Cryptocurrency Fever: Should Southeast Asian Countries Cooperate on Facing Cryptocurrency Market?

Hazmi Tri Laksono and Muhammad Fuadillah Nugraha
Departemen Hubungan Internasional, Universitas Airlangga, Surabaya

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Abstract: Bitcoin frenzy since its emergence in 2009 offers both opportunities and threats to certain parties. Since bitcoin was mined and has become the market leader today, thousands of altcoins and crypto-tokens have also been created. Those cryptocurrencies are being traded actively on both unregulated and registered exchanges. This paper aims to discuss how the unregulated nature of cryptocurrency-related activities in Southeast Asia region may disrupt business, tax collection, and security while at the same time challenging the state monetary and financial authority. These disruptions require cooperation from a group of countries in order to manage them. The authors argue that cryptocurrency pose threats not only in national scale but also in regional and even global scale if it is left in grey area. The transformation of businesses, the growth of crypocurrency markets in ASEAN and its potential to be used for money laundering and/or terrorist-funding are several issues which cannot be managed only by a single nation. The complexity of cryptocurrency-related issues may only be governed by effective regional economic governance. Effectiveness of regional mechanism for multilateral and regional governance stated in Asian Development Bank working paper 2017 was used as a guideline to discuss the issue. The formation of governance by ASEAN, Republic of China, Japan, and Republic of Korea (ASEAN+3) is expected to manage cryptocurrency-related issues.

1 INTRODUCING

Since bitcoin reached a peak of almost US$20,000 at the end of 2017, it has been given a lot of attention by the economists, governments, investors, and other market actors related to digital financial. The demand of cryptocurrency is one of the factors that gives value to it so that its exchange rates towards other fiat currencies are getting higher especially bitcoin. They are unlike fiat currencies which are regulated and backed by a central bank in each country, cryptocurrencies are not regulated neither are they backed by a central bank except Petro in Venezuela and Entapay in Cambodia, the first national cyrptocurrencies that have received official governments support. Since the nature of its impacts either positive or negative is borderless, cooperation from several countries is needed to face this phenomenon. Today, those cryptocurrencies are traded actively on both unregulated and registered exchange markets. All ASEAN Member Countries allow cryptocurrency trading with only Singapore imposing a tax for those trading it. Legal status of cryptocurrencies as payment method in the majority of ASEAN member countries does not indicate that they are monitored or even regulated by the governments. Due to pseudonymous and unregulated nature, cryptocurrencies which are converted into fiat currency can be used to evade important banking protocols which are needed for security purposes. Thus, the research question of this paper is, “to what extent does cryptocurrencies pose threats to nation-states in Southeast Asia countries and how to manage them?”

The authors argue that the unregulated nature of cryptocurrency-related activities such as trading, paying, and investing in Southeast Asia region may disrupt business, tax collection, and security. These disruptions require cooperation from a group of countries in order to manage them. Their threats towards nation-state are very serious because they may lead to another economic bubble burst which can shake financial stability, may be used as tax evasion method, transforming how people do money laundering and terrorist funding. Cryptocurrencies pose threats not only in national scale but also in regional and even global scale if its regulations are left in grey area. Grey area means that there are no

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strict and clear regulations regarding their activities. The promotion and formation of ASEAN Economic Community which encouraged the development of digital financing will be affected by cryptocurrencies so that a close cooperation between the member countries is needed. Meanwhile, there is a formation of governance created by ASEAN, Republic of China, Japan, and Republic of Korea (ASEAN+3/APT) which holds the solution in managing cryptocurrency-related issues.

