections may be explored within the broader context of the global energy transition. Hitherto, the world has been shifting from the "age of oil" to the "age of electricity," driven by decarbonisation efforts and rising investments in renewable energy. Even under optimistic scenarios, where any offshore oil find becomes technically feasible and commercially operational within the next 7-8 years, Pakistan would be entering the market at a time when the global relevance of oil is already in decline.

In Pakistan, evidence of this declining oil trend can already be observed domestically, where several energy assets, such as coal, furnace oil, and even local gas plants, remain underutilised. This is due to a combination of shifting demand towards imported LNG, hydropower, and renewables; higher operating costs that make coal and furnace oil plants less competitive; government policy shifts and environmental considerations;

and technical bottlenecks in ageing infrastructure. Such patterns raise questions about the long-term viability of fossil fuel-based investments.

Moreover, offshore oil exploration remains a high-risk and uncertain endeavour, while Saudi crude continues to be more cost-effective and better suited to Pakistan's existing refineries. In essence, expecting extensive export advantage accruing to Pakistan from these tariff adjustments is unrealistic. The tariffs impact would be modest at best. Another important thing is Tariff Uncertainty, since the structure of both tariffs and investment is not clear. Pattern of investment and trade diversion magnitude is not clear.

- **Is there anything for Pakistan?**

Pakistan's economy faces significant structural challenges. However, the outlook for export-led sustainable growth is not entirely unfavourable, particularly at a time when a key competitor, India, one of the largest exporters to the U.S., is facing higher tariff barriers. If Pakistan can strategically leverage these tariff advantages, which give it a relative edge compared to earlier periods in the U.S. market, and simultaneously address key domestic bottlenecks, it could reposition itself within GVCs.

A major opportunity lies in targeting sectors where Pakistan holds latent or emerging comparative advantage and where international (especially U.S.) demand is strong. One such area is apparel and textiles, a segment worth $5.9 billion in U.S. imports from India. This sector is likely to be among the hardest hit by tariffs as American importers will explore competitive textile alternatives from neighbouring countries. For Pakistan, this presents a rare and time-sensitive opportunity to capture new orders in garments, home textiles, and knitwear. If the extra 25% U.S. tariff on India remains, Pakistan could realistically gain $500-750 million by capturing just 10-15% of India's displaced market share in home textiles and apparel.

Moreover, Pakistan exported 772,725 tonnes of basmati rice in FY24, generating $876.9 million. In FY23 it was just 595,120 tonnes. Reportedly, the U.S. tariff hike may reduce India's basmati exports to the U.S. by 50-80%, with prices reaching nearly $1,800 per metric tonne. In comparison, Pakistani basmati remains priced at around $1,450 per metric tonne, making it more competitive for U.S. importers.

Another promising avenue is pharmaceuticals. In 2024, India exported approximately $8.72 billion worth of packaged medicines to the U.S., accounting for 40% of U.S. generic drug imports. With Pakistan's modest but expanding pharmaceutical manufacturing base, this shift presents a high-impact opportunity for diversification and export growth. However, without immediate policy reforms, Pakistan risks losing this advantage to faster-moving competitors.

- **Recommendations**

Pakistan may:

- Conduct a comprehensive sectoral assessment using comparative advantage analysis, Return on Investment (ROI) evaluation, and value chain mapping to identify other high-impact sectors for the U.S. exports.
- Establish an Export Diversification Task Force focused on pharmaceuticals, high-value agriculture, and IT sectors, to coordinate policy, investment, and marketing initiatives aimed at expanding Pakistan's non-traditional exports beyond its traditional reliance on textiles and rice.
- Based on ROI evaluations, negotiate sector-specific tariff concessions with U.S. trade representatives to secure preferential market access and improve price competitiveness for potential sectors.
- Reduce industrial energy tariffs to regionally competitive levels and ensure price stability for exporters through targeted subsidies and improved energy distribution efficiency, while simultaneously rationalising taxes and duties on export-oriented sectors by introducing sector-specific tax relief and incentives for technology upgrades.

- **Conclusion**

In summary, economic transformation depends on improvements in productivity and reductions in overall production costs. The industrial sector, in particular, plays a critical role in driving this process. Opening up to international trade can accelerate transformation, but it requires the presence of an exportable surplus. Unfortunately, Pakistan has lagged behind in this regard compared to its regional peers.

Moreover, Pakistan's tariff regime suffers from a persistent anti-export bias. High and inconsistent tariffs on imported inputs raise production costs, disincentive exports as well as make exports less attractive. With export-to-GDP ratios stagnant and the industrial share of the economy in decline, evidence from the literature shows that tariff cuts alone cannot drive growth without parallel investment in industrial upgrading, innovation, and skills development.

Since 2005, Pakistan has also signed multiple FTAs. However, the empirical literature suggest that Pakistan Economy has grown at an average annual rate of 2.5% (2019-2025). From 2010 to 2023, labour productivity has increased by only 1%. The share of LSM in GDP declined sharply from 13.5% to just 9%. Over the last decade, the debt-to-GDP ratio has crossed the 60% threshold multiple times. In 2024, the ratio has reached the historical high of 80%. Tariff reduction alone would not generate transformative impact. If that had been the case, the EU GSP+ scheme would have significantly increased Pakistan’s textile and apparel (T&A) exports.

This study finds that Pakistan’s inability to efficiently produce higher-value goods, coupled with the over-allocation of resources to low-productivity sectors such as real estate and construction, has been a central factor behind its weak economic performance.

Nevertheless, the prevailing trade conditions are not entirely adverse for Pakistan. Especially at a time when Pakistan’s regional competitors are constrained by higher tariff barriers. If Pakistan can strategically leverage these relative advantages while simultaneously addressing domestic bottlenecks in productivity, governance, and industrial capacity, it can open new avenues for export growth and industrial upgrading. Such a strategy would allow Pakistan to move beyond temporary tariff-driven gains as well as lay the foundations for sustained competitiveness within GVCs.

The opportunity to integrate into higher-value global sectors is available, but only if met with targeted, reform-oriented action.

About the authors

Dr. Aneel Salman holds the distinguished OGDCL-IPRI Chair of Economic Security at the Islamabad Policy Research Institute (IPRI) in Pakistan. As a leading international economist, Dr Salman specialises in Monetary Resilience, Macroeconomics, Behavioural Economics, Transnational Trade Dynamics, Strategy-driven Policy Formulation, and the multifaceted challenges of Climate Change. His high-impact research has been widely recognised and adopted, influencing strategic planning and policymaking across various sectors and organisations in Pakistan. Beyond his academic prowess, Dr Salman is a Master Trainer, having imparted his expertise to bureaucrats, Law Enforcement Agencies (LEAs), military personnel, diplomats, and other key stakeholders, furthering the cause of informed economic decision-making and resilience.

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