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Regulatory Challenges in Pakistan's Financial Sector: AML-CTF Compliance Amid Geopolitical and Institutional Complexities

Dr. Munir Ahmad Zia Rao
Police Department
Email: raomunir@gmail.com

Dr. Zamin Abbas
Assistant Professor, Department of Management (HSM),
University of Management and Technology, Lahore
Email: zamin.abbas@umt.edu.pk

Tahreem Munir Rao
Christian College (A Chartered University)
tahreemmunirlt@gmail.com

Abstract
The paper critically evaluates Pakistan's intricate engagement with Anti-Money Laundering and Counter-Terrorism Financing (AML-CTF) frameworks, positioning the country as both a target and an alleged facilitator of illicit financial flows. Rooted in ideological paradigms and geopolitical concerns, Pakistan's discriminatory enforcement of AML-CTF regulations has largely been shaped by global scrutiny, particularly from the Financial Action Task Force (FATF). The role of financial institutions—particularly banks—is crucial in this dynamic, functioning simultaneously as enablers and gatekeepers in the effort to counter illegal financial activities. Despite being mandated to implement Know Your Customer (KYC) and Customer Due Diligence (CDD) procedures under the supervision of the State Bank of Pakistan and the Financial Monitoring Unit (FMU), banks remain susceptible to exploitation due to regulatory inadequacies, weak enforcement, and political interference. Drawing on recent empirical evidence, the paper highlights the ineffectiveness of prosecutorial outcomes arising from Suspicious Transaction Reports (STRs) and the continued reliance on informal financial frameworks such as Hawala and Hundi. Moreover, the rise of digital platforms and cryptocurrencies further complicates detection and investigative mechanisms, while international oversight remains influenced by selective implementation and geopolitical bias. Despite technological advancements and global collaboration models like public-private partnerships, institutional corruption and the politicization of regulatory frameworks continue to hinder meaningful progress.

Keywords: AML-CTF, Pakistan, Regulatory Compliance, Financial Sector, Terror Financing, FATF (Financial Action Task Force), Geopolitical Influence, Political Power, Institutional Autonomy, Democratic Governance, Proxy Militancy, Financial Oversight

Introduction

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Pakistan's financial landscape has littered with the allegations of terror financing and money laundering, positioning it country both as victim and an alleged facilitator of financial illicit flows. Its genesis lies within the strategic use of ideology, entwined with the deep-rooted geopolitical complexities, that shaped Pakistan's approach towards countering financial crimes. Since the state has faced sustained pressure from international regulatory bodies such as the Financial Action Task Force (FATF), enforcement of Anti-Money Laundering and Counter-Terrorism Financing (AML-CTF) measures has often been selective, driven by political and institutional interests rather than sincere compliance of international protocols and regulations. At the heart of this challenge lies the role of financial institutions, mainly banks, which act as both enablers and probable counter-check mechanisms in the fight against unlawful financial networks. This paper critically evaluates Pakistan's position within the global AML-CTF framework, exploring how its financial institutions have been are employed in combating terror financing. By analyzing the intersection of regulatory oversight, state policy, and the operational vulnerabilities of Pakistan's banking sector, this study aims to explain away the dual narrative that projects the country as both a target of financial exploitation and a participant in transnational financial crimes.

Conceptual Framework and Theoretical Underpinnings

The conceptual framework comprising **Financial Intelligence Theory, the Risk-Based Approach (RBA), and Institutional Theory** afforded a multidimensional lens for examining the role of banks in dismantling terror financing and money laundering, specially in the context of Pakistan. These theoretical lenses not only describe the functioning of the financial systems but also the detection and prevention of financial crimes along with explicating institutional and regulatory issues formulating the compliance regime. Financial Intelligence Theory has been extended by several professionals in multiple disciplines such as finance, law enforcement, and counterterrorism. **Mark J. Nigrini** employed Benford's Law to the detection of fraud (Nigrini, 2012), whereas **Raymond W. Baker** highlighted illegal financial flows (Baker, 2005). **Joseph T. Wells** expanded his works on forensic accounting (Wells, 2017), and **Richard A. Clarke** explored the role of financial intelligence in counterterrorism (Clarke, 2008).

Besides, institutions like the **Financial Action Task Force (FATF)** and the **Egmont Group** too further advanced the frameworks for detecting financial crimes (FATF, 2023; Egmont Group, 2022). The theory generally focusses on the detection of fraud, money laundering, and terrorism financing through data analysis and regulatory oversight. **It** underscores the role of financial tracking in dismantling criminal networks concerned in money laundering and terror financing. Financial intelligence units operate as basic units in monitoring suspicious transactions, examining financial patterns, and disseminating intelligence to law enforcement agencies to counter the illicit networks (Unger & van der Linde, 2013). **Financial Monitoring Unit (FMU) in Pakistan is assigned with similar duties** to collect, analyze, and disseminate suspicious transaction reports (STRs) to State Bank of Pakistan (SBP, 2023). Despite these labors, still there remains the grey areas such as gaps in real-time financial monitoring, cross-border transaction monitoring, and inter-agency collaboration, hamper Pakistan's capacity to eradicate terror financing networks (FATF, 2022). The dependence on informal financial systems like **hawala/hundi** further complicates the usefulness of financial intelligence mechanisms in Pakistan.

