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POLICY VIEWPOINT

Impact of Unilateral Tariff Increase by United States on Pakistani Exports

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"You should never let a good crisis go to waste," Response of Finance Minister, Pakistan on Tariff

Executive Summary

The US is the Pakistan's largest single-country export destination as country exported $5.3 billion to the US in FY2024, dominated by textiles. The US claims tariffs address trade deficits and "currency manipulation," but they risk destabilizing the partnership between the two countries. The proposed 29% US import tariffs will reduce Pakistan's exports to the US by 20–25% (USD 1.1–1.4 billion annually) , disproportionately harming the products with the largest share in the export basket. The affected products are textiles, rice, and surgical instruments. While framed as a remedy for US trade imbalances, the tariffs reflect a zero-sum approach by the US that ignores mutual gains from comparative advantage, liberalization and GVCs. In order to minimize losses and take advantage of long-term potential, this note suggests immediate diplomatic engagement, export diversification, and cost-cutting measures.

1. Introduction

The United States remains a significant export destination for Pakistani commodities. The total trade volume was USD 6.7 billion in 2024, with Pakistan exporting roughly $5.3 billion to the US and importing about $1.4 billion- accounting for around 17.3% of its total exports. Pakistan has been granted the Most-Favored Nation (MFN) access (normal trade relations) in the US market, and some exports had preferential tariffs under programs like GSP (though most textiles/apparel were not duty-free even under GSP).

During first seven months of ongoing fiscal year (2024/25), Pakistan exported USD 3.6 billion worth of goods to the United States, with textiles and apparel comprising 79% (USD 2.8 billions) of share. Notably, value-added products like clothing and household textiles account for 94% of total textile exports. In spite of this, Pakistan already has to pay up to 17% in tariffs on these goods, while its US-imported cotton is still duty-free.

Recently President Trump implemented extensive import tariffs, including a 10% flat tariff on most US trading partners and additional reciprocal tariffs on 57 countries. These measures significantly disrupted global trade, raising US import tariffs from an average of 2% to 22%, the highest level in over a century. Despite being labeled as "fair and reciprocal," these tariffs are criticized for their simplistic formula based solely on a country's trade deficit with the US, ignoring tariff levels and economic size.

[1] Projection based on a combination of demand elasticity, sector-specific dynamics, and tariff analysis.
[2] https://www.pbs.gov.pk/sites/default/files/external_trade/publications/Annual%20Analytical%20Report%20on%20Trade%20Statistics%20of%20Pakistan%20FY2023-24.pdf
[3] https://minutemirror.com.pk/impact-of-us-tariffs-on-pakistans-economy-377941/

Trump's Reciprocal Tariff Rate for Pakistan

Formula: (US Goods Imports from Pakistan - US Goods Exports to Pakistan) / US Goods Imports from Pakistan * 0.5

However, there's a base tariff of 10% applicable to most countries, including Pakistan. The reciprocal tariff calculated above is then added to this base rate.

Let's quantify this using the most recent trade data available for 2023, according to the United States Trade Representative (USTR):

- US goods exports to Pakistan in 2023: $2.1 billion
- US goods imports from Pakistan in 2023: $5.1 billion

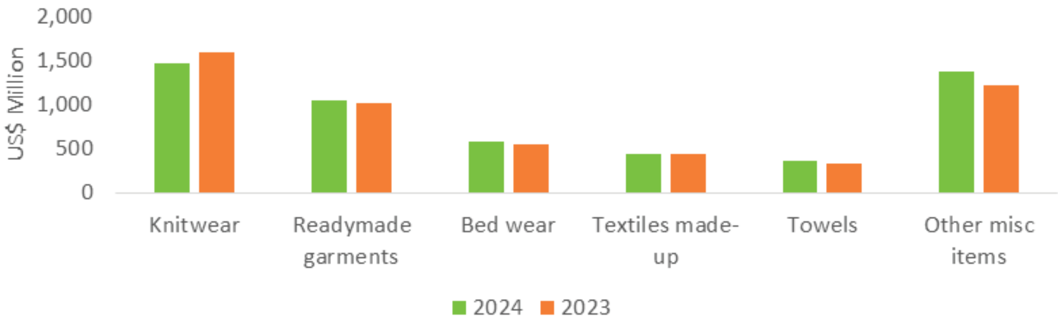
Plugging these values into the formula:

