



A CASE FOR EXPORT-LED ECONOMIC DIPLOMACY

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The world is experiencing a period of disorders it has not seen in decades. Escalating tariff rates, high debt, low growth and recurrent geopolitical tensions, especially around the closure of the Strait of Hormuz are aggravating geopolitical fragmentation. In these unprecedented geopolitical shifts, the International Monetary Fund (IMF) has downgraded global growth projections to 3 per cent for 2026, highlighting that pressures felt will be uneven.¹²⁶ The countries that are heavily reliant on imported energy and still recovering from the pandemic and the war in Ukraine will be affected the most. Amid this chaos, Pakistan has emerged as a crucial player in the geopolitical theatre by facilitating the first ceasefire and holding the Islamabad talks between the warring United States (US) and Iran.¹²⁷ Islamabad enjoys the confidence

and support of both sides, which look to Pakistan as the conduit through which they would meet again to formulate a diplomatic framework for a possible future dialogue over the conflict. For a country that was more often described as a problem to be managed, this is a real diplomatic triumph and has raised the international profile of Pakistan to one it has not seen during the past few years.

What was normally anticipated from this endeavour was that Pakistan's stagnating economy,

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127. Dawn.com, AFP, and Reuters, "Tireless and Courageous Diplomacy: World Reacts to Islamabad-Brokered US-Iran Ceasefire," Dawn, April 8, 2026, <https://www.dawn.com/news/1989778>

which is trapped in a quagmire of low growth and meagre foreign investment, would attract improved trade opportunities and export revenues. But that has not been the case so far. Foreign direct investment fell 34 per cent in FY2025-26 to \$1.64 billion, with net inflows of just \$14 million in June¹²⁸. Meanwhile, merchandise exports contracted about 6 per cent to \$30.13 billion, and the trade deficit widened to a four-year high of \$39.47 billion¹²⁹.

The blockage of the Strait of Hormuz, through which 20% of the world's oil¹³⁰ and liquefied natural gas passes added another layer of strain to Pakistan as it imports a substantial amount of its energy from this channel, which intensified cost-push inflation with headline inflation rising to 11.1 percent year on year in June 2026¹³¹, pushing more households below the poverty line. Pakistan's role as a facilitator definitely strengthened its standing abroad but diplomatic triumph alone can not cover the decades-old economic morass in which Pakistan find itself today.

Hence, the answer lies in enhancing exports by building endogenous sustainable growth model premised on restructuring uncompetitive existing tariff schedules, high energy pricing and revisiting decades-old poor brokered trade agreements. Therefore, the onus lies on the policymakers to convert the hard-earned improved geopolitical dividend into a meticulous trade strategy; otherwise, the moment achieved from this disorder will dissipate quickly.

Any strategy that has to be formulated must begin with textiles, which still account for close to three-fifths of Pakistan's exports. The sector's weakness is well understood by the government: unpredictable business policies, high cost of doing business, expensive energy, costly finance, complex taxation regime and tariffs on man-made fibres (MMFs) that modern apparel increasingly requires¹³². Globally, MMFs dominate yarn and fabric trade. It has surpassed cotton in traded value and accounts for 65-70 per cent of traded value in these categories.¹³³ The future of textile exports is mainly moving in this direction. However, the imposition of high duties on yarns and fabrics restricts domestic producers and exporters from transitioning to MMF-based finished products. Pakistan's transition toward MMF-based apparel will depend on whether these structural issues are addressed to improve the textile sector's regional competitiveness.

Similarly, among the targeted regions, Europe is the first of those markets. Under GSP+, roughly 90 per cent of eligible exports enter the EU duty-free, worth about €7.5 billion in 2024 and €732 million in tariff savings.¹³⁴ But the July 2026 monitoring report flagged limited progress and some regression on the human-rights and governance commitments the scheme requires.¹³⁵ With 40 per cent of Pakistan's exports heading to the EU, efforts must be made to address some concerns. Moreover, GSP+ should be treated as a bridge, not a destination, and Pakistan should aim to graduate from it into a full EU-Pakistan trade agreement, as India and Indonesia have already moved to do.

