

An Econometric Approach on Money Laundering and Its Impact on Economic Growth (A Study of Pakistan)

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ABSTRACT

Money laundering is not the issue of today, as it is coming from the early days in many ways and the evil to society as it effects not only those peoples which are related to this evil as well as it also hits the noble peoples of the society by not paying the legal levies that increases the prices of products in the market. Research is carried out to check the impact of money laundering on the economy of Pakistan in an econometric way along with the other control variables (inflation, unemployment, remittances, number of crimes, total investment, and corruption).

Money laundering is measured with informal economy and economic growth is measured with GDP. Annual data from 2000 to 2019 is employed for the purpose of analysis and suitable statistical tools are applied to derive the results. Through these test short run and long run effects are derived also. For analysis of the data, secondary data of two recent decades are used which is collected from the different sources i.e. economic surveys, published papers, and World Bank database etc. At the end it is concluded that money laundering has negative effect on the economy of Pakistan along with other variables.

Keywords: Money Laundering, Economic Growth, Corruption, Crimes, Inflation, Unemployment Rate, Remittances

Introduction

Generally, it is observed that economy of any state or country depends upon the financial structure of that specific country. Financial structure refers towards the cash inflow and outflow of a country and also includes the components such as debts and equity, but the problem arises that what about those things which are

happen beyond the table. Whether they affect the structure in any way or not. These things include all the illegal activities whether they are tangible or intangible. Among these activities money laundering is the widely spread activity in many developing and developed countries. All those peoples who want to become economically strong without knowing the cause and effects on the economy of country are the actual loss to the economy. This is not the issue of only underdeveloped or developing countries but it also reaches to many developed countries. The main reason behind the money laundering is make position safe within host country. Now a day's money laundering has become the topic of consideration for many authorities inside and outside the countries. According to 2018 report of UNODC (United Nation Office on Drug and Crimes) almost 5% of the gross domestic product in each year is circulated as illegal money as money laundering that is enough to create adverse effect on the economy of any country. During the last ten to fifteen years the issue of money laundering is increasing with the rapid rate and it is because of globalization among the countries and invention of new modes of technology and use of easy and fast methods for transfer of money from one place to another place. There are very few measures that were described in the framework of legislation about the control of money laundering which are not enough or have less attention, so it must be restructured with valid and justified arguments and preventions must be described there (Beqiri & Beqiri, 2018).

The word money laundering refers to the money generated from illegal resources and then the use of that money for other activities. In 2011 the money generated from the illegal activities was almost 3.5% of the total GDP, and more than 2.7% was laundered during the year. And according to the report of IMF about 5% of total GDP was laundered in the world. Most of the cases of money laundering are related to the upper class of any country these include the businessman, politician and rulers of that country. Money laundering leads to many other crimes and then these crimes generate money which is further laundered so this chain remains continuous. So, prevention must be taken against such crimes to strengthen the financial structure of any country and rules regulation must be constructed to be followed (Pietschmann & Walker, 2011). Money laundering is a serious crime which give rise to many other crimes, USA passed the act against the money laundering after the attack of 9/11 because it was the major terror attack and criminal proceeds were used in that target, (Mulig & Smith, 2015).