2 GLOBALIZATION OF TECHNOLOGY, CRYPTOCURRENCIES AND THEIR THREATS

Technological invention is no longer dominated by concrete things such as vehicles or machines. In today's digital era, the invention of technology is in the form of programming codes which ends up in the creation of softwares, programs, application, platforms, etc. The advancement of new information technologies such as encryption, network computing and decentralized distributed ledgers are driving transformational change in the global economy. Digitalization occurred in financial terms are swarmed with new fintechs (financial technologies) while in the process giving birth to the emergence of virtual currencies. One of the most disruptive forms of virtual currencies is the currencies created through cryptography, peer to peer networks and circulated in decentralized distributed ledgers, or blockchain, which is called cryptocurrency. Bitcoin, the first created cryptocurrency, has been spreading in the world where it challenges the global economic order as a whole. The technology bitcoin blockchain, which underpin bitcoin, was also left in the public domain where nobody has the patent to it by its original inventor whose identity is unknown. Anyone can modify the bitcoin blockchain such as improving the security, add more features, accelerate the transaction processes, or even increase the block transaction size to create a whole new coin which has their own value. The birth of new coins such as Bitcoin Cash, Bitcoin Gold, Bitcoin Diamond, etc is due to the modification of the technology. In a technical definition, bitcoin is a digital cash that is transacted via the internet in a decentralized trustless system using a public ledger called blockchain (Swan, 2015). Since its launch in 2009, bitcoin's success as payment method led other alternative crypto coins or altcoins to be invented with different optimizations and features. Those crypto coins have been used as payment medium, value transfers and as investment globally.

The global economy which relies on the US Dollar made the Dollar as the reserve currency of the global economy. The ability of the United States to maintain its dominance in the world is because of the Dollar standard. The emergence of bitcoin and thousands of other altcoins disrupts the form of centralization formed by the Dollar standard system. Even before the emergence of cryptocurrencies, there has been already a lot of electronic money which was regulated and used as transaction means such as e-money, WebMoney, etc. Nation-state represented by their Central Banks and governments as regulatory body may execute their authority and power by applying restrictions and regulations regarding those electronic money since essentially, those electronic money are merely the representation of value owned by the physical fiat money with their transformed form to be electronic. They are also issued by certain parties such as WebMoney Company and certain parties who issued e-money such as Banks. On the other side, cryptocurrencies created through blockchain technology are not merely the alteration of the dollar, rupiah, or yen banknotes issued by the central banks in general, but radically transform the concept of money and global economic order as a whole. In a nutshell, cryptocurrencies and crypto assets are not about ups and downs of the digital currency market; it's not even about a new unit of exchange to replace the dollar or euro or the yen, it's about freeing the pople from tyranny of centralized trust. It's taking away power away from the center – from the banks, governments, and lawyers – and transfers it to the peripherty, the People (Vigna & Casey, 2015).

The control towards currency is one of the biggest power execution tools held by the central banks and nation-state. A currency will always be valid when they win the trust of the community using it whether it is the currencies issued by central bank or institution who holds monetary authority or decentralized currency issued by computer programs (Vigna & Casey, 2015). The currencies issued by the central institution are used by the community inside political territorial scope or in global scale in certain case. This is due to the the trusts given by the users towards the monetary authority who issued those currencies. The emergence of bitcoin, the first crypto currency / asset issued by computer program which had been codified by someone or a group of people who called itself Satoshi Nakamoto gave alternative trust models which have been rooted in the society.

The intermediaries are no longer needed for the authorization and authentication due to blockchain technology. Centralized payment processing protocol through financial institutions which was needed to prevent funding for money laundering or tax evasion, terrorist financing, and other illicit activities have been breached. Since cryptocurrencies came, it becomes much harder for the authority to trace transaction conducted pseudonymously or even anonymously in order to prevent those evil activities.

Despite its positive impacts, there are generally three major threats posed by the emergence cryptocurrencies markets; economic bubble burst, potential for illicit activities, and cyber attacks (Leonardo, 2018). Its extremely high volatility holds the potential to create the burst of economic bubble and disrupt businesses. According to Global Cryptocurrency Benchmarking Study (2017), there is a high increase of cryptocurrency market capitalization, exchanges and cryptocurrency companies based in Asia-Pacific Region since 2016. The high level of deregulations in Southeast Asia region regarding cryptocurrency-related activities will affect the national and even regional economy if there is actually cryptocurrency bubble burst. The burst will potentially shut down the billion of dollars cryptocurrency industries in Southeast Asia including the companies, exchanges, down to individual level traders and investors. Thus, it will lead the disruption of businesses when the regional economy is shaken by the bursts.