The Risk-Based Approach (RBA) characterizes how banks evaluate and alleviate financial crime risks. RBA enables the fiscal institutions to allocate funds effectively to areas of highest vulnerability (Basel Committee on Banking Supervision [BCBS], 2021). Banks are bound to implement Know Your Customer (KYC) procedures, meant to improve due diligence (EDD), and customer risk profiling for forestalling illegal transactions from entering the formal financial system (Levi, 2018). In Pakistan, banks have adopted risk-based compliance mechanisms to identify high-risk clients and transactions linked with money laundering or terror financing. Though, regulatory poor oversight, lack of technical integration, and political interfering often weaken the efficiency of RBA implementation (Naheem, 2020). Despite the improvement at the legislative to improve risk-based fiscal oversight, the enforcement issues persist, mostly in rural areas and international monetary transactions wherein informal networks take the better of the informal.

However, Institutional Theory explains the domestic and international regulatory pressures that influence financial sector compliance. The **Financial Action Task Force (FATF)** is one of the main factor in structuring Pakistan's financial regulatory landscape by basing international standards for counter-terrorist financing (CTF) and anti-money laundering (AML) compliance (FATF, 2022). The country being placed at FATF **"Grey List"** since 2018 to 2022 typifies the extent to which international institutions can coerce the national monetary policies. Pakistan as a response has adapted multiple financial sectoral reforms, such as strengthening financial intelligence, enhancing bank due diligence requirements, and increasing legal actions against entities linked to terror financing. However, compliance issues persist due to **institutional apathy, weak implementation-mechanisms, and the continued presence of shadow-banking networks**. The institutional constraints within Pakistan's banking sector transpire the need for **greater regulatory coordination, interagency collaboration, and digital financial surveillance apparatuses** to realize sustained compliance of global AML/CTF protocols.

Research Methodology

The research draws on qualitative research method, applying content analysis to scrutinize the efficacy of finical institutions in countering terror financing in Pakistan. Given the covert nature of terror financing networks, the qualitative methods allow the researcher for a nuanced understanding of contextual dynamics which usually remain inaccessible when approached through quantitative analysis. The study depended on the inclusive review of primary and secondary data sources ensuring a multi-perspective examination. Structured content analysis comprising data coding, thematic cataloguing, and comparative assessment augmented the reliability of study outcomes. The research combined criminological, political, and economic standpoints exploring the role of Financial institutions and regulatory oversight in dismantling the nets of terror financing and financial crimes. The subject methodological approach underwrites the academic discourse and counter-terrorism policy development by choking the terrorist funding.

Data Collection

The study drew on manifold data sources for in-depth analysis of the issue. Official reports from the Ministry of Finance, the State Bank of Pakistan, and the Financial Monitoring Unit (FMU) afforded insights into regulatory apparatuses. Institutional reports from organizations like Pakistan Institute for Peace Studies (PIPS) and the Center for Research and Security Studies (CRSS) informed current trends. Academic research from Google Scholar, JSTOR, and SAGE Publications added to the theoretical depth of the research. Media reports and security- centered NGO publications offered real-time data on terrorist financing. Furthermore, the author's three years of investigative experience at Pakistan's Federal Investigation Agency (FIA) provided practical insights into financial crime investigations.

Conceptual Framework and Theoretical Underpinnings

The conceptual framework discussed above affords the **lenses** to assess banks as counter-check measures against financial crimes. Financial Intelligence Theory highlights the significance of intelligence-sharing and surveillance protocols, whereas the Risk-Based Approach underlines the need of targeted financial risk mitigation. Institutional Theory additionally explicates how global regulatory ethics impact domestic financial sector compliance. Pakistan's placement on the FATF Grey List (2018–2022) led to reforms, yet systemic weaknesses persist, necessitating improved regulatory coordination and digital surveillance.

Strengths of the Research

This study highlights the functioning and role of Financial institutions and regulatory oversight to counter terror financing in Pakistan. It evaluates international and domestic regulatory frameworks, analyzing Pakistan's counter terrorism funding measures and recognizing gaps in the implementation framework. By evaluating the functioning of DFIs, role of foreign funding, **the intersection of global financial networks, regulatory frameworks, and illicit financial flows, ideological constraints and** the role of political economy, military influence, and deep state networks; the study highlights the necessities of policy improvements to alleviate terror financing threats.

The Impact of Financial Institutions on Preventing Terror Financing and Money Laundering

Acting as both conduits for illicit transactions and frontline defenses against financial crimes, financial institutions play a pivotal role in either allowing or preventing financial crimes such as money laundering and terror financing (Unger & Ferwerda, 2020). Given the growing sophistication of transnational financial networks, banks and other financial entities are prime targets for money launderers and terrorist financiers, seeking to transfer illicit funds under the guise of legitimate transactions (Levi, 2018). The Financial Action Task Force (FATF), as the global watchdog on Anti-Money Laundering and Counter-Terrorism Financing (AML-CTF) measures, has repeatedly underlined the role of robust financial regulations in eradication of illicit financial flows (FATF, 2022). However, enforcement gaps, regulatory arbitrage, and political objectives often undermine the effectiveness of such controls, allowing financial institutions to become ignorant or complicit contributors in these illicit networks (Sharman, 2017).