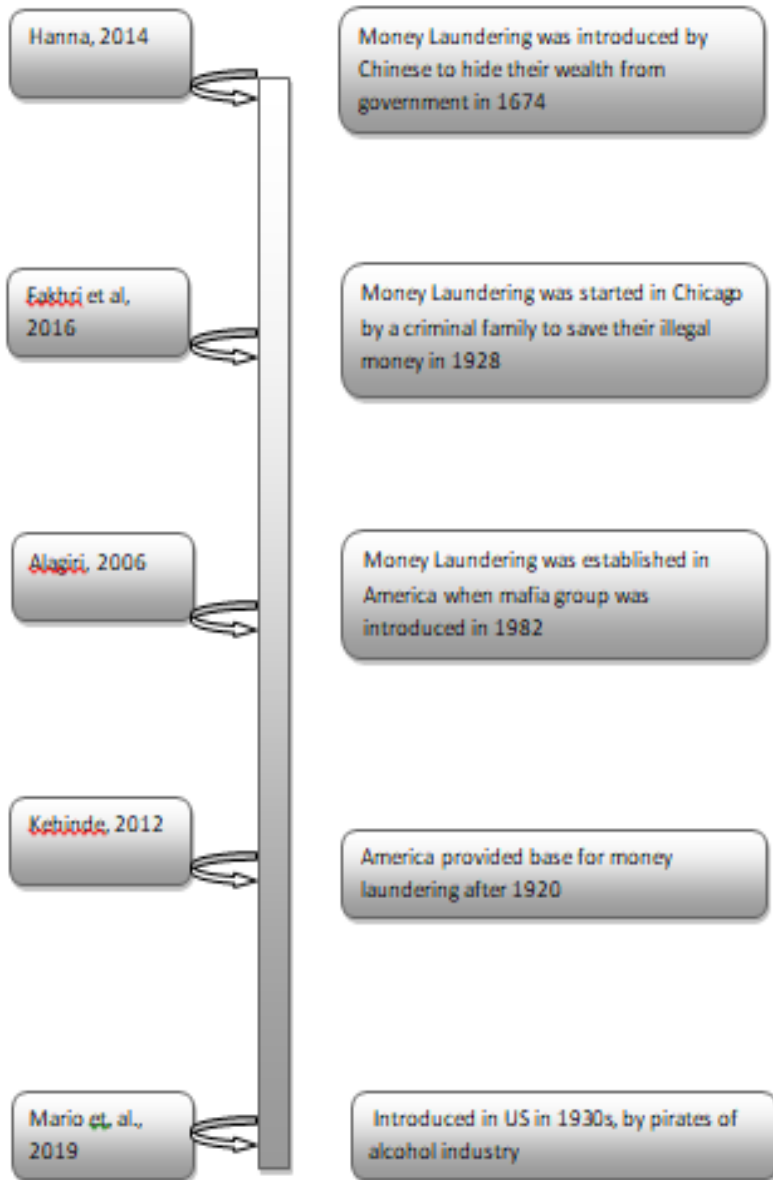
Economic View and Social View of Money Laundering

Money laundering is the method in which a person acts as an agent for making illegal money to legal by converting potential purchasing power to actual purchasing power to make the money useable and acceptable in the laws and

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legislation (Masciandaro, 1998). IMF defines that money laundering includes the proceeds from the corrupted sources of earning which is earned from that asset which cannot be used in general course of business and then making it legal to hide the origin of the money (Schaap, 1999). The money which cannot be easily and openly used in any society by violating some rules and regulation, and differ from the usual earning means of money. That money cannot be used for the visible things means property like buildings, vehicles etc. (Ferwerda, 2012). Amount of money that is collected from the different means of fund raising by avoiding and escaping from the tax impositions, is called dirty money and effect the society by negative ways. And the process which is used to make this money clean by passing it through a cyclical procedure is called money laundering. Money laundering is the open crime in all the countries because it disguises the structure and function of and country. Money laundering deals with the all types of crimes and originates the profit from those ill sources of society (Leong, 2007).The money which is used for the destruction of any society by committing the crimes and spending the amount on those social crimes is called money laundering (Ahmed & Ahmed, 2000).That proceeds of earning and business which are earned by violating the social rules and regulations and then these proceeds are further used in the criminal acts in any society by passing it through a cycle of cleaning is called money laundering (Shehu, 2010). Any illegal act which is not acceptable by the peoples of any place or the certain place where the activities are carried out, and these activities are harmful for the internal and external environment is known as dirty money. These activities can be target killing, drugs spreading, corruption etc (Oluwadayisi & Mimiko, 2016).

