ESG or Exit: Pakistan's Trade Future at a Crossroads

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In the rapidly evolving landscape of international trade and investment, Environmental, Social, and Governance (ESG) standards have become the de facto currency of credibility. No longer confined to boardroom ethics or public relations, ESG compliance now functions as a fundamental axis along which capital flows, trade preferences, and regulatory access are aligned. Global institutional investors, supply chain regulators, and sovereign partners are increasingly filtering engagement through the ESG lens.

For import-reliant economies like Pakistan—where exports account for approximately 10% of GDP and fiscal space is perennially constrained—faced with a persistent trade deficit and limited access to concessional financing, the cost of ESG non-compliance is material, mounting, and macroeconomically consequential.

Despite the growing prominence of ESG, Pakistan's institutional and corporate response remains fragmented, under-regulated, and grossly underutilized. Pakistan's exports, concentrated in textiles, cement, chemicals, and low-value agriculture, are especially vulnerable to ESG-based exclusion due to a lack of verifiable disclosure systems, absence of standardized reporting protocols, and minimal regulatory enforcement *(SECP, 2023; Transparency International Pakistan, 2024)*.

The lack of mandatory ESG disclosures, limited enforcement, and inconsistent corporate transparency are not only reducing access to sustainable capital but also diminishing Pakistan's eligibility for ESG-conditioned trade regimes, such as the European Union's Carbon Border Adjustment Mechanism (CBAM) and evolving international procurement norms. ESG is now embedded in trade conditionality, and non-compliance is resulting in an effective "invisible tariff" on Pakistani exports, undermining competitiveness and long-term trade viability.

ESG readiness in Pakistan remains critically deficient, as evidenced by comprehensive empirical data that underscores systemic weaknesses in transparency, governance, and regulatory enforcement. According to the TRAC Report 2024, which assessed 69 publicly listed companies, only 14.5% of firms demonstrated "significant transparency" across core ESG dimensions, with the average overall ESG disclosure score standing at 72.3%, classifying firms as "moderately transparent."

However, disaggregated metrics reveal deep structural deficiencies: anti-corruption programs, a cornerstone of the governance pillar, recorded the lowest average score at 47.28%; human rights and corporate responsibility averaged 60.43%, with only 16 firms achieving full transparency; and gender and non-discrimination policies scored 68.84%, with only 22 companies fully transparent. In contrast, organizational transparency and domestic financial reporting scored higher, at 90.54% and 94.35%, respectively—highlighting a pronounced imbalance wherein financial disclosure is prioritized over sustainability governance.

These patterns reflect a broader systemic inertia: over 36% of assessed firms were rated "partially transparent" or worse, with persistent gaps in emissions transparency, anti-harassment policies, beneficial ownership disclosure, and supply chain due diligence—all of which are increasingly mandated under international buyer and investor ESG standards (SECP, 2023; Transparency International Pakistan, 2024).

Further, the TRAC Report 2024 adds fuel to the fire by showing a strong correlation between poor ESG performance and deeper organizational weaknesses, such as weak governance, low innovation, and minimal investor interest (*Transparency International Pakistan, 2024)*.

The Securities and Exchange Commission of Pakistan (SECP) introduced ESG Disclosure Guidelines in 2023, covering metrics such as GHG emissions, sustainable sourcing, board diversity, and corruption risk. However, these remain voluntary, with minimal adoption, impeding convergence with global ESG norms *(SECP, 2023)*.

These deficiencies are particularly perilous in the context of the EU's CBAM—a trade policy instrument applying carbon tariffs on high-emission imports like cement, steel, aluminum, and textiles.