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129. Salman Siddiqui, "Four-Year High: Pakistan Trade Deficit Hits \$39.5bn in FY26," Business Recorder, July 2, 2026, <https://www.brecorder.com/news/40428230>

130. Aref Mohammed and Ahmed Rasheed, "Iraq Declares Force Majeure on Foreign-Operated Oilfields over Hormuz Disruption, Sources Say," Reuters, March 20, 2026, <https://www.reuters.com/business/energy/iraq-declares-force-majeure-foreign-operated-oilfields-over-hormuz-disruption-2026-03-20/>

131. Ali Ahmed, "Pakistan Inflation Hits 11.1% in June 2026," Business Recorder, July 1, 2026, <https://www.brecorder.com/news/40428026/pakistan-inflation-hits-111-in-june-2026>

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133. UN Trade and Development (UNCTAD), Trends in Natural and Man-Made Fibres Trade, UNCTAD/DITC/COM/2025/2 (Geneva: United Nations, 2025), <https://unctad.org/publication/trends-natural-and-man-made-fibres-trade>

134. Farooq Awan, "Pakistan Secures €732m Tariff Relief as GSP+ Use Rebounds to 95%," INP-WealthPk, July 20, 2026, <https://www.inp.net.pk/article-detail/inp-wealthpk/pakistan-secures-732m-tariff-relief-as-gsp-use-rebounds-to-95>

135. Naveed Siddiqui, "EU Warns Pakistan GSP+ Hinges on Human Rights Progress," Business Recorder, July 17, 2026, <https://www.brecorder.com/news/40430446/eu-warns-pakistan-gsp-hinges-on-human-rights-progress>

The United States comes next. It is Pakistan's largest single-country market with goods trade between the two countries reaching \$9.4bn last year. But after the imposition of "Great Liberation Tariff" last year, Islamabad negotiated the reciprocal tariff down to 19% from the threatened 29%, which would be in line with Bangladesh, but it does not provide any clear competitive advantage to Pakistan. Meanwhile, the concessions that Pakistan has given on American cotton and crude will call for a preferential trade agreement and that should be negotiated to obtain a genuine duty free access on apparel goods, not tariff relief alone. Meanwhile, Pakistan must facilitate investments and establish an investor-friendly framework in areas including IT, AI, energy manufacturing, critical minerals and agriculture. So that what Pakistan gives is matched by what it gets.

Lastly, the nearer opportunity lies to the north. Central Asia's landlocked economies have looked for a reliable route to a warm-water port for three decades, and with the Afghan route disrupted, Pakistan has begun offering one, through the Gabd-Rimdan crossing into Iran toward Turkmenistan and Uzbekistan, and through the Sost crossing into China toward Kyrgyzstan, Kazakhstan and Tajikistan¹³⁶. Gwadar lies well east of the disrupted Strait and gives them an outlet clear of the war zone. Afghanistan itself must not be written off. Although trade with Kabul has collapsed, costing Pakistan a market worth some \$1.5 billion. However, the shortest natural route to Central Asia still runs through Afghan territory. Thence, a two-track approach is required: bypass Afghanistan completely through Iran and China where necessary, while working to stabilise relations enough to revive the trans-Afghan railway, which remains the most efficient long-term link.

These corridors will help only if Pakistan does more than move goods through them. Transit alone earns a handling fee and the larger gain comes from value addition and processing the goods that pass through. The Ministry of Commerce responded to this opportunity by issuing the Transit of Goods through Territory of Pakistan Order in April 2026, officially announcing six routes for transshipment of goods to Iran and establishing the customs and bonded procedures to facilitate the handling of foreign goods in Pakistan. But given the return of

hostilities in the region, further introspection on this plan is required. Similarly, efforts must be made to increase regional trade, as Pakistan sells less than a billion dollars' worth of goods to Bangladesh, India and Nepal and has barely reached Latin America, Africa and Southeast Asia, where firm-to-firm engagement could achieve more than further intergovernmental agreements.

For Pakistan, the writing is on the wall, and all of these options are reliant on the same conditions, as investors are not going out of Pakistan due to its weak diplomacy. They are exiting because of the high cost of doing business, uncertain taxes and slow permits/refunds. Nothing can make up for those conditions at home; no amount of market access abroad will make up for them. The solution lies in undertaking long overdue structural reforms in energy, regulation, cost of doing business, eliminating input taxes for certified export production and ensuring the tax regime remains stable from one budget to the next. To sum up, the question of whether the diplomatic and geopolitical dividends which Islamabad earned will translate into sustainable export-led growth or will gradually fade like previous windfalls will not be answered in Islamabad's conference rooms, but rather in its tariff schedules, power tariffs, and trade talks.

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