Figure 1 Historical Review of Money Laundering



An Overview of Pakistan Economy

After the freedom, Pakistan has gone through various stages of economy establishment in which it faces the ups and down situations from time to time. Newly born country has to face many problems but among those, economy

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establishment was the major issue and upon this issue all remaining issues were depending. In this situation leaders were taking steps to grow the economy up to maximum extent. But the creation of stable economy was seemed to be impossible due to different styles of rules and involvement of external powers (Mahmood, 2009). Instead of these all-problems Pakistan showed growth in its economy with appreciated way. Pakistan economy has gone through many stages from 1947 to now, and each stage was approximately about five years. At the time of independence Pakistan has to fulfill the requirements of 30 million peoples, and these peoples were having less than \$100 capita income, now the number of peoples are increased to 200 million and per capita income is \$1470 approximately. In 1947 the country was relying on agriculture mostly, but now this dependence on agriculture is decreased by the establishment of other resources and output of agriculture is also increased which are exported to external environment. In south Asian countries Pakistan is considered as the rapidly growth making country (I. Husain, 2018).

Money Laundering and Economic Growth

Money laundering and economic growth have effects on each other, money laundering can be a very serious and major threat for any national economy which hits the all sectors of the country by negative side. Besides the financial structure, political and social sectors get affected more in results of saturated money laundering. Money laundering comes under the crimes of economy which directly harm the economic condition of any state which ultimately affect the peoples who were involve or even not. Because money laundering causes the corruption and no payment of taxes to government, in these scenario government collets lower proceeds which will not be sufficient for the public developmental spending and this act causes the decline in of living standards. Same like the cheating of firms and institutions that not only cheat the stock holders but also affects the future investors for any company and in this way the economy gets affected (Kumar, 2012).

As far Pakistan, money laundering is acting on its peak and for this purpose a law against money laundering was put forwarded in 2009, in which a person will be considered guilty if commits the following acts

- If an individual has any type of property which is processed due to any crime, shall be treated under the laws of money laundering
- If any person converts the asset from one form to another form which comes under the umbrella of criminal transactions
- If anyone hides the origin of property in order to escape from taxation (Ministry of foreign affairs, 2009).

It is hard to calculate the amount that how much money laundering effects the economy of Pakistan or any other country. But it cannot be denied that money

laundering encourages the crimes at national and international level that affects the financial sectors of the country. These financial sectors are responsible for the grooming of economy. And these sectors based upon the financial system in which a government collects taxes and levies from the public. When money laundering takes place then corruption and bribes increases and number of tax payers decreases that reduces the annual tax receipts and in this way economy reduces. Money laundering affects the financial sectors, real sectors, working of banks and many other institutions which makes the base for the growth of economy (Kumar, 2012).

It is not known yet for Pakistan and also for other countries that what is the actual amount of effect on economy caused by the acts of money laundering because these acts are performed under the table and no one knows the actual scene. But it is understood that money laundering effect the whole financial system of any country by causing negative impact on the economy. As money laundering degrades the level of investment in the country which is the major source of economic growth and development so it produces problems for the financial smooth running. Money laundering is not a single problem but it gives rise to many other problems in the society which causes socio economic effects (Bartlett, 2015).

Channels of Money Laundering in Pakistan

Pakistan is the country in which money laundering can be carried out on easy ways due to its lenient laws and regulations. And this money was laundered through following commonly used channels (Qureshi, 2017).

Cash Smuggling

Among the other things that are used as medium of money laundering, first one is the cash itself which the criminals earn through illicit means. This cash is smuggled in Iran or Afghanistan which are the border sharing countries of Pakistan. Criminal have their agents who perform this act on behalf of the owner. This smuggling is also done on the airports through the authorities who took their own bribe at the spot and clear the criminals (UNODC, 2009).

Corroupt Administration

In the country many officials and politicians are claimed to be involved in the criminal activities. These peoples are supposed to involved directly in the money laundering or either received bribes from the criminals to settle their matters and place the money. Among these many administrators found guilty by anti-corruption department who were reported as criminal in being involvement in money laundering or other types of crimes. Mostly the peoples at ports and borders

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are found involved with the smugglers who assisted them in their destinations. In return they also earn huge amount from that smuggler as bribes (Haq, 2016).