One of the primary mechanisms whereby financial institutions facilitate financial crimes is through weak Know Your Customer (KYC) and Customer Due Diligence (CDD) protocols. Banks that fail to conduct rigorous background checks and transaction monitoring inadvertently allow the infiltration of dirty money into the global financial system (Ferwerda et al., 2019). In jurisdictions with lax regulations or political instability, financial institutions often become vehicles for state-sponsored money laundering and terror financing (Passas, 2020). For instance, cases of politically exposed persons (PEPs) utilizing banking channels to launder money highlight the complicity of financial institutions in enabling financial crimes (Reuter & Truman, 2019). Moreover, the digitalization of banking services and the rise of cryptocurrencies have introduced new challenges, making it easier for unlawful actors to mystify money-trails and exploit regulatory loopholes (Tzioumis, 2021).

Conversely, financial institutions also serve as the first line of defense against illicit financial activities by implementing stringent AML-CTF frameworks. The adoption of Artificial Intelligence (AI) and machine learning in transaction monitoring has significantly enhanced banks' ability to detect suspicious activities and report them to financial intelligence units (FIUs) (Moiseienko & Izenman, 2021). Additionally, the development of public-private partnerships (PPPs) in financial intelligence sharing has also proven to be an effective model in mitigating the risks of terror financing and money laundering (Bell, 2022). The Wolfsberg Group, an association of leading banks, has highlighted the importance of industry-wide compliance mechanisms for preventing financial crimes at institutional level (Wolfsberg Group, 2021). Nonetheless, challenges persist due to the globalized nature of financial crime, where illicit funds can quickly move across multiple jurisdictions, rendering national enforcement efforts insufficient.

Eventually, the effectiveness of financial institutions in preventing financial crimes depends on a combination of regulatory oversight, institutional resolve, and technological innovation. Although banks and financial service providers are crucial stakeholders in the AML-CTF ecosystem, systemic weaknesses and geopolitical interests often create enforcement gaps. Strengthening financial institutions' ability to function as counter-check mechanisms necessitate international cooperation, improved compliance frameworks, and incessant adaptation to emerging financial crime trends (Levi & Reuter, 2020).

Regulatory Challenges and Financial Oversight: Pakistan's Response to AML-CTF Obligations

The intersection of global financial networks, regulatory frameworks, and illicit financial flows is a critical area of concern for states combating financial crimes, particularly in regions like Pakistan, where vulnerabilities in financial governance have facilitated terror financing and money laundering. Notwithstanding the strategic geopolitical position, Pakistan has faced sustained scrutiny over its financial system, with the **Financial Action Task Force (FATF)** repeatedly highlighting deficiencies in its **Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF)** measures (FATF, 2022).

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These regulatory shortcomings are not only a domestic governance issue but also a reflection of the challenges posed by an interconnected global financial network that often enables illicit actors to exploit regulatory loopholes (Reuter & Truman, 2019).

Pakistan's financial system has frequently been exploited by illicit actors due to weak enforcement of **Know Your Customer (KYC)** and **Customer Due Diligence (CDD)** regulations, allowing terror networks and transnational criminal organizations to use its banking channels for money laundering and terror financing (Shah, 2021). The **Hawala and Hundi systems**, which operate parallel to formal banking structures, further complicate AML-CTF enforcement, enabling anonymous and untraceable cross-border transactions (Farooq, 2020). Although informal financial networks are deeply rooted in the region's socio-economic fabric, their unregulated nature has made them a key conduit for illicit financial flows linked to extremist groups operating within and beyond Pakistan's borders (Azam, 2022).

Pakistan's periodic placement on the **FATF grey list**—most recently from 2018 to 2022—was a direct consequence of its failure to implement robust AML-CTF regulations (Khan, 2022). The FATF's recommendations required Pakistan to enhance financial intelligence-sharing, regulate **Non-Profit Organizations (NPOs)** that have been misused for terror financing, and strengthen the oversight of banking institutions (IMF, 2022). Although Pakistan made significant reforms, including amendments to its **Anti-Money Laundering Act (AMLA) 2010**, enforcement remained inconsistent due to political and institutional resistance (Ahmad, 2021). The **military establishment's** historical ties with certain militant groups for strategic purposes further complicated AML-CTF compliance, revealing how political and security considerations often override financial regulatory imperatives (Siddiqa, 2019).

Pakistan's financial vulnerability is further exacerbated by external funding from Gulf states, particularly **Saudi Arabia and the UAE**, where private charities and donors have historically financed religious seminaries (**madrassahs**) and militant groups in Pakistan (Awan, 2021). While Saudi Arabia officially stopped direct funding for extremist groups, yet the funds kept flowing through **charitable foundations**, bypassing formal banking channels (Basit, 2022). This highlights the global challenge of illicit financial flows, where geopolitical alliances often influence the implementation and enforcement of AML-CTF regulations (Passas, 2020).

Since Pakistan has taken **quantifiable measure** to improve financial transparency, the effectiveness of these measures is contingent on sustained enforcement and depoliticization of regulatory mechanisms. Without addressing structural weaknesses in its financial and political systems, Pakistan will continue to navigate a precarious position—both as a **victim** of illicit financial networks and as an **accused** exporter of terror financing (Jalil, 2023). Strengthening **banking sector oversight**, ensuring **judicial independence in financial crime investigations**, and fostering **international cooperation** remain critical in countering these challenges (Shah, 2023).

Pakistan's Counter-Terrorism Paradox: Battling Terror While Facing Allegations of Financing It

Pakistan's dual identity in the global counter-terrorism discourse reflects its struggle as both a victim of terrorism and an alleged exporter of terror financing.