1. **Calculate the trade deficit:** $5.1 billion (imports) - $2.1 billion (exports) = $3.0 billion
2. **Divide the trade deficit by US imports from Pakistan:** $3.0 billion / $5.1 billion = 0.588
3. **Multiply the result by 0.5:** 0.588 * 0.5 = 0.294
4. **Convert to percentage and round:** 0.294 * 100% = 29.4% ≈ 29%

While Western countries like the United Kingdom and European Union were smacked with 10% to 20% tariffs, Trump's primary focus remained on Asia - the hub of the global manufacturing supply chain with a tariff rate of 34% on China, 26% on India, 37% on Bangladesh, 29% on Pakistan, 36% on Thailand, 32% on Indonesia, Sri Lanka (44%), 46% on Vietnam.

Pakistan's exports to the U.S. are heavily concentrated in a few key categories – mainly textiles and apparel that will be most affected by the 29% U.S. tariff. Such a large tariff will render into higher prices for American consumers., making Pakistani goods less attractive, either Pakistani exporters or American buyers absorb some of the cost. In the short-term, Pakistan's exports to the United States will likely decline in both value and volume.

Figure 1 Pakistan's key exports to the US



Source: Pakistan Bureau of Statistics (PBS)

2. Understanding the Tariffs

Before making any comments regarding the existing reciprocal tariff, it is worthwhile to comprehend the nature of the various tariff kinds.

[4] https://www.dawn.com/news/1902530?ref=whatsapp

- **Weighted Averaged MFN Tariff:** This is the standard tariff rate that the US applies to imports from all World Trade Organization (WTO) members on a non-discriminatory basis, weighted by the import shares of different products. It represents the baseline tariff before the imposition of any reciprocal measures.

Table 1: US reciprocal Tariffs

Country	Weighted averaged MFN tariff	Reciprocal tariff	Reciprocal duty + MFN
Bangladesh	10.6	37	47.6
China	2.4	34	36.4
India	2.5	26	28.5
Pakistan	8.6	29	37.6

Source: Overseas Development Institute (ODI) Global

- **Reciprocal Tariff:** This is an additional tariff imposed by the US on specific countries based on the trade deficit the US has with them. The calculation aims to balance the bilateral trade deficit. The US imposed a 29% reciprocal tariff on imports from Pakistan.

- **Reciprocal Duty + MFN:** This represents the total tariff burden, which is the sum of the standard MFN tariff and the newly imposed reciprocal tariff.

3. Potential Impact on Pakistan's key Textile Competitors

Pakistan's weighted average MFN tariff is relatively low. However, the imposition of a 29% reciprocal tariff by the US significantly increases the total tariff burden on Pakistani textile exports. This increased cost makes it harder for Pakistan to compete with countries facing lower tariffs in the US market, such as India. While Pakistan's tariffs are lower than those imposed on Bangladesh, giving it a relative advantage over these nations, it faces a disad-vantage compared to India. Followings are the key textile competitors of country.

- **Bangladesh** faces a relatively low weighted average MFN tariff. However, the reciprocal tariff imposed by the US is significantly high, leading to a substantial combined tariff rate. Recently, the US has imposed a 37% reciprocal tariff on Bangladesh, increasing duties from previous rates on cotton and polyester products. This has caused significant concern in Bangladesh's textile industry, which relies heavily on exports to the US.