Second, the high deregulations also increase the potential for cryptocurrencies to be used in illicit and criminal activities including money laundering and terrorist funding. It is a common knowledge for anyone who is familiar with bitcoin especially since its emergence on the market that it used to be a tool for transaction in Silk Road, a dark web online shop that cannot be accessed in the ordinary way. It is the nest for illicit activities such as money laundering, drug-trade, human markets and so on (Swan, 2015). However, as technologies, bitcoin and blockchain are actually neutral and dual use that means they can be used for good or evil. It is difficult for regulators to track who does the illicit activities since it is a pseudonymous enabler that can be used to facilitate illegal and malicious activities (Swan, 2015). Even after the shutdown of Silk Road in 2013 by Federal Bureau Investigations, bitcoins which had been confiscated by the U.S authority was sold out directly on the auction occurred in 2014. Today, bitcoin and other cryptocurencies pose other threat such as terrorist-funding. Terrorists are using anonymous cryptocurrencies to fund their operations and evade detections as they move huge sums of money internationally. According to Cornish (2017), there is a report that showed an increase in terrorists using bitcoin in US, the Gaza Strip, and Indonesia. Authorities are able to track cryptocurrencies despite the belief that they are untraceable because criminals often stumble at so-called “real world chokepoints” where they have to exchange the cryptocurrencies into fiat currencies[1]. The third threat is the potential of cyber attacks which are pointed to the cryptocurrency exchanges and wallets. In 2018 alone, there are more crypto-related cyber attacks than all the other cyber attacks combined (Partz, 2018). These cyber attacks such as hacking and phising to gain access into exchanges and personal wallets have stolen millions of dollars in the form of cryptocurrencies. However, the attacks are also encouraging the technology to get more matured. Also, there is always a chance for cyber attack when talking about digital technology. Then, what can ASEAN do to manage such threats?

3 MANAGING CRYPTOCURRENCIES ACTIVITIES IN ASEAN

ASEAN Work Programme on Electronic Commerce (AWPEC) which aimed to facilitate cross-border e-commerce in ASEAN mentions the needs for secure payment system, trade facilitation and electronic transactions. Without regulating the use of cryptocurrencies in ASEAN, the cross-border electronic transaction will surely be disrupted because the internet users keep growing in the region and more startups in the region would be integrating cryptocurrencies into their respective models[2]. Keohane and Nye (2000) defined governance as the process and institutions, both formal and informal that guide and restrain the collective activities of a group. Since the government is the subset that act with authority and creates formal obligation, their position is not replaced by other actors as the primary instrument of domestic, regional, and even global governance. Moreover, the other actors’ roles are supplemental to the role of nation states. The complexities in

[1] See https://www.express.co.uk/finance/city/902517/ISIS-Bitcoin-terrorist-attack-deadly-weapons-funding-cryptocurrency-money-laundering

[2] See https://theaseanpost.com/index.php/article/do-cryptocurrencies-have-future-southeast-asia

ASEAN+Three (APT) behavior which become the product of contingent interaction between the material (power, territory, wealth) and the ideational (norms, ideas, identity) are fortified since the member states' interests and identities remain paramount (Nesadurai, 2009). This means the long-standing ASEAN norms of non-interference remain central to regional governance. However, the institutionalization of APT Macroeconomic Office (AMRO) may assist the formation of financial governance in the region.

The authors will discuss how APT is expected to be able to manage cryptocurrencies' threats by analyzing its 2018-2022 work plan regarding security cooperation which will shape regional governance. First of all, the authors will describe the regulations and policies regarding cryptocurrencies in all member countries. The impacts of cryptocurrency on businesses whether it is going to be positive or negative are still speculative. Nevertheless, the impacts can actually be predicted from each authority decision to accept it as legal tender in daily transaction since cryptocurrencies are considered as "currency" as well as "assets". The increase of cash digitization in Southeast Asia also enforces people to use digital currency in transaction[3]. Since Amazon and Microsoft already accept bitcoin as their payment method, more will surely follow. Regarding crypto-assets, high level of volatility and the absence of regulations make cryptocurrencies stands in risky position for investment. In fact, both the currency and overall industry are volatile.