Hundi

It is the channel of transferring money from one country to another without actual movement of money and most popular in Pakistan and India. Although Pakistan banned it but still some private dealers are using this method. Through this method the money is transferred by international family members to their relatives without noticing any economy. It is considered that about 15 billion money laundering take place through hundi (Iqbal, 2015).

Trafficking of Drugs

Pakistan is the country where the opium is produced and traded on prior basis among the drugs. Even its borders sharing countries also have the cultivation of opium at peak. However, the borders of these countries are not much restricted and rules are easily violated so the criminals did not take many efforts to smuggle it from one country to other and get cash in exchange which is used in trafficking and terrorist purpose. Although the cash which is received, itself money laundering because it is obtained without reporting (UNODC, 2009).

Evation from Taxes

In Pakistan many authoritative peoples not pay their taxes but their status is paid. They pay a chunk of money to the tax department employees who change their status accordingly. In this way they affect the revenue system of the country. They also pay bribes to officials for their illegal transferring by showing as clean without paying any penny of tax. So, the money laundering done by two ways once by not paying tax and secondly by transferring money without reporting (T. Husain, 2016).

Figure 2 World Wide Channels of Money Laundering

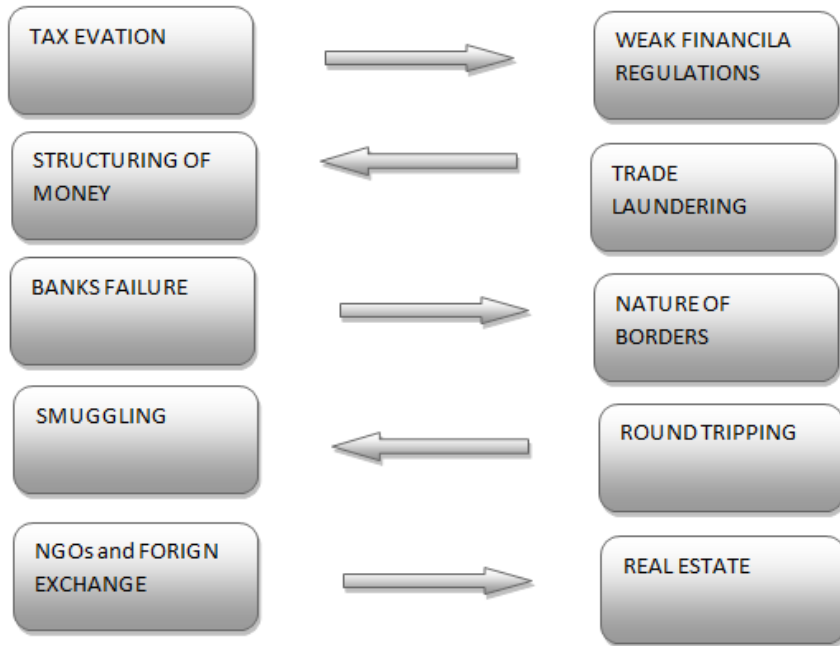


Table 1 Action against Money Laundering Taken by Pakistan

NO	YEAR	ACTIONS
1	1986	South Asian Association for regional cooperation for suppression of terrorism was established
2	1988	United Nation convention against drugs and illegal money was founded
3	1997	Anti-Terrorism act was established
4	1997	Asia Pacific Group entered the Pakistan against money laundering
5	1999	Pakistan signed the Organization for Islamic cooperation for international terrorism and corruption

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6	2000	Pakistan signed convention of UN for organized crimes
7	2002	To handle the hundi, state bank of Pakistan established companies
8	2003	Pakistan signed UN convention for anti-corruption acts
9	2003	Banned many organizations and NGOs for involvement in corruption
10	2004	State bank of Pakistan took some steps to control money laundering and terrorist funding
11	2004	Anti-terrorist act was amended by increasing its scope
12	2007	Financial monitory unit was established
13	2009	Money laundering was found extraditable offence
14	2010	Anti-money laundering ordinance become anti money laundering act
15	2015	To counter terrorism and money laundering National Action Plan was established
16	2015	Pakistan signed with 29 nations for anti-terrorism policies and plans
17	2015	Pakistan signed United Nations Security Council for the boycott of terrorism

Source: (Mukhtar, 2018).

