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Global Geo-Economic Impacts of the US-EU Schism and Its Fallout on Pakistan

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Introduction

The geopolitical rift between the United States and the European Union is redefining global economic paradigms. Rooted in diverging strategic priorities, trade approaches, and regulatory policies, this schism is fragmenting traditional alliances and destabilizing global economic governance. As these economic powers adopt increasingly different positions on China, Russia, trade rules, digital regulation, and climate change, the global economy faces heightened volatility, uncertain trade flows, and fractured investment regimes. For Pakistan, a developing country already grappling with macroeconomic instability, these shifts carry significant consequences.

Since World War II, the transatlantic alliance between the United States and the European Union has been a bedrock of global economic stability, cooperation, and institutional development. Together, the US and EU account for nearly 43% of global GDP and 30% of global trade (EU Council, 2024). They have historically cooperated through multilateral institutions like the WTO, IMF, and OECD. However, growing strategic, regulatory, and economic differences have begun to undermine this alliance. Key sources of divergence include the US's increasingly protectionist economic stance under the Inflation Reduction Act (IRA), Europe's more conciliatory approach to China, differing digital privacy regimes (GDPR vs. US sectoral model), and tensions over defense burden-sharing in NATO.

This divergence became more visible in 2023, with the EU criticizing the US's green subsidies as discriminatory and investment-diverting. Meanwhile, the US viewed Europe's energy policies and strategic autonomy as undermining collective Western pressure on Russia and China. The result is a fragmentation of global economic governance, increasing the cost of compliance for third countries, reducing global investment efficiency, and adding volatility to trade and financial markets.

For emerging economies like Pakistan, the implications are profound. The country's economy is highly sensitive to external shocks due to high levels of public debt-over 67.5% of GDP as of FY2024 (Ministry of Finance, 2024) dependence on exports to the West, and limited foreign reserves -$15.9 billion on February 14, 2025 (Ministry of Finance, 2025). As the global economic order realigns, Pakistan must adapt its strategies to secure economic stability, diversify trade, and attract resilient investment flows.

Global Geo-Economic Implications

The increasing economic divergence between the European Union and the United States is bringing major disruption to the world's economic dynamics, with global implications for international trade flows, investment patterns, and supply chains. This accelerating rift, characterized by differing monetary policy, trade policy, and fiscal perspectives, is increasingly redrawing the structure of global economic relationships. The juxtaposition between EU stability and U.S. policy uncertainty is causing companies and governments globally to reorient their economic strategies.

Policy uncertainty has risen considerably in the United States during early 2025. Major factors are a new wave of threats of tariffs---indeed even against long-standing allies---and uncertainty regarding fiscal consolidation actions. Investor confidence has thus been weakened, as well as domestic consumer confidence. Consistent with these difficulties, the U.S. GDP growth estimate for 2025 has been reduced to 1.5% from the previous mid-2024 projection of 2.5%. The deceleration is aggravated by chronic inflationary pressures and a policy setting characterized by uncertainty, which has kept long-term capital planning and cross-border trading alliances at bay.

In contrast, the European Union is undertaking a more synchronized and intentional economic agenda. While eurozone growth is modest at a forecasted 0.7% for 2025, the bloc's relatively stable macroeconomic policies are building investor confidence. As the European Central Bank is moving toward accommodation monetary policy and member nations boost public expenditure, particularly on infrastructure like digital development and renewable power, Europe is positioning itself to be a better predictable and resistant economic partner. This clarity of purpose is being drawn by cross-border capital inflows, even more so as investors move towards safe-havens away from U.S. market unpredictability.

This divergence is also sparking a rearranging of worldwide supply chains. Multinationals are shifting away from production paradigms highly reliant on U.S.-dominated trade corridors. Nearshoring and reshoring movements are gaining pace, especially in priority areas such as semiconductors, pharmaceuticals, and clean energy technology. The effect is quantifiable: world trade volume growth will slow down to 2.1% in 2025, down from 3.4% in 2024, highlighting the impact of increased protectionism and the fragmentation of global trade regimes.

Emerging markets closely integrated within U.S.-focused supply chains---like Mexico, Vietnam, and South Asia's regions---are highly susceptible to this volatility. These nations can see a reversal in export-led growth and investment inflows. In contrast, the EU is aggressively deepening its trade presence in Africa, Southeast Asia, and Latin America. This strategic reorientation is doubling down on an incremental but increasing trend towards a more multipolar trade environment in which dependence upon any one bloc is softened through diversified relationships.

Capital markets are echoing this transatlantic divergence. In America, increased fiscal uncertainty and conflicting messages about regulatory paradigms have been accompanied by rising volatility, notably in interest-rate-sensitive industries and international supply chains. Conversely, European financial markets are enjoying relative policy unity and long-term financing strategies centered on industrial innovation and energy transformation. This dichotomy is inducing global investors to rebalance portfolios, preferring settings with more transparent governance and strategic focus.

