

DIGITAL ASSETS IN PAKISTAN: NAVIGATING THE SHIFT FROM GREY MARKETS TO LEGAL FRAMEWORKS

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Abstract

The fast development of cryptocurrencies has had a dramatic impact on the global financial system with the emergence of decentralized digital assets functioning through blockchain. Starting from the creation of Bitcoin in 2009, cryptocurrencies have become a significant asset class that can be used not only for investments but also for payments, decentralized finance, tokenization, and cross-border transactions. The attractiveness of cryptocurrency mainly relates to the features of the asset such as limited issuance, transparency, low reliance on intermediaries, and fast international money transfers. Moreover, decreasing trust in the national currency because of its inflation and devaluation has led to growing interest in digital assets across many countries.

Despite the absence of regulatory clarity during many years, Pakistan showed noticeable growth of cryptocurrency adoption driven by various factors including inflation, currency depreciation, remittance needs, lack of investment possibilities, and increased digital literacy. However, for many years, there was no legislation regulating the cryptocurrency in Pakistan, and therefore there was a lack of clarity concerning investor protection, taxation, financial regulation, and anti-money laundering compliance.

It seems there is a gradual trend towards adopting a more formalized approach to regulation. The present research paper attempts to discuss the legal position of cryptocurrencies in Pakistan through history, the reasons behind their popularity in the country and the current framework of regulations concerning the virtual currencies. Using the methods of doctrinal legal research, comparison of regulatory regimes abroad and policy analysis, the paper aims to discuss whether Pakistan could manage to strike a balance between the four.

Keywords: Cryptocurrency, Blockchain, Virtual Assets, Pakistan, Regulation, Financial Technology, Digital Assets, Financial Governance.

Introduction

A very important development in the history of modern finance is related to cryptocurrencies, and particularly the emergence of Bitcoin. It was invented in 2008 when a white paper named 'Bitcoin' was published by someone called Satoshi Nakamoto. It was designed as a payment system that would operate without the involvement of banks and governments. It appeared just after the 2008 world economic crisis when public distrust in traditional financial structures increased, and fears regarding the excess production of money rose. Contrary to fiat money, whose issuance is unlimited, Bitcoin has a restricted number of units: only 21 million coins exist.

The constant loss of purchasing power that occurs in fiat currencies due to inflation and other factors such as deficit financing and expansionary monetary policy plays an important role in the growth of the popularity of cryptocurrency. This phenomenon takes place both in developed and developing countries as a consequence of regular money printing, which

devalues savings and wages. The problem is very important in cases of high levels of inflation and currency depreciation; people are actively looking for alternative means of value storage. Blockchain, the distributed ledger system behind cryptocurrencies, allows secure, transparent, and tamper-resistant transactions without the need for traditional intermediaries (Perez-Marco, 2016).¹

Cryptocurrency becomes even more appealing in developing nations because of currency depreciation, lack of capital market accessibility, expensive international money transfer charges, and poor financial inclusion. Pakistan is one of the best examples that prove the case. In spite of regulatory ambiguity, Pakistani residents demonstrate increasing activity in the crypto asset space, including crypto exchange transactions, peer-to-peer payments, freelance crypto payment processing, and crypto business. It is because of the devaluation of the Pakistani rupee, persistent inflation issues, and a relatively young, technology-savvy population that led to increased interest in crypto as investment opportunities and hedging assets (World Bank, 2024).²

However, even with this growing popularity, there was no legislative base for cryptocurrency in Pakistan. In 2018, the State Bank of Pakistan instructed banks and other licensed institutions not to conduct any transactions in virtual currency; it made ambiguous the legal position on the matter. Nonetheless, private ownership and holding of the cryptocurrency were not banned by the Parliament. Such a contradiction between growing popularity and legal regulation resulted in the situation when individuals had to work in the space without adequate security, protection, dispute resolution procedures, and regulatory control (State Bank of Pakistan, 2018).³

Given the increasing volume of activities involving cryptocurrencies, along with the issues connected to investor protection, anti-money laundering rules, financial regulation, and technology, the issue of cryptocurrency regulation in Pakistan has gained more momentum in recent times.