Money laundering has negative effect on the all types of economies but the economies of developing countries like Pakistan are more subject to this evil because these countries have informal economies. An informal economy has less resistance towards the money laundering. Informal economy refers toward the earning of a country which is earned other than the formal ways. Simply an informal economy means the proceeds of unlawful and illegal activities, in which the goods and services are produced for sale but these goods and services are not created in normal course of action. If major part of the economy is composed of informal money, then the economy of this country gets worse effect from money laundering. In Pakistan almost every second person is producing illegal resources of earning which weaken the economy (Becker, 2004). As developing countries want to get out from the different problem of their lives so they conduct illegal activities and informal economy was considered as the sign for their survival. This informal economy is composed of producing goods and then transferring from one

place to another by evading the tax, the opening of unregistered and illegal small-scale organization which not fulfills the rules of countries, the movement and working of unregistered labor force etc. Sometime this economy is made of fully informal acts proceeds while sometime the goods are produced legally but they are sold illegally that creates the negative impact on the economies (OECD, 2009).

General Objectives

1. To explore history and purpose of money laundering in Pakistan.
2. To study the channels of money laundering in Pakistan.
3. To give an overview of actions taken by Government against money laundering in Pakistan.
4. To give a theoretical review of previous studies.

Theoretical Literature Review

Conducted study in Pakistan to know the relationship between money laundering and economy of the Pakistan by taking the two groups of persons. The one group was businessman and other group was salaried persons. In this study they selected the sample of 51 peoples who take part. They take the time period of three months from March 2012 to May 2012. In this study they cover the effect of money laundering, awareness about money laundering, laws relating to money laundering, use of this money and corrective measures to eradicate the evil. At the end they concluded that the effect of money laundering on the economy is not related to the occupation. But it can adopt by person having illegal money relating to any field. They found that the groups have awareness about money laundering, they want to have laws against it, and Government must adopt policies to stop it. They also concluded that money laundering has effect on the economy of Pakistan but this effect can be positive or negative depending upon the treatment of money laundering. If this money is used for the welfare of society, then it has positive result and if it is used for criminal acts, then it has negative impact (Ihsan & Razi, 2012).

Conducted a survey nature study in India to check the relation between economic development, economic and political stability and money laundering. At the end study was concluded by positive relation between all the variables and negative effect of money laundering on these variables. That if the rate of money laundering increases in any period, then the stability of the country decreases. The reason behind the negative impact was that money laundering provided availability of more fund due to no tax rate that is used for criminal activities and when there is more funding than there will be more crimes. Secondly it was said that money laundering discourages the investment due to frauds and corruption. It also had negative impact on political and social stability by due to non-tax payment which is used for the welfare of society and those peoples who are not involved in this

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crime get affected automatically. Money laundering had adverse effect on the financial institutions of the country, and these financial institutions are the backbone for the economic development of any country. It affected the financial institutions due to involvement of employees in frauds and due to loss of customer satisfaction. So, money laundering is not an evil only for country but it affects individual also. At the end this study stated that money laundering cannot be controlled until and unless all the nations joined their hands (Kumar, 2012).

Worked in Kosovo on the adverse effect of money laundering on the domestic economy and found negative relation between two variables. They took the data of one year to conclude the results and then apply to overall economy. In this study they found that billions of Euros are revolved in Kosovo in each year but there was no exact evidence about this money at national and international level. So, they concluded that whatever the amount is, it is necessary to check the methods which are used to earn this money, the techniques which are used to transfer this money and measures must be taken to control and stop it. This study showed the situation of Kosovo for the year but according to them, the condition was same in the previous years due to unavailability of laws regarding this crime and borders interaction. In the end it was found that money laundering is not only affecting the economy of Kosovo but it had same effect on the world, however it is impossible to found the damage of money laundering but due to its impact it can be said that it has adverse effect on the health of any economy (Beqiri & Beqiri, 2018).