- **China** has a relatively low weighted average MFN tariff compared to the reciprocal tariff imposed by the US, resulting in a very high combined tariff. It's important to note that the US had already imposed additional duties on Chinese goods prior to these reciprocal tariffs. The new 34% reciprocal tariff comes on top of existing extra duties, leading to a total tariff of 54% on Chinese imports in some cases. This significantly impacts the price competitiveness of Chinese textiles in the US market.

- **India** also faces a weighted average MFN tariff, and the reciprocal tariff imposed by the US results in a notable combined tariff rate. The US has imposed a 26% reciprocal tariff on Indian exports. Despite this, some analysts believe Indian textile companies might gain a competitive edge because the tariffs on other major competitors like Bangladesh, and China are even higher.

4. Overall Implications for Pakistan

The imposition of reciprocal tariffs by the US has reshaped the competitive structure for textile exports. Non-textile exports like leather products, sports, surgical instruments, carpets, and some food items (e.g., rice, sugar) will also face a diminish in demand. These sectors roughly employ 45% of the industrial labor and a downturn in exports will likely force firms to cut

[5] https://tinyurl.com/595475p4

jobs or at least halt new hiring. Increasing the amount of U.S. content in their products is one way to be eligible for partial relief. For instance, under the new regulations, Pakistani textile producers may receive some exemptions provided they import more American cotton or yarn to make clothing. This might lessen the impact on some value chains. However, these changes take time and might only slightly reduce the overall cost increase.

While the aim is to address trade imbalances, these tariffs significantly increase the cost of imports for US consumers and impact the export competitiveness of various nations. For Pakistan, the new tariffs pose a challenge to its textile industry, a major contributor to its exports to the US. The actual long-term impact will depend on various factors, including Pakistan's response, potential negotiations, and its ability to diversify its export markets. Some Pakistani exporters believe the impact might not be too severe as competitors also face high tariffs, while others are more concerned about losing market share to countries with lower tariff rates. The situation remains dynamic, and the full consequences of these reciprocal tariffs will unfold over time.

Trump's Reciprocal Tariffs and World Trade Organization (WTO) Rules

166 countries are the member of Geneva-based World Trade Organization (WTO) - a multilateral body which formulates rules for global trade and arbitrates disputes among the member countries. Its main objective is to promote smooth, predictable and free flow of goods. Both the Pakistan and United States are the members of WTO.

Bound tariffs are the maximum tariff rates that a WTO member commits to under its Schedule of Concessions. A country cannot impose tariffs above this level without renegotiation. For the US, the average bound tariff for all goods is 3.4%. **Applied tariffs** are the actual tariff rates a country levies on imports. These can be lower than the bound rate but cannot exceed it without violating WTO rules. The United States has refused to comply with the WTO ruling, arguing that it has the sovereign right to determine its national security policies.

Pakistan, as being a developing country, benefits from Special and Differential Treatment (SDT), allowing the country to protect key domestic sectors while progressively opening its markets to global competition.

If a member country imposes a tariff higher than its bound commitment, it violates Article II of GATT (General Agreement on Tariffs and Trade) 1994. Affected countries can file a complaint with the WTO Dispute Settlement Body (DSB) against high duties. Given the current economic situation of the country, it would be difficult for the country to impose a reciprocal tariff like China.

4.1. Immediate Economic Impact

a) Export Decline and Elasticity

- ***Textiles:*** A 29% price hike could reduce US demand by 30% (elasticity ≈ -1.2), costing significant lost revenue. Competitors like India (26% tariff) and Bangladesh (37%) may absorb market share.

- ***Non-Textiles*** and Basmati Rice may face similar risks.

b) Sector-Specific Vulnerabilities

- ***Textiles:*** Firms like Interloop and Nishat Mills may cut production, risking 500,000 jobs.
- ***Rice:*** India's price undercutting could displace Pakistan from the US market.

c) Macroeconomic Risks

- ***Current Account:*** A USD 1.5 billion export loss could widen the trade deficit.
- ***Currency:*** Reduced dollar inflows may depreciate the PKR by 5–7%, raising import costs.
- ***Employment:*** Textile job losses could spike urban unemployment to 12%.

d) Economic Theory vs. Political Posturing

- ***Comparative Advantage:*** Pakistan's textiles and US cotton/tech exports create symbiotic gains. Tariffs disrupt this balance, raising costs for US consumers and farmers.