As a victim, Pakistan has faced economic and security repercussions, with terror financing facilitating the growth of extremist networks that undermine state authority, economic stability, and investor confidence.

The financial costs of terrorism have been devastating, with losses exceeding $126 billion between 2001 and 2020 (Government of Pakistan, 2021). Foreign direct investment (FDI) has suffered considerably, dropping from $5.4 billion in 2008 to $1.9 billion in 2022 due to insistent security concerns (SBP, 2023). Pakistan's positioning on the Financial Action Task Force (FATF) grey list (2018-2022) has further battered economic growth, resulting in a 2% annual GDP reduction and an assessed $38 billion loss due to compliance costs and constrained access to financial markets (FATF, 2022; Karachi Chamber of Commerce, 2022). Moreover, informal monetary networks like as Hawala and Hundi, which constitute 35% of Pakistan's GDP, have fueled illicit financial flows and weakened state revenue (Farooq, 2021; Reuter & Truman, 2020).

On the security front, terror financing has fueled insurgency, as Pakistan witnessed a 73% rise in terrorist attacks in 2023, mainly because of resurgence of Tehrik-i-Taliban Pakistan (TTP) and Baloch sub-nationalists' groups (South Asia Terrorism Portal, 2023). Counter-terrorism operations like Zarb-e-Azb (2014) and Radd-ul-Fasaad (2017) have had some success, yet extremist groups continue to exploit unregulated financial flows to sustain operations (Khan, 2022). Besides, defense expenditures went disproportionately high at 4% of GDP, diverting resources from socio-economic development (SIPRI, 2023). Furthermore, radical groups such as Tehreek-e-Labbaik Pakistan (TLP) exploited financial networks to activate street power, destabilizing governance structures.

Pakistan's financial system has long been under international scrutiny due to allegations of facilitating terror financing, leading to sustained diplomatic and economic repercussions. Global concerns stem from reports of **terrorist networks exploiting Pakistan's financial infrastructure**, including **charitable organizations, madrassahs, and informal financial systems like Hawala and Hundi**, to fund extremist activities (Reuter & Truman, 2020). The **Financial Action Task Force (FATF)** placed Pakistan on its **grey list (2018-2022)**, citing **deficiencies in countering money laundering and terror financing** (FATF, 2022). This label resulted in increased monitoring, reduced foreign investments, and heightened global scrutiny of Pakistan's financial transactions, causing an estimated **$38 billion in economic losses** (Karachi Chamber of Commerce, 2022). Additionally, reports from the **United Nations Security Council (UNSC)** and **U.S. Treasury Department** have highlighted concerns over financial networks allegedly linked to groups such as **Lashkar-e-Taiba (LeT), Jaish-e-Mohammed (JeM), and Tehrik-i-Taliban Pakistan (TTP)** (UNSC, 2023). While Pakistan has taken steps to curb illicit financing—such as freezing bank accounts and prosecuting individuals linked to terrorist groups—its **AML-CTF (Anti-Money Laundering and Counter-Terrorism Financing) measures remain inconsistently enforced** (Pakistan Financial Monitoring Unit, 2022). For instance, only **5% of reported suspicious transactions** resulted in prosecutions, reflecting weak judicial implementation (Pakistan Financial Monitoring Unit, 2022). Moreover, concerns persist over the **political and strategic dimensions** of Pakistan's counter-financing efforts. Western analysts argue that **selective enforcement** allows certain militant groups to operate

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under state influence while cracking down on others based on geopolitical considerations (Basit, 2022). **Saudi-funded religious charities** and **China's financial dealings under CPEC (China-Pakistan Economic Corridor)** further complicate Pakistan's efforts to align with international counter-financing mandates (Awan, 2021). The country's **failure to fully sever financial links to extremist groups** has reinforced international skepticism, affecting Pakistan's relations with key financial institutions such as the **International Monetary Fund (IMF) and World Bank**, which tie compliance with **global AML-CTF standards** to financial assistance (IMF, 2022). As a result, Pakistan faces continued pressure to implement **transparent financial regulations, strengthen oversight of informal networks, and depoliticize its counter-terrorism financing measures** to restore global confidence in its financial system and avoid future economic isolation.

Ideological Constraints: A Challenge to Countering Terrorist Financing in Pakistan

Pakistan's ideological basis is rooted in Muslim identity; since the partition of the sub-continent, as it was highly essential for distinguishing the Indian Muslims from the Western concepts of nationhood. This identity not only formed the nation's self- identity rather it played a critical role in compensating for its military weaknesses. Pakistan's ideological schema was on constant expansion including its nuclear capability (Islamic bomb), which further reinforced its distinct national identity. The military establishment being in total control over both nuclear assets and religious ideology, posing as the sole guardian of Pakistan's ideological and strategic interests (Mann, 1986). This self- styled role placed the military beyond democratic control and judicial accountability, conceding it unchallenged dominance in national affairs. The alleged self-image placed the military establishment beyond any democratic scrutiny and judicial accountability undoubtedly approving its dominance in national affairs. However, this ideological concept, rather than underpinning Pakistan's internal security, became a constraint in the current countering of terrorist financing. The military's claim to be the champion and the embodiment of that notion aligns with what Weber (1946) explicates as a 'myth of legitimacy' a narrative intentionally built to justify its unrestrained authority. By equating its own interests with those of Pakistan, the military has been successful in suppressing political opposition and maintaining control over national narratives.