Pakistan's existing trade and fiscal architecture is fundamentally misaligned with its environmental ambitions and export diversification agenda, placing it at a growing disadvantage in an increasingly ESG-regulated global economy. A study by the Consortium for Development Policy Research (CDPR) highlights that the average tariff on environmental goods (EGs)—such as renewable energy components, air pollution control equipment, energy-efficient appliances, and electric vehicles—is between 11% and 15.7%, with an additional 5% in para-tariffs. This makes the importation of green technologies economically unviable (Iqbal, 2025). These are the very technologies critical for decarbonizing Pakistan's supply chains and meeting its Nationally Determined Contributions (NDCs) under the Paris Agreement.

In comparison, regional peers like India (7.4%) and Vietnam (6.2%) have undertaken aggressive tariff rationalization on EGs and are actively employing non-tariff measures (NTMs) — such as mandatory certifications, emissions labeling, and lifecycle assessments — to promote ESG-aligned trade and facilitate compliance with international standards.

Pakistan, by contrast, has the lowest NTM coverage and frequency index in South Asia. CDPR's analysis shows near-zero application of NTMs in critical categories like Air Pollution Control (APC), Renewable Energy Plants (REP), and Environmental Monitoring Equipment (MON), indicating an institutional void in certifying, verifying, or monitoring green goods and services (Iqbal, 2025).

This regulatory shortfall becomes particularly damaging in light of the CBAM, which applies carbon tariffs on emissions-intensive imports—core sectors in Pakistan's export portfolio. The EU alone accounts for nearly 30% of Pakistan's total export market (Durrani, 2024; PBC, 2023), yet Pakistan lacks the foundational infrastructure to comply with its documentation requirements. With 55.7% of its energy mix still dependent on fossil fuels (Economic Survey, 2024–25) and no national emissions registry or mandated Scope 1, 2, and 3 carbon accounting measures at the corporate level, exporters are unable to produce the verified carbon data required to avoid punitive levies (Iqbal, 2025).

This institutional incapacity and policy inertia effectively impose a hidden cost on exporters. Without verifiable ESG credentials, Pakistani firms risk trade exclusion, price markups, and supplier disqualification from global value chains increasingly governed by environmental compliance standards. Simultaneously, high tariffs on green imports deter technological upgrading, slowing the very decarbonization efforts needed to maintain trade relevance. Regional competitors, in contrast, are not only aligning with ESG standards but leveraging that alignment to capture preferential trade access, green investment, and supply chain relocation opportunities.

Further, this counterintuitive policy regime - marked by high EG tariffs, negligible NTM enforcement, and absent carbon traceability - restricts access to sustainability-linked capital, sidelines Pakistan from green trade regimes, and undermines its competitiveness in ESG-compliant procurement platforms. Collectively, these structural deficiencies pose a strategic threat to Pakistan's export resilience and its ability to transition toward a climate - compatible, market - integrated economic model.

Moreover, Pakistan is effectively locking itself out of a $5.7 trillion global ESG investment pool—not because it lacks need, but because it lacks credibility. While capital allocators worldwide are tightening ESG filters across sovereign debt, equity portfolios, and sustainability-linked loans (Durrani et al., 2025), Pakistan's ESG disclosure regime remains weak, voluntary, and largely performative. As a result, the corporate sector continues to miss the green capital bus, unable to meet even the minimum transparency thresholds set by global asset managers and ESG-screened funds.

Institutional investors managing pensions, insurance, and sovereign wealth are no longer dabbling in ESG—they're demanding it. And Pakistan's opacity, both regulatory and operational, has placed it squarely on the no-go list. Despite being a party to global climate agreements and sustainability pledges, the country has captured only a negligible share of climate-linked capital. Its exclusion from green bond indices, ESG equity trackers, and blended finance deals is not about politics—it's about poor data, lack of standardization, and the absence of enforceable ESG architecture.

Even where frameworks exist—such as the SECP's alignment with the Global Reporting Initiative (GRI), International Sustainability Standards Board (ISSB), and Women Empowerment Principles (WEPs)—their voluntary nature and lack of enforcement mechanisms severely limit their effectiveness in driving consistent, high-quality ESG disclosure.