Conducted study in 52 countries including Pakistan, which were more exposed to crimes. The main purpose of this study was to know about the nature of money laundering and its social and economic effect. In economic side the main concern was lie with to know about the involvement of financial sectors in the crimes ,the cost of reputation which they loss due to bad image, role of private sectors ,instability of economic environment, loss of control on the country polices and plans due to involvement of external forces, reduction in the revenue and budget reduction, decreases in the rate of investment increase in the number of crimes unavailability of funds for social welfare due to non-tax payments, lack of funds due to transfer in other countries. This study was concluded at the end that money laundering has negative and adverse effect on all the above elements and increases the power of criminals which is not good for any state and working of any country. And it results loss of power by government due to condensed criminal activities (McDowell & Novis, 2001).

Conducted study in Pakistan in order to check the impact of money laundering on Pakistan. The purpose of this study was to find out whether money laundering is beneficial or not for the economy of the country or to any other element of the country. He collected the data and presented the results that money laundering is not beneficial in any way for the country, institutions or individuals except the criminal activities. It is only causing damages to all the sectors and economy of country by evading powers and control from government over the policies of the

country (Qureshi, 2017) And increasing the risk for the businesses and banks due to bad reputation and frauds. Moreover, it was also found in the study that money laundering of Pakistan not only affecting the Pakistan but its rays are also affecting international policies relating to monetary system and dealings with Pakistan. Following draw backs of money laundering was found by (Qureshi, 2017), in his study

1. Money laundering had negative impact upon the emerging markets such as if Pakistan has open borders trade with another country, then money launders must take advantage of it to transfer their illegal money to finance their crimes which may affect the relation between two countries and also effect the trade.
2. Money laundering affect the competition among private sectors because those institutions and firms which are involved in the transactions of money laundering for launders, they got handsome amount from those and then reduces the prices of their services and product which become damaging to the other sectors and they cannot maintain competition. In this way the portion of economy due to private sectors reduces and negatively affect the growth of country.
3. Money laundering on at its top negatively affect the banks and financial institutions and there are many reasons behind this but the main reason was when a large amount is deposited in any bank and then after few days it transferred to another bank, this causes the liquidity problem for a bank and results bank insolvency. The major example of this damage is The Liberty Reserve Bank which becomes insolvent due to money laundering.
4. Money laundering not only affect the economy of country but it has very divesting effect on the social environment of the country by not only hitting from the financial side but attacking from the cultural and ethical side as it provides free and safe environment to the criminals. The rate of crimes, corruption, terrorism and many evils rises due to this single sin.

Conducted study in the 18 developed countries from the time period of 1982 to 1990. In this study the relation between economy and money laundering of these all countries was checked. This study was based upon the study of (Barro, 1991), in which the human capital was used instead of money laundering. In this study he concluded that money laundering is directly related to economy of these countries but this also depends upon the other independent variables. As his model included government expenditure which was directly related to money laundering but when the government expenditure was removed from the model then results become opposite and money laundering showed negative relation with economy. (Quirk, 1997). He said that when government consumed more than more peoples are employed and the rate of money laundering also go high. So, he suggested that the economy and money laundering had the relation with each other but the nature of this relation changes by changing of other independent variables. The model was

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$$GDP = \beta_{PI} + \beta_{TER} + \beta_{CRIM} + \varepsilon$$

Where GDP = gross domestic product, PI = private gross domestic capital, TER = student enrollment at tertiary level, CRIM = number of crimes