Mann (1986) held that power relations are usually shaped by ideological pledges to imagined communities. In the background of Pakistan, this dynamic is apparent in the military's capacity to frame its political and economic supremacy as essential factor in national stability. This ideological structure becomes mostly significant when evaluating Pakistan's engagement with Anti-Money Laundering and Counter-Terrorist Financing (AML-CTF) compliance mechanisms. The persistence of illicit monetary networks has not only encouraged by parallel economies but also reinforced the military's influence, permitting it to exploit the both ideological accounts and economic controls to uphold its supremacy. Consequently, the enforcement of severer AML-CTF controls directly impends this ingrained structure by targeting the financial networks that enable the military to selectively overwhelm political opposition while defending aligned militant outfits. As Khalilzad (2016) observed, the military's tactical instrumentalization of ideology has become a key obstacle to starting an inclusive

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and impartial clampdown on terrorism financing.

Instead of serving as a unifying force, ideology has turned into an apparatus of state politics that favors power politics over its security requirements. The Deep State's averseness to absolute implementation of **AML-CTF** procedures clearly highlights the fact that counterterrorism is countered selectively, protecting the monetary and political objectives of the establishment. The situation entails in a paradox wherein Pakistan is faced with an ever growing global pressure to fulfill the international **AML-CTF** standards and its ideological perspective makes the genuine implementation politically untenable. Consequently, what was once envisioned to serve as the mainstay of national unity has now turned a structural liability, hampering Pakistan's capacity to efficiently counter terrorist financing and line up itself with global financial regulations.

The enforcement of **AML-CTF** protocols in Pakistan highlights the inextricable link between global financial oversight and political maneuvering. **FATF's compliance framework**, though presented as a impartial mechanism for restricting terrorism financing, has been partially applied, frequently lined up with geopolitical preferences rather than impartial enforcement (Financial Action Task Force, n.d.). The erosion of Pakistan's authority in financial decision-making is quite obvious, as outside pressures dictate its regulatory course. More concerning, however, is the prejudiced nature of these protocols, which fail to consider the historical and political intricacies, mostly the Deep State's role in militant financing (Khalilzad, 2016). Consequently the sequel to such a complex paradigm is not the eradication of terrorism financing rather a discriminatory crackdown consolidating power within the existing hegemony and waning democratic institutions in this process. Moreover, the economic and social costs of such regulations usually range from burdening the already resource constrained institutions to the infringement of civil liberties. The situation gives birth to certain critical questions about long-term impact of the policy. In the weak democratic systems like that of Pakistan, wherein state surveillance is already intrusively pervasive, **AML-CTF execution** risks further aggravating authoritarian control under the ruse of financial security. A re-assessment of the existing approach is highly essential not only to ensure the effective counterterrorism efforts but also to prevent regulatory mechanisms from degenerating int an oppressive tool of political suppression.

The implementation of AML-CTF measures in Pakistan underlines the inextricable connection between global financial oversight and geopolitical dictates. While the FATF's compliance framework is apparently planned as an impartial apparatus to challenge terrorism financing, its application has often reflected geopolitical predispositions rather than objective implementation (Financial Action Task Force, n.d.). This has caused a visible erosion of Pakistan's independence in financial policymaking, as exterior pressures progressively influence its regulatory course. More critically, the execution process often neglects the complex historical and political factors on the ground such as the role of Pakistan's Deep State in the backing of proxy militancy (Khalilzad, 2016). Consequently, rather than eradicating terrorist financing, the existing framework looks to facilitate a discriminating crackdown that consolidates current power structures while weakening the democratic culture. Moreover, the economic and social repercussions of these regulations are overtax the already resource-constrained organizations further encroach on civil liberties. This raises pressing questions in fragile democracies like Pakistan, wherein persistent state surveillance coupled with the execution of AML-CTF procedures can lead to the intensification of authoritarian tendencies under the ruse of financial security. What was once envisioned as a column of national unity has now become a structural obligation, hindering Pakistan's ability to efficiently counter terrorist financing in consonance with the international regulatory frameworks.

Politics of CTF Regulations: Global Obligations vs. Geopolitical Agendas

Pakistan's execution of AML-CTF regulations has been greatly influenced by geopolitics, regional conflicts and global configurations. Since the 1990s, Pakistan's establishment has been nurturing militant proxies in Kashmir, motivated by its longstanding security apprehensions from India (Jalal,2008). Its courting with the Afghan militant organisations were primarily directed at realizing "strategic depth" against an Indo-Afghan alliance (Rashid ,2008). In fact foreign factors like US and Saudi Arabia, played an extensive role in nurturing such proxies; as during the Soviet-Afghan War Pakistan became a rallying point mujahideen-a perfect model for militant sponsorship. Saudi money for jihadist movements further entangled Pakistan in international power struggles (Segura-Serrano,2014). Hence such undercurrents complicated the simplistic accounts of Pakistan's role in terrorism financing and generated questions regarding the selective execution of AML-CTF measures. Despite Pakistan's alleged role in terrorist financing, interestingly FATF took a lenient view of it from 1989 up to 2008. During 1999 US State Department's *Patterns of Global Terrorism* documented South Asia as a center for terrorism, censuring Pakistan's involvement in this regard. Even in 1990s when FATAF was presided over by US, despite intelligence reports endorsing these links, ignored Pakistan's financial connections to Kashmiri and Afghan jihadists (DeYoung, 2012). During 1999 US State Department's *Patterns of Global Terrorism* documented South Asia as a center for terrorism, censuring Pakistan's involvement in this regard.US intelligence too acknowledged Pakistan's solid support for the Taliban, but Washington preferred geopolitical objectives such as bin Laden's extradition over AML-CTF enforcement. Watson (2002) rightly observed FATF's apathy before 9/11, notwithstanding international reports on Pakistan's connection in money laundering and terrorism financing, further discloses that its choices are more influenced by political considerations. Yet, FATF's unexpected change of focus toward Pakistan in 2008, overlapping with deteriorating US-Pakistan relations, signifies that AML-CTF implementation mechanisms serve strategic objective rather than the enforcement of financial regulation. Hence Pakistan's greylisting in 2012 was an intimidating measure connected with US pressure rather than a fair regulatory decision (Ahmad,2021) The lengthy greylisting process, marked by intensifying FATF demands and Pakistan's shallow legislative compliance, replicates a wider geopolitical contest (Financial Action Task Force, n.d.).
Pakistan's experience with FATF clearly indicates that AML-CTF implementation is dictated by political alignments. According to Ahmad, (2021) The fact that Pakistan faced criticism for terrorism financing only after weakening of US relations undermined FATF's credibility as an independent regulator. If compliance mechanism is subservient to political pragmatism and runs the risk