In this article, we will analyze the response of Pakistan to cryptocurrencies and explore whether the current attempts at regulation will be able to turn the crypto market from being active and unregulated into a productive sector of economy.

Historical Development of Cryptocurrency and Blockchain Technology

The basis of cryptocurrencies is blockchain technology, a decentralized method of accounting based on distributed ledger technology that aims to make the transactions made secure and transparent. Information is stored using blockchain technology in a series of blocks connected in such a way that each block has some information about its preceding block. The use of blockchain technology reduces reliance on central intermediaries while ensuring transparency and security.

The first successful use of blockchain technology was seen in the form of Bitcoin. It differs from the other currencies that are issued by central banks since the transaction in Bitcoin takes place using a decentralized system where transactions are collectively approved by all participants and not any central agency.

Following Bitcoin's success, thousands of different cryptocurrencies and digital assets have been created. Blockchain technology has evolved from peer-to-peer payment systems into decentralized finance systems, smart contracts, tokenization, non-fungible tokens (NFTs), and different kinds of digital assets. The widespread adoption of blockchain

1Perez-Marco, R. (2016). Blockchain Technology: Principles and Applications. arXiv preprint, arXiv:1601.05254.

2World Bank. (2024). Pakistan Development Update. World Bank Group.

3State Bank of Pakistan (SBP). (2018). BPRD Circular No. 03: Caution Regarding Risks of Virtual Currencies / Tokens. Karachi: SBP.

technology has led to governments all over the world trying to understand the legal implications of decentralized financial technologies.

The global debate on cryptocurrency regulations is largely characterized by two main tensions. Firstly, governments would like to promote technological advancement, economic growth, and financial inclusion. However, at the same time, regulators are also worried about possible risks related to fraud, market manipulation, money laundering, terrorism financing, consumer protection, and financial stability.

These two conflicting objectives have resulted in different regulatory approaches in different countries. Whereas some countries have chosen to adopt cryptocurrencies by using licensing schemes, others have opted for restrictive regulations aimed at limiting the use of digital assets. In this regard, Pakistan's regulatory approach should also be analyzed in light of the wider global picture.

Cryptocurrency Adoption in Pakistan

Cryptocurrency adoption in Pakistan has mirrored general developments in the economy, technology sector, and demographics of the nation. There were several reasons for people's growing interest in digital currencies amid continued uncertainty on the part of regulators.

First of all, the reason was the constant decline of the value of the Pakistani rupee as well as the presence of inflationary risks. Persistent inflation might undermine the purchasing power of people and lead them to seek other forms of value storage. Digital currencies have frequently been considered the tools for hedging against inflation and currency depreciation.

Secondly, there is the large market of remittances from abroad in Pakistan. The transfer of money abroad using traditional banks entails various costs. At the same time, cryptocurrencies allow for international payments in a new way and become an incentive for people to adopt them as a tool of payment, especially for freelancers and foreign workers.

Finally, another reason is the relatively young and technologically oriented population of Pakistan. Despite regulatory warnings and institutional caution, cryptocurrency usage continued to expand through peer-to-peer markets and international trading platforms. The absence of formal regulatory structures did not eliminate demand; rather, it contributed to the development of informal channels through which users accessed digital asset markets.

Based on Chainalysis statistics and industry analysis, the amount of cryptocurrency transactions carried out by Pakistanis between 2021 and 2023 was approximately estimated at US\$18.6 billion to US\$25 billion. At the same time, Pakistan occupied one of the leading positions in the global indexes of crypto adoption among citizens (Chainalysis, 2024). This information shows that the restrictions in regulation were not enough to reduce the public demand for cryptocurrencies and there were significant transactions made without any control.⁴

The development of cryptocurrency market in the conditions of unclear legislation leads to a number of questions about the efficiency of such policy and requires an evaluation of the ability of the regulation to provide more effective solutions for investor protection, tax collection, financial stability, etc., than market activity..

Literature Review and Theoretical Foundations

The rise of digital currencies poses numerous questions for the traditional financial and legal system, causing an increase in literature dedicated to the regulation of cryptocurrencies. In the early stages of academic research in this field, the emphasis was on the technology of the bitcoin and its features of decentralization, limited volume, and capacity to serve as an alternative to fiat money systems (Nakamoto, 2008).⁵

⁴Chainalysis. (2024). The 2024 Global Cryptocurrency Adoption Index. Chainalysis Research Reports.