Conducted study in fourteen European countries by establishing a linear regression model, to check the relationship between money laundering and growth. Real GDP rate was taken for the measurement of growth of economy while percentage of GDP was used for the money laundering. In order to calculate the money laundering data AUSTRIC report was utilized to get the figure of crimes data. They included 11 types of crimes taking place in the countries for money laundering. Then the proceeds of the crimes and number of the crimes were multiplied to get the figure for money laundering. Money laundering was taken as independent variable and growth was taken as dependent variable (Stancu & Rece, 2010). At the end of research, they concluded that these both variables are directly related to each other. When money laundering in any country increases then the economic growth of that country also increased but with the slower rate. The reason behind this is, that firstly the process of laundering money completed from one country to another country and after it the money came back to the home country for the consumption and investment. So money laundering had positive relation with economic growth. Many theories criticized this concept that if money laundering not controlled than there will be more availability of funds for criminals and they can do crimes on their peak but many other also refused these theories because the money laundering is not the reason behind the crimes but the convenient laws are not much strict to control the other crimes

The linear regression model was

$$Y = f X$$

Where Y = GDP = gross domestic product, X = money laundering

Worked on the money laundering and its effect on growth by taking the Gulf countries that included UAE, Oman, Qatar, Saudi Arabia, Kuwait and Bahrain. They analyzed the data from 1980 to 2014 by taking the different variables. GDP was taken as the measure of growth while crime along with the other variables was taken as explanatory variables. In the end they found different results for the countries (Issaoui, Hassen, & Wassim, 2016). Their model was

$$\text{LogGDP} = \beta + \beta_1 \text{Crit} + \beta_2 \text{amllit} + \beta_3 \text{strit} + \beta_4 \text{ctfit} + \beta_5 \text{opnit} + \beta_6 \text{proxit} + \beta_7 \text{M2} + \mu + \varepsilon$$

Where GDP = gross domestic product, Cr = crimes ,amll = anti money laundering law, str = suspicious transactions reporting, ctf = crminilize terrorist financing ,opn = openness (imports and exports) prox = proximity (degree of risk), M2 = quasi money, μ = individual effect, ε = error term

it = time period

In the results they concluded that the effect of money laundering and anti money laundering laws was found positive on the economies of Bahrain, UAE and

Oman while it had negative effect on Kuwait, Saudi Arabia and Qatar. The difference of effect was due to the adoption of rules and laws in the countries.

Analyzed the effect of money laundering on the economic growth of Kosovo and its trading partners. For this purpose, they used the data of 8 years from 2008 to 2015. GDP was used as measure of economic growth and informal economy estimates were used for the measurement of money laundering along with other variables. In this study they concluded that when the variables of money laundering increases then the economic growth of the countries decreases and vice versa. All the results of this study were supported with empirical evidences and it was the main point of this study. The major conclusion of the study was that money laundering had significant and negative impact on the economic growth (Hetemi, Merovci, & Gulhan, 2018). The model of the study was

$$GDP = \beta_0 + \beta 1IE_{i,t} + \beta 2FDI_{i,t} + \beta 3R_{i,t} + \beta 4G_{i,t} + \beta 5Cr_{i,t} + \beta 6NC_{i,t} + \varepsilon$$

Where GDP = gross domestic product, IE = informal economy, FDI = foreign direct investment, R = remittances, G = government expenses, Cr = corruption, NC = number of crimes, ε = error term

I, t = time period

In this study they hypothesized that money laundering had negative impact on the economy of Kosovo and its 20 trading partners, and this hypothesis comes true after the results. They conducted the study in the Kosovo because before this study no empirical researched based study was conducted to check the degree of effect of money laundering. While this study concluded the results with literature facts.

Concluding Remarks

Central idea of this research paper is to give an overview of money laundering in Pakistan and its impact on economic growth with theoretical perspective. Money laundering has enhanced in the last few years in Pakistan and it has badly affected not only economy but also badly damaged our social values. Money laundering not affect the economy at micro level but it also affects the macroeconomic variables by producing high level of unemployment; decrease in investment and in the developing fund. Researcher of all over the world has agreed that money laundering is a curse and it should be rid off. Pakistan needs serious implementations of money laundering acts.

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