Fallout for Pakistan

The United States is one of the most important trading partners for Pakistan. US-Pakistan trade was approximated at $7.3 billion in 2024, with US exports to Pakistan of $2.1 billion worth of goods and US imports from Pakistan of $5.1 billion worth of goods. This led to a $3 billion US trade deficit in 2024, up 5.2% from 2023 (USTR, 2024). The US is Pakistan's largest single destination for exports with $5.3 billion of exports in 2024 and accounts for nearly 18% of the overall exports of Pakistan (Topline Securities, 2025). Textiles account for 75-80% of the US exports followed by leather goods, surgical instruments, and rice (Topline Securities, 2025).

In April 2025, US President Donald Trump declared a 29% reciprocal tariff on US imports from Pakistan, given Pakistan's already imposed 58% tariff on US imports. Although suspended temporarily, the tariffs would be on top of the already in-force 8.6% Most Favoured Nation (MFN) tariff and could bring the total duty to 37.6% (PIDE, 2025). This is over the World Trade Organisation's (WTO) bound tariff rate of 3.4%, which may contravene multilateral trade regulations (PIDE, 2025). The US has imposed equivalent tariffs on other regional rivals, with Vietnam, Bangladesh, and China having tariffs ranging from 29-46% and India having a lower tariff of 26% (Topline Securities, 2025). The discriminative treatment between India and Pakistan might result in further competitive issues for Pakistan in the US market.

Pakistan Institute of Development Economics (PIDE) projections show the tariffs could result in a 20-25% decline in exports to the United States, valued at $1.1-1.4 billion per year (PIDE, 2025). Large textile exporters such as Nishat Mills and Interloop may be forced to cut production, jeopardizing more than 500,000 jobs (Pakistan Today, 2025). Textile exports from Pakistan would become less price competitive, especially against India, which is subject to a 3% lower tariff rate (Topline Securities, 2025). The US-Pakistan textile supply chain, which involves US cotton being processed in Pakistani mills for the US market, would be severely affected, affecting stakeholders on both sides (Zeshan, 2025).

Being Pakistan's leading export sector to the US, the textile industry will be most affected. Factory owners in manufacturing centers like Faisalabad expect workforce cuts of up to 20%. As one factory owner reported, "I'm looking at pink slips for maybe a fifth of my people if these tariffs stick. We're not talking about abstract economic theories here -- we're talking about real people who might not make rent next month" (Zeshan, 2025). Some relief will also come from the competing nations such as Bangladesh and Vietnam that are subject to even steeper tariffs, which Topline Securities says may offer "some respite" to Pakistani exporters (Topline Securities, 2025).

Other sectors beyond textiles will also have serious challenges. Surgical instruments of Sialkot, an important export with potential for affecting US healthcare costs, will witness increases in prices that can affect both Pakistani producers and American health providers (Zeshan, 2025). Exports of leather goods, rice, and sports equipment will also suffer from greater susceptibility in the US market (Pakistan Today, 2025). Textile exports "are going to suffer more" than non-textile exports, as predicted by business and economic journalist Khurram Husain quoted in the report, perhaps because of less entrenched market positions and higher price sensitivity.

Although the risk of export is high, it is less than 1.5% of Pakistan's GDP, as per Ali Hasanain, an associate professor of economics at LUMS. He observes that "Even if these [exports] are completely erased --- which is extremely unlikely -- the effect will be less than several times we have reduced our economy by our own mismanagement". However, the tariffs come at a difficult moment for Pakistan's economy, which is already subject to IMF program oversight. According to Sajid Amin of the Sustainable Development Policy Institute (SDPI), the short-term effect will be adverse, necessitating policy action. He highlights that "To counterbalance that, Pakistan may have to subsidise domestic production to compete better," though he wonders whether "the IMF will let the country subsidise"

Recommendations

Immediate Response (0-6 months)

- ***High-Level Diplomatic Engagement***

Pakistan must engage immediate diplomatic talks with US counterparts in order to make the two countries' tariff costs known to one another. These talks must highlight the interdependent character of the US-Pakistan textile value chain, where disruption hurts both economies. According to Zeshan (2025), "Pakistani mills purchase American cotton, process it into goods, and then resell the product to American buyers. American farmers profit. Pakistani laborers prosper. American households find clothing for themselves and their kids at modest prices. All's well!" Because Pakistan operates within a situation of limited budgets, out-of-framework bilateral negotiation will perhaps prove wiser than proceeding to official resolution of differences (PIDE, 2025).