New traders and investors who have not enough experience in cryptocurrency world may be attracted to invest in huge amount and sell their real assets or make a loan to the bank in order to invest in this business. This may lead to the huge lost for them since not many exchanges impose know-your-customer protocol to prevent this. On the other hand, the volatility in cryptocurrency market can also mean instant money for them who are luckily able to purchase when the price is low and sell them back to fiat currencies when the price is high. After they successfully take advantage of the market condition, the traders may withdraw the amounts from the exchange with several fees depending on the exchangers' policy. Traders who are making a decent amount of funds in cryptocurrency trading may leave their income untaxed especially in ASEAN Member Countries except Singapore since selling, spending and even exchanging for other tokens likely have capital gain implications. Thus, it is important to make a review regarding cryptocurrency regulations in APT member countries.

4 REGULATIONS IN APT MEMBER COUNTRIES

Singapore can be seen as the most potential destination for cryptocurrency since there are several companies that sought to flee the regulators presented in China. However, Monetary Authority of Singapore does not distinguish between transactions in fiat and cryptocurrency which means all financial institutions will be subject to the same regulations. Citizens may use cryptocurrencies as payment method but they will still be charged by tax as well. Singapore's regulators will impose Anti Money Laundering/Combating the Financing of Terrorism (AML-CFT) on intermediaries that exchange fiat for virtual currencies. Similar to Singapore, Thailand has also drafted new rules regarding cryptocurrencies regarding taxation in an effort to prevent money laundering and tax avoidance by obligating the businesses to provide transaction information as well as the names of buyers and sellers to the AML office. The law would require cryptocurrency exchanges, brokers and dealers to register with relevant authorities, following a public consultation that called for rules to be implemented by security agency[4]. Meanwhile, Vietnam, Laos, Myanmar and Brunei still leave cryptocurrencies-related activities in grey area while Philippines are planning to regulate them. Cambodia is the only country in Asia who has officially launched its own state-backed cryptocurrency called Entapay even though the whole regulations regarding cryptocurrencies there are still also left in grey area. Meanwhile, Malaysia has addressed a new AML-CFT which specifically focuses on cryptocurencies. The government also reaffirmed that virtual currencies, including cryptocurrencies are not recognized as legal tender in Malaysia. This new regulation required anyone who is conducting digital currency exchanges to mandate know-your-customer (KYC) adherence, including the collection of ID documentation. This aims to promote greater

[3] See https://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/reimagining-e-commerce-for-southeast-asia

[4] See https://www.coindesk.com/thailand-inches-closer-to-cryptocurrency-taxation/

transparency in the use of digital currencies to prevent their abuse for illegal activities[5].

The plus three members stand on different stances regarding cryptocurrencies regulation but this does not change the fact that they have clear regulations in this matter. China can be seen as the first country to react regarding cryptocurrencies frenzy. The authorities completely ban anything related to cryptocurrency in the country. They block bitcoin and cryptocurrency-related websites through their “Great Firewall” which disabling their citizens from accessing crytpcurrency exchanges and digital asset trading platforms. Even using virtual private network (VPN) to breach the firewall is prohibited thus forcing the cryptocurrency exchange markets to relocate somewhere else. Unlike China, South Korean regulators do not ban cryptocurrencies but only allowing the trade from real-name bank accounts. This real-name cryptocurrency identification service aims to crackdown the anonymity and the illegal use that some cryptocurrencies might have[6]. Meanwhile, as a global leader in cryptocurrency investment, Japan is the only country in APT members who has a proper legal system regulating cryptocurrency. They have a law that brought cryptocurrency exchanges under AML and KYC rules while legalizing it as a payment instrument.

In Indonesia, there is a strict law regarding legitimate payment method by using Rupiah. This law puts cryptocurrencies to be considered as assets not as currency. However, prohibiting it as payment method does not mean there is a specific regulation regarding cryptocurrency in Indonesia. The citizens can still trade and invest in cryptocurrencies freely without taxation and cryptocurrency market exchanges in Indonesia allow foreigners to be a member to do cryptocurrencies-related activities except paying, thus opening the opportunities for money launderer from other counries to operate. Moreover, even though cryptocurencies consideration as money by monetary authority does not prevail de jure in majority of ASEAN member countries, it is de facto in the crypto holders especially when they are doing transactions in global online shop which are accepting them. In the end, the majority of ASEAN monetary authorities merely consider bitcoin, litecoin, and the others as crypto assets instead of cryptocurrencies. The differences in viewing bitcoin and its kind as crypto assets still do not shut the threats that they bring which is why effective governance among a group of coutries is needed.