This is not just a missed opportunity; it's an escalating risk premium. According to McKinsey & Company (Henisz et al., 2019), ESG integration reduces capital costs, shields firms from regulatory shocks, and attracts both customers and top-tier talent. Pakistan, by contrast, is stuck in a vicious cycle: weak ESG = low investor confidence = high cost of capital = limited growth.

In today's market, ESG is not window dressing—it's a proxy for stability, risk governance, and long-term value creation. By failing to internalize ESG as a core economic strategy, Pakistan is not merely struggling to attract capital—it is, in many cases, actively discouraging it due to gaps in ESG alignment and disclosure practices. Unless ESG compliance is made mandatory, disclosures digitized, and financial incentives aligned, the country will remain on the sidelines of sustainable finance—watching trillions flow elsewhere.

Nowhere is this risk more imminent than in the GSP+ preferences, which hinge on adherence to 27 international conventions on human rights, labor standards, and environmental safeguards. The European Commission's 2024 review flagged serious lapses in governance and climate policy, casting doubt over Pakistan's renewal prospects (Durrani, 2024). Failure to comply could mean losing access to one of its most lucrative markets.

And it is not just the EU—ESG is now hardwired into multilateral financing, sovereign credit ratings, and preferential trade agreements. The cost of non-compliance is no longer hypothetical; it's structural and compounding. Multinational corporations, particularly in the EU, are already recalibrating their supply chains to exclude non-compliant vendors. Supplier audits now routinely include Scope 3 emissions, labor rights records, and water stewardship. Pakistani firms that lack traceability, ESG certifications, or third-party audits are being quietly dropped from procurement lists. They're not losing out on price—they're losing on principles.

To reposition ESG from a compliance burden to a competitive advantage, Pakistan must execute a comprehensive, policy-integrated strategy that embeds ESG principles across its trade, financial, and industrial frameworks. First, the SECP should amend its 2023 ESG Disclosure Guidelines to make ESG reporting mandatory for all firms listed on the Pakistan Stock Exchange (PSX) and for those receiving export-related incentives. This should be aligned with the aforementioned international frameworks to ensure standardization and global comparability.

Simultaneously, the State Bank of Pakistan (SBP) should incorporate ESG performance into export refinancing schemes, enabling firms with third-party verified ESG credentials to access concessional financing and enhanced duty drawbacks. Tax incentives for exporters should similarly be indexed to ESG compliance.

On the trade policy front, Pakistan must reduce import tariffs and para-tariffs on environmental goods (EGs) to below 5%—especially on renewable energy inputs and emissions-reducing technologies—and complement this with the phased introduction of a carbon pricing mechanism targeting high-emission imports to fund domestic green transitions.

To operationalize ESG compliance at the industrial level, dedicated ESG facilitation units should be embedded within Special Economic Zones (SEZs) to assist SMEs with emissions reporting, labor rights audits, and sustainability certifications—offering subsidized access to expert consultants and verification platforms.

Additionally, a centralized ESG reporting registry, jointly administered by the Ministry of Climate Change and SECP, should be established to consolidate firm-level data on emissions, governance structures, labor standards, and anti-corruption safeguards. This registry should also support sectoral emissions benchmarking aligned with Pakistan's Nationally Determined Contributions (NDCs).

Finally, ESG metrics must be formally integrated into the Strategic Trade Policy Framework (STPF), ensuring that all sectoral incentives—particularly in textiles, IT, and renewable energy—are conditioned on verifiable ESG performance. Without these coordinated structural reforms, Pakistan will remain confined to low-margin export markets and miss the opportunity to integrate into high-value, ESG-sensitive global value chains.

Coda: As global markets pivot toward mandatory and auditable ESG standards, countries that fail to align will not just fall behind—they will be written out of the rules entirely. For Pakistan, the stakes are clear: ESG integration is no longer a corporate initiative but a national economic imperative. Without urgent structural reforms, the country risks strategic irrelevance—outpaced, outpriced, and ultimately, out of the market.

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