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of degenerating into the tools of coercion rather than a genuine a financial crime control endeavor.

Domestic Framework: The Role of Political Economy, Military Influence, and Deep State Networks

The application and the execution of AML-CTF protocols in Pakistan are profoundly influenced by domestic power disparities, wherein international mandates intersect with national political imperatives. Even though Pakistan has officially implemented FATF's 40 recommendations, their execution often replicates the strategic objective of dominant state actors rather than a steady commitment to legal uniformity. This discriminatory application is mostly apparent in the insistent civil-military imbalance, where financial compliance procedures are normally instrumentalized by military to strengthen political influence. Consequently Ahmad (2021) held that political leaders are subjected to severe financial scrutiny, whereas the militant organisations perceived as strategic assets tend to evade these regulatory procedures with relative impunity.

Pakistan's chronically weak civilian governance further compounds these structural imbalances, undermining the effective application of AML-CTF measures. Rather than supporting institutional integrity, financial monitoring apparatuses are usually arrayed against opposition leaders, serving biased interests instead of larger regulatory objectives. Concurrently, the judiciary being vulnerable to both political influence and ideological propensities, struggles to maintain its independence. Judicial rulings often reflect the priorities of the state rather than maintaining fair legal principles, thus weakening the reliability of AML-CTF enforcement (Ahmad, 2021). For example is the 2015 money laundering case against Asif Zardari, rather following a transparent legal process, was ostensibly exploited to advance the political purposes of the establishment, it clearly illustrated the discriminatory and politically driven execution of financial crime regulations (Ahmad, 2021).

The judiciary's compromised role in the enforcement of AML-CTF stems from an intricate interaction of coercion, political meddling, and ingrained ideological biases. In many instances, the presiding judges prioritize personal safety over institutional honor, evading conflict with powerful actors; they align tacitly or explicitly with the larger interests of militant groups. The Justice Shaukat Aziz Siddiqui faced the charges of the corruption soon upon his open criticism on the intelligence agencies, exemplifying how disagreement within the judiciary is repressed through targeted vengeance. Establishment operates through systemic entanglement within political and judicial spheres, thereby eroding the very foundations of judicial independence (Ahmad, 2021). Consequently, the enforcement of AML-CTF measures in Pakistan becomes less a matter of financial governance and more a manifestation of the Deep State's strategic calculus. Rather than functioning as an impartial arbiter of justice, the judiciary ever more reinforces prevailing power structures whether out of dread, ideological alignment, or political pragmatism.

Foreign Funds, Domestic Compromises: Foreign Patronage and the Politicization of Terrorism Financing Discourse in Pakistan

Foreign funding remains a grave yet ignored dimension of terrorism financing in Pakistan and the key external funder, Saudi Arabia has played a substantial role

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(Khalilzad, 2016). Though direct state funding from Riyadh has allegedly ceased yet the financial funding continues to flow through affluent individuals and charitable organizations. A similar design is observed with funding emanating from sources based in the United Arab Emirates. Despite the awareness of these dynamics, both the states remain out of the dominant global counter-terrorism financing (CTF) discourse. This omission becomes more glaring considering Saudi Arabia's inclusion in the Financial Action Task Force (FATF) in 2019, despite of its well-documented record of financing extremist organisations. The inclusion reflects broader geopolitical discrepancies in the implementation of anti-money laundering and counter-terrorism financing (AML-CTF) procedures. Being a strategic ally of the United States, Saudi Arabia's profound financial and military links with Washington render it political immunity. In contrast, Pakistan continues to face sustained scrutiny through FATF's greylisting process. This discrepancy underlines how financial and geopolitical concerns shape regulatory outcomes, with implementation often directed more by strategic alliances than by neutral standards. Internally, the discourse on foreign terrorism financing within Pakistan is equally skewed. The narrative frequently highlights Indian hostility whereas downplaying the constant influx of petro dollars into religious seminaries and extremist organisations. Pakistan has also become an arena for the broader Saudi-Iranian rivalry. Since the 1980s, Iran has been actively financing Shia militant groups and madrassahs, adding to the country's sectarian polarization. This twofold entry of foreign funding has aggravated sectarian violence, thereby hindering the development and execution of neutral AML-CTF policies. Furthermore, Pakistan's financial dependence on Saudi Arabia particularly in the form of loans and relief packages restricts its capacity to challenge Saudi-linked funding networks. Riyadh's recurring financial assistance during economic crises has resulted in Islamabad's constant silence concerning Saudi-sponsored networks (Ahmad, 2021). This dynamic highlights the politicization of Pakistan's AML-CTF implementation landscape.