⁵Nakamoto, S. (2008). Bitcoin: A Peer-to-Peer Electronic Cash System (Whitepaper).

Further research in the literature became more related to the issues of regulation, such as money sovereignty, regulation, taxation, consumer protection, and money laundering enforcement. In international literature, the notion of cryptocurrencies is often associated with disruptive financial instruments which are regulated in no way at all. As pointed out by Böhme et al. (2015), although the use of the blockchain technology provides increased transparency and efficiency, it leads to new regulatory challenges due to the anonymity of users and the lack of central control. 6

In the context of developing nations, there emerges a dual theme in the extant literature. One, where adoption has been facilitated by inflationary reasons, exchange rate volatility, necessity of sending remittances, and lack of adequate financial facilities. Two, there is an issue of financial stability, illicit finance, and effectiveness of the existing framework raised by governments.

In the case of Pakistan, there is not much academic literature available. Present debates in the literature mainly revolve around the regulations and warnings from the State Bank of Pakistan, fears about non-compliance with Anti-Money Laundering laws, and doubts about legality of cryptocurrencies. However, recent policy development indicates that there has been a change in the thinking process and now the recognition of the fact that cryptocurrencies are financial innovations that need regulation.

This article, therefore, adds to the literature in this regard.

Monetary Sovereignty and Cryptocurrency

From the traditional point of view, modern states enjoy a monopoly over the production, regulation, and administration of their money. However, cryptocurrency runs counter to this model of the state because it forms decentralized systems of money transactions outside the control of the state. For instance, there is no country or monetary institution that produces or regulates Bitcoin; rather, this cryptocurrency exists through mathematical algorithms and decentralized decision making.

This innovation has sparked considerable discussion among scholars of law. On the one hand, some consider this innovation to be a challenge to the monopoly of the state over the monetary system. On the other hand, it can be considered a new and useful tool that can co-exist with the existing financial institutions. The problem becomes especially topical for developing countries such as Pakistan, where monetary policy is an important tool of economic management.

Theoretical Frameworks for Cryptocurrency Governance

Regulatory theory represents yet another important base for analyzing cryptocurrency governance. It claims that government interference in markets becomes inevitable because of markets' failure, risks, information asymmetry, and issues related to consumer protection.

These features are inherent in cryptocurrency markets. The investors frequently lack the information about potential risks related to investments, technological vulnerabilities, solvency of exchanges, and regulatory matters. Moreover, the volatility of digital currencies implies certain risks for consumers of the goods.

In terms of regulation, governments try to address these risks through licensing, disclosure, compliance, anti-money laundering activities, and consumer protection mechanisms. The purpose is not to stop innovations but to create mechanisms which will minimize risks while promoting markets' growth.

This issue is especially topical for Pakistan as the absence of a proper legal framework in this country led the people to suffer from frauds, scams, hacking cases, and exchange failures.

Empirical Evidence and Global Regulatory Trends

However, empirical studies analyzing cryptocurrency adoption demonstrate that there is one clear pattern in relation to cryptocurrency adoption in various jurisdictions. Countries, which implement very strict regulatory framework, do not eliminate the use of cryptocurrencies in their jurisdiction. The market activities migrate to other informal means, peer-to-peer networks, and offshore trading platforms.

As per Chainalysis reports, the emerging countries are among the leading nations when it comes to cryptocurrency adoption due to high levels of inflation, instability of currencies and need for money transfers (Chainalysis, 2024).⁷

In addition, there are also empirical studies, which highlight the impact of uncertainty on creation of informal markets. As users are unable to participate in exchanges, use banking services and other regulated digital assets, they turn to alternative channels.

The situation in Pakistan demonstrates most of the described global trends, as the estimated amounts of cryptocurrency activity show that the lack of clarity about legal framework of cryptocurrency market was the factor of market development, rather than hindrance.