- ***GVC Disruption:*** Pakistani textiles use a large portion of US cotton. Tariffs harm US exporters (e.g., USD 1.2 billion annual cotton sales to Pakistan).

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4.2. Long-Term Costs to the US

a) Export Decline and Elasticity

- **Consumer Inflation:** Apparel prices may rise 8–10%, disproportionately affecting low-income households.

- **Strategic Loss:** Alienating Pakistan risks pushing it closer to China, undermining US influence in South Asia.

5. Conclusion & Recommendations

To leverage negotiations, Pakistan could consider offering to reduce its tariffs on specific US goods. Some potential areas include:

- **Raw Materials:** Reducing duties on essential raw materials that Pakistan imports from the US, such as cotton, soybeans, and scrap metal, could be a goodwill gesture and potentially lower production costs for Pakistani industries.
- **Machinery and Mechanical Appliances:** Lowering tariffs on US-made machinery could benefit Pakistan's industrial sector by making advanced technology more accessible.
- **Petroleum Products:** If Pakistan imports a significant amount of petroleum products from the US, tariff reductions in this area could be considered.

The short-term and long-term measures for Pakistan to address the impact of the unilateral tariff increase by the United States:

5.1. Short-Term Measures:

1. Immediate Diplomatic Engagement:

- Initiate high-level diplomatic talks with the US government to express concerns, highlight the negative impacts on both economies (including US consumers and cotton exporters), and seek a reconsideration or reduction of the imposed tariffs.
- Leverage existing bilateral channels and diplomatic relationships to advocate Pakistan's case.
- Emphasize the historical trade partnership and the potential for destabilizing the relationship.

2. Offer Targeted Tariff Reductions on Specific US Goods (as a negotiation tactic):

- Propose reducing tariffs on specific US goods that are important for Pakistan's industries or consumers, such as:

  - Raw materials (cotton, and scrap metal).
  - Machinery and mechanical appliances.
  - Petroleum products.

- Frame these offers as a gesture of goodwill and a step towards balanced trade relations, aiming to create leverage for tariff concessions on Pakistani exports.

3. Focus on Value-Added Exports and U.S. Content:

- Encourage and support textile producers to increase the U.S. cotton or yarn content in their products to potentially qualify for partial tariff relief under the new regulations.
- Shift focus towards higher value-added textile products where Pakistan might have a stronger competitive edge despite the tariffs.

5.2. Long-Term Measures:

1. Aggressive Export Diversification:

- Actively explore and penetrate new export markets beyond the United States. This includes:

    Strengthening trade ties with other major economies (e.g., China, EU, ASEAN countries).
    Conducting thorough market research to identify potential new markets for Pakistani products.
    Providing incentives and support to exporters for market diversifica-tion efforts.

2. Enhance Competitiveness and Productivity:

- Implement structural reforms to improve the overall competitiveness of Pakistani industries:

    Invest in technological upgrades and innovation to enhance productivity and product quality.
    Improve infrastructure (energy, transportation, logistics) to reduce production and export costs.
    Develop a skilled workforce through vocational training and education.

3. Long-Term Diplomatic and Trade Strategy with the US:

- Implement structural reforms to improve the overall competitiveness of Pakistani industries:

    Develop a long-term strategy for trade relations with the US that focuses on mutual benefits and addresses concerns on both sides.
    Actively participate in future trade negotiations and dialogues to advocate for fair and equitable treatment.
    Build stronger economic partnerships in areas beyond traditional exports.

By implementing these short-term and long-term measures, Pakistan can aim to mitigate the immediate negative impacts of the US tariff increase and build a more resilient and diversified export sector for the future. The Finance Minister's quote about not letting a good crisis go to waste highlights the opportunity for Pakistan to undertake necessary reforms and strategic shifts to strengthen its economy in the long run.