Additionally to these structural concerns, Pakistan's futile engagement with international coalitions and its diplomatic faults such as poor negotiations and the absence of skilled lobbying have further inhibited its ability to influence the prevailing narratives. The country's overreliance on highlighting its counterterrorism "sacrifices" has proved counterproductive, as international stakeholders assess Pakistan's credibility through the prism of practical actions rather than on rhetorical claims.

Pakistan's Banking Sector in AML-CTF: Identifying and Reporting Illicit Financial Flows

Banking institutions play a vital role in countering illicit financial flows like money laundering and terror financing. Under **Anti-Money Laundering (AML)** and **Counter-Terrorist Financing (CTF)** regulations, banks serve as frontline units responsible for detecting, preventing, and reporting suspicious fiscal activities. Despite these improvements, structural weaknesses, regulatory inefficiencies, and geopolitical pressures continue to hamper the effectiveness of Pakistan's financial system in fully countering the illicit financial transactions. For countering unlawful financial dealings, Pakistani banks operate under the regulatory oversight of the **State Bank of Pakistan (SBP)**, which applies **AML/CTF compliance** in alignment with **Financial Action Task Force**

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(FATF) policies. **Know Your Customer (KYC)** protocols and **Customer Due Diligence (CDD)** frameworks are mandated to avert financial institutions from being exploited by criminal networks (FATF, 2022). Nevertheless, **informal financial networks, such as Hawala and Hundi**, continue to bypass formal banking channels enabling illicit transactions (Farooq, 2021).Banks are mandated to file **Suspicious Transaction Reports (STRs)** and **Currency Transaction Reports (CTRs)** with the **Financial Monitoring Unit (FMU)**. However in 2022, just over **150,000 STRs** were filed, yet only **5% led to investigations or legal action stage,** highlighting poor **enforcement mechanisms** (Pakistan FMU, 2022). Moreover, **political influence and institutional corruption** have further diminished the level of transparency. In 2020, FATF identified deficiencies in **Pakistan's implementation of AML/CTF laws**, citing **delays in prosecution and weak risk assessment models** (IMF, 2022). In addition to that according to Basit (2022) banking institutions struggled to regulate **charitable organizations** some of which served as fronts for unlawful financial activities of certain militant outfits. A **Pakistan Financial Monitoring Unit (FMU) report (2022)** stated that despite technological upgrades, 30% of suspicious transactions remain undetected because of loopholes in financial surveillance and lax implementation.

Global Perspectives on the Effectiveness of Financial Regulations in Countering Illicit Financial Flows

International monitoring bodies, particularly the **Financial Action Task Force (FATF), the International Monetary Fund (IMF), and the United Nations Security Council (UNSC)**, have set up global **Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) standards** to enhance financial transparency and reduce illicit financial flows. However, **varying enforcement, political influences, and short comings in regulatory systems** normally weaken its impact. From an **international monitoring perspective**, countries under FATF scrutiny, such as **Pakistan, Iran, and North Korea**, have faced sanctions and grey-listing due to weaknesses in **their financial compliance** (FATF, 2022). Pakistan's position or ranking on the **FATF grey list (2018-2022)** verified how non-compliance with AML-CTF regulations occasioned in **restricted financial transactions, reduced investor confidence, and significant economic losses** (IMF, 2022). Despite enacting reforms, **Pakistan's feeble enforcement mechanisms** whereby just 5**% of Suspicious Transaction Reports (STRs) led to legal action clearly signifying a** gap **between regulation and implementation** (Pakistan Financial Monitoring Unit, 2022).

Contrarily at an international level, **financial secrecy regimes** such as **Switzerland, Cayman Islands, and the UAE** have been just censured for permitting **terrorist and criminal financial networks** (Reuter & Truman, 2020). The **UNSC (2023) report** on terror financing also reported **Saudi-linked charitable organizations and digital financial platforms** as main facilitators of illicit funds transfers. Basit (2022) held that the international regulatory bodies which championed the **stringent compliance**, **geopolitical interests** repeatedly dictated **discriminatory enforcement**, raising concerns over the **politicization of AML-CTF implementation mechanisms.**

Banking Sector as a Counter-Check Mechanism: Reporting and

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Compliance Challenges

According to Minute Mirror (2023) as of June 2023, Pakistan had 31 commercial banks, and total bank accounts exceeded 177 million, including commercial, microfinance, branchless banking, and Electronic Money Institutions. Whereas Reuters. (2024) held that out of these, 83 million were unique accounts, covering 60% of the adult population. Women owned 49 million accounts, with 29 million being unique, representing 43% of the female adult population. Besides, as of September 2024, banking sector in Pakistan has registered momentous growth in digital payments mode, with Visa and 1Link work together to increase digital payment tenfold in the coming three years. This initiative is directed to improve infrastructure and strengthening user-friendliness and security.