It is possible to conclude based on comparative analysis that in case of well-developed regulatory framework investors' protection, institutional involvement, compliance measures and tax revenues grow, while excessive regulation encourages capital outflow.

These findings suggest that effective regulation may provide a more sustainable solution than outright prohibition. Rather than attempting to eliminate cryptocurrency activity entirely, policymakers increasingly focus on integrating digital assets into formal regulatory systems.

The Legal Status of Cryptocurrency in Pakistan

The legal standing of cryptocurrency in Pakistan has been one of ambiguity as opposed to outright prohibition.

The State Bank of Pakistan gave instructions in 2018 prohibiting banks and regulated financial institutions from engaging in transactions related to virtual currencies. This was as a result of issues concerning money laundering, terrorist financing, consumer protection, and financial stability (State Bank of Pakistan, 2018).⁸

Although there was a general feeling that cryptocurrency had been banned, upon further legal assessment, it becomes clear that although regulated entities could not facilitate cryptocurrency transactions, Parliament had never made legislation that outlawed the use of cryptocurrency. Therefore, there was no legal standing against cryptocurrency in Pakistan.

This has implications on how the crypto markets developed in the region since although formal channels for conducting transactions were out of reach for crypto assets, people found other ways through which they accessed these assets such as p2p websites and overseas exchanges.

This left the user with ambiguous laws and no guidance as far as legal protection of their rights is concerned, while financial institutions remained unaware of how to deal with digital asset companies. Tax authorities faced difficulties in identifying and taxing crypto-related gains. Law enforcement agencies encountered challenges in addressing illicit activities involving decentralized and pseudonymous systems.

On the other hand, regulators started noticing that cryptocurrency use was growing despite regulatory limitations. This fact led to debates about the necessity of creating a new

⁷Chainalysis. (2024). The 2024 Global Cryptocurrency Adoption Index. Chainalysis Research Reports.

⁸State Bank of Pakistan (SBP). (2018). BPRD Circular No. 03: Caution Regarding Risks of Virtual Currencies / Tokens. Karachi: SBP.

regulatory system that would deal with opportunities and dangers presented by digital currencies.

Emerging Regulatory Challenges

Regulation of cryptocurrencies is faced by some challenges because they do not belong to any category of legal terms; they possess features of money, commodity, securities, technology platform, and investments.

One of the biggest challenges is anti-money laundering issues. Pseudonymity associated with cryptocurrency transactions poses problems with respect to illegal activities, cross-border transactions, and enforcement issues. Consequently, there needs to be a way to increase transparency while not hindering innovative characteristics of decentralization technologies.

Investor protection is another important challenge. Market volatility of cryptocurrency combined with scams and fraud, market manipulation, exchanges failure, and cybersecurity threats makes investing into them dangerous and risky with no legal protection.

Taxes are one more aspect that needs to be taken into consideration when regulating cryptocurrency. It becomes necessary to classify cryptocurrency as currency, commodity, security, or something else in order to impose taxes on them.

Technological and cybersecurity threats present extra challenges. Exchange hacks, smart contracts issues, and exchanges failure create financial risks which require both legal and financial expertise.

Finally, regulators must balance risk management with innovation. Excessively restrictive measures may discourage investment, technological development, and entrepreneurship. Conversely, inadequate regulation may expose consumers and financial systems to unacceptable levels of risk.

These competing considerations form the central challenge confronting Pakistan as it develops its emerging cryptocurrency regulatory framework.

Pakistan's Emerging Cryptocurrency Regulatory Framework

Further growth in the use of cryptocurrency in Pakistan has made policymakers face pressures to go beyond uncertainty regarding regulatory policies and create an elaborate legal structure. For many years, the policies followed by the country were mainly focused on being cautious, issuing warnings from institutions, and restricting access through banks. However, the increase in the volume of cryptocurrency usage, along with the development of digital assets regulation policies in other countries, has made policymakers look for new ways to govern cryptocurrency.

There are several reasons behind the push for regulation. Regulators are trying to protect their citizens from being involved in fraudulent schemes, market manipulations, and exchange failures. They also want to strengthen compliance with money laundering laws and monitor the flow of transactions conducted with the help of digital assets. Finally, there is an understanding that there are numerous opportunities linked with the innovative use of block chain and financial technologies.