- ***Strategic Tariff Changes***

Pakistani policymakers can consider the potential lowering of Pakistan's 58% tariff on specific US imports as a bargaining chip. It should be directed towards high-value imports like machinery and petroleum products where lower tariffs could help Pakistan's manufacturing base while offering leverage for bargaining. As suggested in the PIDE report, Pakistan "might consider reducing tariffs on selected US imports, such as machinery and petroleum, to create room for negotiations" (Pakistan Today, 2025). This approach would signal willingness for compromise while maintaining vital sources of revenue.

- ***Supply Chain Adaptation***

Pakistan can also incentivize industries to raise levels of US-origin inputs, notably cotton. As observed by Zeshan (2025), "Using more US cotton might help dodge some tariff bullets under the new rules." This course of action might have the added benefit of opening tariff exemptions under US content terms in Pakistani trade, as well as bolstering the case for bilateral trade serving the interests of both nations. Building certification processes to authenticate and promote US content in Pakistani products might form a platform for granting exemptions on this basis.

Medium-Term Strategy (6-24 months)

- ***Market Diversification Initiative***

Pakistan has to hasten efforts to increase export markets beyond the US to the European Union (already Pakistan's second-largest trading partner at 15.3% of total trade), ASEAN countries, African markets, and the Middle East (European Commission, 2023). Pakistan needs to use its position as "the largest beneficiary of the EU's Generalised Scheme of Preferences Plus (GSP+)," which allows essential tariff exemptions and facilitates sustained trade expansion (European Commission, 2023). As Zeshan (2025) points out, "We need to aggressively expand into new markets -- Asean, Africa, you name it -- and diversify what we're selling. We've been discussing export diversification for decades, now we're paying the price for lagging behind."

- ***Product Diversification Program***

The government must come up with incentives for exporters to diversify beyond the conventional textile products. It is recommended that the program concentrate on new industries such as IT services, halal food items, processed food items, and more value-added items that are not as vulnerable to tariff walls. According to the PIDE report, this crisis offers Pakistan an opportunity to "recalibrate its export strategy" (Pakistan Today, 2025). By moving up the value chain and developing more specialized products, Pakistan can decrease its vulnerability to tariff shocks in commodity-like textile products.

- ***Competitiveness Improvement Steps***

Pakistan would put in place targeted subsidies to counter short-run tariff effects, subject to IMF approval. Initiatives to cut energy and logistic costs would enhance export competitiveness in all sectors. As Maleeha Lodhi, the country's erstwhile ambassador to America, advises, Pakistan will have to "make its exports more competitive" due to these problems. Streamlining rules to make it easier for exporters to meet their compliance responsibilities would further strengthen competitiveness. The steps would have to be implemented in a measured way to adhere to IMF program terms while causing actual benefit to affected industries.

Long-Term Structural Reforms (2-5 years)

- ***Industrial Modernization Program***

Pakistan can invest in automation and technology upgrade to enhance quality and productivity in its manufacturing base. Creating more higher value-added manufacturing capabilities with less tariff competition vulnerability would create long-term robustness. As pointed out by Zeshan (2025), "Perhaps the silver lining is that it forces us to finally address structural issues we've been ignoring for too long." By promoting innovation in product design and manufacturing processes, Pakistan can become a higher-value supplier to international markets.

- ***Trade Policy Overhaul***

An overall tariff review of Pakistan is essential to be aligned with strategic economic interests. Pakistan needs to transition incrementally towards more balanced trade arrangements with leading partners, redressing high tariff levels that have led to the current scenario. Institutional capacity for trade negotiation and dispute settlement would be bolstered, allowing Pakistan to better navigate the more complex global trading environment with increased protectionism and economic nationalism (Pakistan Today, 2025).

- ***Economic Resilience Building***

Pakistan has to decrease reliance on any single export market through systematic diversification of both markets and products. Developing local market alternatives for export industries would serve as a cushion against shocks. Establishing financial cushions to ride out future trade disruptions, possibly in the form of export insurance programs or stabilization funds, would increase the resilience of Pakistan's export sector to future protectionist actions by its major trading partners (PIDE, 2025).

Conclusion

The US tariff measures pose a substantial challenge to Pakistan's export sector, especially its vital textile industry. However, through pragmatic diplomatic intervention, responsive trade policy, and intensified diversification, Pakistan can contain the short-term hurt while setting itself up for increased economic robustness in the longer term.

The crisis should serve as a catalyst to address long-standing structural issues in Pakistan's export strategy, moving away from concentration in textiles and the US market. By implementing the suggested recommendations, policymakers can turn this into an opportunity for much-needed economic change that will serve the economy of Pakistan for decades to come. According to Zeshan (2025), "Economic nationalism might feel good for a minute, but history shows it just makes everyone poorer in the end." Pakistan's reaction should be informed by such knowledge, pursuing pragmatic measures that maintain trade relations while developing enhanced economic independence.

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