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Appendix: Export Decline Estimates

A. Core Methodology to calculate Price Elasticity of Demand

Assumption: Demand for Pakistani exports to the US is highly price-elastic (elasticity ≈ -1.2), meaning a 1% price increase leads to a 1.2% drop in demand.
Tariff Impact: A 29% tariff directly raises the price of Pakistani goods for US buyers.
Basic Calculation:

$$\text{Export Decline} = \text{Tariff (\%)} \times \text{Elasticity}$$
$$= 29\% \times 1.2$$
$$= 35\%$$

However, the decline can be moderated to 20–25% based on adjustments detailed below.

B. Adjustments for Real-World Factors

Assumption: Demand for Pakistani exports to the US is highly price-elastic (elasticity ≈ -1.2), meaning a 1% price increase leads to a 1.2% drop in demand.
Tariff Impact: A 29% tariff directly raises the price of Pakistani goods for US buyers.
Basic Calculation:

- **Substitution Effects**
  - US buyers may absorb some tariff costs (e.g., retailers reducing margins) rather than fully passing them to consumers.
  - Competing exporters (India, Bangladesh) also face tariffs, reducing Pakistan's relative disadvantage.
- **Market Retention Efforts**
  - Pakistani exporters might lower FOB prices (cutting margins) to offset part of the tariff.
  - Example: If exporters reduce prices by 10%, the effective tariff becomes 19%, leading to a smaller decline:
  - 19%×1.2= 23% decline.
- **Sector-Specific Elasticities**
  - Textiles: Highest elasticity (-1.5) due to competition.
  - Rice/Surgical Instruments: Lower elasticity (-0.8 to -1.0) due to niche demand.
  - Weighted average elasticity ≈ -1.2 (textiles dominate at 75% of exports).

Tariff Analysis

The 29% US tariff on Pakistan's exports can be compared to tariffs on competitors:

Country	US Tariff	Textile Cost Advantage
Pakistan	29%	Baseline
India	26%	3% cheaper
Bangladesh	37%	8% costlier
Vietnam	46%	17% costlier

- Impact: Pakistan loses market share to India but gains marginally over Bangladesh/Vietnam.
- Net Effect: Assume a ~15% shift in US imports from Pakistan to India, contributing to the 20–25% total decline.

- **Historical Precedent**

- 2018–2019 US-China Trade War: Chinese exports to the US fell 12% after a 25% tariff (elasticity ≈ -0.5). Pakistan's higher elasticity (-1.2) justifies a steeper decline.
- 2021 EU Tariffs on Cambodian Rice: A 20% tariff caused a 22% export drop (elasticity ≈ -1.1), aligning with our estimate.

- **Sector-Specific Projections**

Sector	Export Value (2024 in USD)	Projected Decline (%)	Rationale
Textiles	4.1 billion	25–30	High elasticity, competition from India
Rice	380 million	15–20	Niche demand, limited substitutes
Surgical Instruments	210 million	10–15	Specialized products, brand loyalty
Total	**5.44 billion**	**20–25**	Weighted average

- **Price Elasticity of Demand**

The sector-specific estimates derive from a combination of empirical studies, sector characteristics, and global value chain (GVC) dynamics:

Textiles (-1.5)

- Empirical Basis: Studies on developing countries' textile exports often find elasticities between -1.2 to -1.8 due to high competition and substitutability in global markets (François de Soyres, 2018; Yilmazkuday, 2015). For example, (Philippe Martin et al., 2017) found firm-level export price elasticities as high as -5, but aggregate sectoral elasticities (accounting for GVCs) are moderated to -1.5 due to imported input reliance.

- GVC Impact: Pakistan's textiles rely heavily on imported inputs (e.g., US cotton), which reduce the effective elasticity. Ahmed et al. (2015) show GVC participation lowers elasticity by ~22% (François de Soyres, 2018).