An elaborate regulatory framework could bring the change from informal market to a regulated one. Using the system of licensing and taxation, regulators would be able to mitigate risks while fostering innovations.

However, at the same time, the efficiency of any regulatory system is determined by its implementation. Just because there are regulatory frameworks does not necessarily mean that they can effectively control the markets. Regulatory organizations need enough expertise, power, and mechanisms for coordination in order to regulate new digital markets.

Therefore, the creation of cryptocurrency legislation in Pakistan cannot be considered an isolated act but rather a continuous process of institutional adaptation to innovations in finance.

Comparative Analysis of International Regulatory Models

The experience of other jurisdictions provides valuable insight into how Pakistan might approach cryptocurrency regulation. While no universal regulatory model exists, comparative analysis reveals several common principles and best practices.

1. United Arab Emirates

The United Arab Emirates (UAE) has managed to position itself as one of the leading global centers for cryptocurrency and blockchain development through the implementation of unique regulatory frameworks. Instead of trying to curb digital currencies and fit them into existing legal structures, UAE regulators devised specific rules for regulation of virtual asset service providers (VASPs), licensing of businesses, and market surveillance (Virtual Assets Regulatory Authority, 2023). In other words, a special proactive system of balancing innovation within institutions and vigorous financial regulation has been developed. Through creating full regulatory certainty and licensing systems, the country has been able to attract huge amounts of global investment and digital currency business organizations. It is important to note that openness of the market is accompanied with strict compliance with the AML/CFT guidelines.⁹

2. Singapore

While UAE has chosen the specialized agency model of regulation, Singapore has opted for an integrated regulation framework run via the central bank structure. While the Monetary Authority of Singapore seeks to integrate digital assets into the mainstream financial system by making them adhere to strict risk-based compliance requirements under an overarching statute (Monetary Authority of Singapore, 2019), the integrated regulatory framework focuses more on consumer protection, market integrity, and risk management rather than speculative growth. Unlike in the UAE, Singapore does not treat cryptocurrencies as a separate asset class but regulates digital assets using the payment and financial services legislation. The risk-based regulatory framework has enabled Singapore to maintain its reputation as a stable Fintech center.¹⁰

3. United States

The United States offers an intricate regulatory system where the authorities from the federal and state governments overlap. Regulatory bodies have often been observed to classify digital assets differently based on the nature and application of such assets. The U.S. regulatory scenario can be considered one of the prominent examples of how the process of regulation by enforcement creates problems in the absence of a unified statute. The inherent problem is demonstrated by the famous case of SEC v. Ripple Labs Inc. (2023). In this case, the US Securities and Exchange Commission filed a case against the issuance of the XRP token without registration, as per the 1946 securities laws. It was a crucial split verdict as the court decided that the direct sales to the institutional customers were securities whereas sales through programmable trading systems to retail customers in digital exchanges did not qualify as securities. The case highlights the legal problems that arise when an outdated legal definition is tried to be applied to decentralized protocols. For the young ecosystem of Pakistan, the chaotic litigation seen in the U.S. provides a strong justification for bypassing legacy frameworks entirely in favor of a proactive, codified regime under the Virtual Assets Act

Lessons for Pakistan

Comparative analysis suggests several lessons for Pakistan.

⁹Virtual Assets Regulatory Authority (VARA). (2023). Virtual Assets and Related Activities Regulations 2023. Dubai: VARA.

¹⁰Monetary Authority of Singapore (MAS). (2019). Payment Services Act 2019.

- Regulatory clarity is generally more effective than prolonged uncertainty. Jurisdictions that provide clear rules often experience greater institutional participation and stronger compliance outcomes.
- Investor protection mechanisms remain essential for maintaining public confidence in cryptocurrency markets.
- Anti-money laundering compliance must form a central component of any regulatory framework.
- Excessive restrictions may drive market activity into informal channels rather than eliminating it entirely.
- Successful regulation requires balancing innovation with risk management rather than prioritizing one objective at the expense of the other.