Table 1

Statistic	**Value**
Total commercial banks (June 2023)	31
Total bank accounts (June 2023)	Over 177 million
Total unique accounts (June 2023)	83 million
Adult population percentage holding unique accounts (June 2023)	60%
Accounts owned by women (June 2023)	49 million
Unique accounts owned by women (June 2023)	29 million
Female adult population with unique accounts (June 2023)	43%

Financial institutions are by law bound to generate STRs to the Financial Monitoring Unit for subsequent analysis and its dissemination to relevant institutions such as the FIA. In 2018, the FMU reportedly received 8,708 STRs, which improved further up to 14,545 in 2019, reflecting improved monitoring. The total number of **Suspicious Transaction Reports (STRs) when seen in** comparison with the total number of bank accounts the former appear **enormously low**, giving rise to queries about the effective functionality of our financial institutions regarding oversight and reporting of suspicious activities. This clearly amounts to the p**otential conflict of interest. Since the** banks must generate business through rise in customer deposits and transactions and if they start sending too many STRs, it will they may risk losing customers and will incur contingent regulatory scrutiny. Hence the bankers dissuade from proactively flagging suspicious transactions.

Table 2: Suspicious Transaction Reports

Year	**STRs Reported**	**Total Bank Accounts (millions)**	**Percentage of Total Bank Accounts (%)**
2018	8,708	177	0.0049%
2019	14,545	177	0.0082%

*Data for 2019 is up to September.

The percentage of STRs when seen in comparison with total bank accounts is

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astonishingly low as it is less than 0.01%. Keeping in consideration of the volume of financial transactions in Pakistan and alarms over terrorist financing and **money laundering it** suggests either **under-reporting of STRs** by banks to avoid scrutiny or **STR ceilings are too high making** or **compliance mechanisms are weak** rendering **financial crime in Pakistan extremely low?** The situation becomes more glaring when viewed in a comparative analysis of Suspicious Transaction Reports (STRs) between India and Pakistan as it reveals substantial differences in reporting volumes during 2018 and 2019.

Table 3: Comparison of Suspicious Transaction Reports (STRs) in Pakistan and India

Country	**Year**	**STRs Received**	**Key Observations**	**Source**
Pakistan	2018	8,708	Increased financial monitoring efforts	Financial Monitoring Unit [FMU], 2023
	2019 (up to Sept)	14,545	**67% increase** from 2018	FMU, 2023
India	2016–2017	65,829 forwarded to law enforcement	**13% increase** from the previous year	Financial Intelligence Unit-India [FIU-IND], 2018
	2017–2018	Over **1.4 million**	**1,400% surge** due to demonetization impact	FIU-IND, 2018

Since both states have made **substantial progress in monitoring the financial crime,** India's increased volume **of STRs** transpires a **more inclusive reporting framework**, influenced by **policy-driven financial initiatives. However** Pakistan's **slow rise** in STRs suggests **enhanced regulatory efforts** yet necessitating **robust enforcement mechanisms** on reported transactions.

Table 4: Terror Financing Cases in Pakistan: A 2022-2023 Analysis and 5-Year Review.

Region	**Year**	**Registered Cases**	**Amount Recovered (Rs)**	**Total Arrests**	**Arrests for Financial Aid to Proscribed Groups**
Khyber Pakhtunkhwa (KPK)	2022	298	-	-	-
	2023	960	13.46 million	-	-
Peshawar (KPK)	2022	46	-	-	-
	2023	179	-	-	-

Region	Year	Registered Cases	Amount Recovered (Rs)	Total Arrests	Arrests for Financial Aid to Proscribed Groups
Pakistan (Nationwide)	2018-2023	-	1 billion	1,732	900

Source: Gishkori, M. (2023). *Terror financing in Pakistan: A growing challenge*. [Publication details if available].

In Pakistan Terror financing remains an insistent challenge despite the law enforcement agencies growing efforts to counter financial aid for proscribed organisations. There was a surge in the registered cases in KPK up to 222%, as against 298 in 2022 to 960 in 2023. The fact suggests an improved enforcement strategy along with a rise in unlawful financial activities as well (Financial Monitoring Unit [FMU], 2023). Likewise, in Peshawar, the cases rose from 46 in 2022 to 179 in 2023, underpinning the province is focusing on counter-terror financing activities. As against Rs. 13.46 million in KPK in 2023, the countrywide recoveries during 2018-2023 went up to Rs. 1 billion, showing significant efforts along with the scale of illegal financial flows (NACTA, 2023). Even though 900 of the 1,732 apprehensions, the former arrests were mainly linked with funding of proscribed groups, clearly highlights a focused approach aiming at terrorist financiers rather than minion operatives.

Conclusion

The enforcement of AML-CTF regulations in Pakistan highlights the intricate interplay between financial oversight and political power. Since the FATF framework is allegedly an impartial international mechanism to combat terrorism financing, its uneven and often selective application reveals the extent to which geopolitical interests shape its implementation. External pressures have not only compromised Pakistan's financial sovereignty but have also influenced regulatory priorities, which have failed to address the deeper structural issues most particularly, the immersion of the Deep State in supporting proxy militancy. Rather than cracking terrorist financing networks, AML-CTF execution in Pakistan has frequently been employed to destabilize democratic institutions and engrain authoritarian governance. The broader socio-economic costs of this approach raise serious issues regarding its long-term implications. Without a comprehensive reassessment, AML-CTF procedures risk becoming the instruments of political suppression rather than effective tools for disrupting terrorism financing.

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