Analysis and Discussion

It is clear that the use of cryptocurrencies in Pakistan evolved through lack of any form of regulation. Economic factors, technical factors, remittance needs, and increased awareness have provided sufficient incentives to engage in cryptocurrency trading.

The case of Pakistan is consistent with other studies made at the international level which show that lack of regulation does not necessarily mean that there is no activity in the cryptocurrency space. Instead, what normally happens is that people tend to move towards peer-to-peer platforms, offshore trading platforms, and informal trading.

The implications for public policy here are significant in the sense that if there is substantial cryptocurrency activity, policymakers will need to establish if continuing with the uncertainty is better than regulating the process.

Regulation can help provide some form of protection to investors and increase market transparency. The issue of licensing and compliance requirements can minimize some risks in informal environments. Similarly, tax regulations will help in collecting revenues.

Nevertheless, regulation cannot be seen as an all-encompassing solution to all problems linked to cryptocurrencies. Market dynamics in digital asset space can be considered as very volatile and technologically complicated. Investors still face various risks of market volatility, cyber attacks, technical failure, and other issues even in highly regulated countries.

Therefore, proper governance of cryptocurrencies needs to include not only regulation but also technological, institutional, and international aspects, as well as public awareness.

The general problem for Pakistan lies in the need to find the balance between innovation and control of the government. Too strict regulations might suppress entrepreneurial activity, investments, and technology development, while too little control might lead to serious risks.

A sustainable regulatory environment thus needs to take into account advantages and limitations of cryptocurrencies as an element of financial system.

Conclusion

The evolution of cryptocurrencies shows a transformation from an experiment in technology to a major financial and legal issue involving the governance of money, financial regulations, taxes, investor protections, and economic development. The experience of Pakistan shows the increasing difficulty of dealing with digital asset markets using regulatory ambiguity.

Even without proper regulation, the adoption of cryptocurrencies increased significantly within Pakistan. Economic conditions, depreciation of currencies, necessity of making remittances, and innovative capacity were some of the factors responsible for the growth of digital assets.

As can be seen in the discussion presented in this article, cryptocurrency regulation cannot be understood merely in terms of prohibition or liberalization. Instead, the problem is

to formulate the regulatory framework which can adequately take care of the regulatory issues while also allowing for innovation and economic growth.

As experience of international law shows, those who provide regulatory certainty usually enjoy better results in such matters as investor protection, compliance, taxation, and institutional involvement. The efforts of Pakistan to develop its approach towards regulating of virtual assets can be considered an essential step in adapting its laws to new financial technologies.

At the end of the day, the success of any kind of regulation will depend on how well it is implemented, whether there is enough institutional capacity, what are the mechanisms of enforcement, and how effective are policymakers' responses to quickly changing technological environment. Cryptocurrency will remain an important part of global financial markets in the foreseeable future.

Recommendations

Based on the analysis conducted in this study, several recommendations may assist policymakers in developing a balanced and sustainable cryptocurrency regulatory framework.

- Pakistan should establish comprehensive legislation specifically addressing cryptocurrency and virtual assets. Clear legal definitions would reduce uncertainty and improve consistency across regulatory institutions.
- Structured licensing framework should be introduced for cryptocurrency exchanges, custodians, and other virtual asset service providers. Licensing requirements can improve accountability and strengthen market supervision.
- Policymakers should develop clear taxation rules governing cryptocurrency transactions, investment gains, and digital asset-related business activities. Greater clarity would improve compliance and facilitate revenue collection.
- Investor protection mechanisms should be strengthened through disclosure requirements, transparency standards, dispute resolution procedures, and consumer awareness initiatives.
- Anti-money laundering and know-your-customer compliance measures should remain central components of cryptocurrency regulation. Effective monitoring systems can help address concerns regarding illicit financial activity while preserving legitimate economic uses of digital assets.
- Pakistan should encourage innovation through regulatory sandboxes and controlled testing environments that allow financial technology firms to develop new products under regulatory supervision.
- Investment in regulatory expertise and institutional capacity is essential. Cryptocurrency regulation requires specialized knowledge in law, finance, cybersecurity, and blockchain technology.
- Policymakers should continue examining international best practices while adapting regulatory approaches to Pakistan's unique economic, legal, and institutional circumstances.

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