5 MULTILATERALISM TO MITIGATE BORDERLESS CRYPTOCURRENCIES NEGATIVE IMPACTS

After the Asian Financial Crisis 1997-1998, a series of bilateral currency swap agreements called Chiang Mai Initiative was set up by ASEAN, People’s Republic of China, Japan, and the Republic of Korea (ASEAN+3) . In the process of making the Chiang Mai Initiative a multilateral effort, the members conceived the idea of setting up an independent surveillance unit to monitor regional economic situations and issue early warnings (Chutikamoltham, 2017). This led to the creation of ASEAN+3 Macroeconomic Research Office (AMRO) and became an international organization in February 2018[7]. AMRO’s strategy and policy for managing operations is set by its Executive Committee whose members are the deputy or vice ministers of finance and deputy of central bank governors from the member countries. They also present its surveillance reports regarding financial and economic development directly to high-level officials of each country’s member’s Ministry of Finance and Central Bank and give the findings and recommendations to the member in an informal and confidential manner. ASEAN+3 have shown a strong commitment to regional financial cooperation and if this keeps up the support, it should be able to expand the scope and significance of its work as well as forming regional governance.

The rise of digitalization in economic activities in member countries may encourage AMRO to observe the impact of virtual currencies which included in it. Cryptocurrencies which are related to a state’s economy should give AMRO another focus to analyze the threats which they may bring. However, AMRO does not have the authority to force members to heed its analyses or advice. This makes AMRO essentially a research institution that provides analyses and advice in an informal manner. Cryptocurrencies’ threats are considered as global issue since money laundering and terrorist financing may affect multiple states and there is already a

[5] See https://news.bitcoin.com/new-malaysian-cryptocurrency-regulation-come-into-effect/

[6] See https://www.cnbc.com/2018/01/29/south-korea-cryptocurrency-regulations-come-into-effect.html

[7] ADBI Working Paper 719

regional cooperation to manage these issues such as in EU. Since governance can be understood to concern the nature and distribution of decision-making power within organizations and societies, the lack of decision-making power in APT means there is no standardized rules and policy in the community.

The APT cooperation work plan 2018-2022 aimed to establish closer cooperation regarding security which includes counter terrorism and anti-money laundering through sharing information on terrorists, supporting infrastructures as well as criminal activities and implementing measures to combat money laundering and terrorist financing[8]. Since cryptocurrencies hold the potential to do both, this work plan should be the base for each member countries to commit for closer cooperation. Leaving the cryptocurrency regulation in grey area in most of ASEAN Member Countries indicates that they still do not take the threats seriously. It is no longer enough to enhance cooperation in the field of border management to help identify terrorism-related funds since cryptocurrencies are moving in cyber-space. The authors see this counter terrorism strategy to be in need for updates because there are already several reports stating ISIS' use of cryptocurrency to finance their operations[9]. We propose the community to form their own digital financial action task force since Singapore and Japan can be considered as the most cryptocurrencies-friendly states while most of other members still leave the cryptocurrencies in grey area. Furthermore, the Head of Indonesian National Police also stated in one of his interviews that the terrorist operation which occurred in 2016 was funded through bitcoin[10]. Thus, a strict regulation regarding cryptocurrencies is needed by Indonesian authority and since terrorism could occur anywhere, the same can also be said to other countries.

As two of the most cryptocurrencies-friendly states and the members of APT, Japan and Singapore can also provide policy and regulatory recommendations to Indonesia as well as other countries in order to track terrorist funds in cyber-space. Moreover, these two digitally advanced countries may also share their technology for cryptocurrency regulation such as real-name wallet services or better firewall to prevent network breach. Not only terrorist-funding, most of ASEAN Member Countries are also considered to be the most corrupted countries which means the potential for cryptocurrencies to be used as money laundering is high in those member states. Moreover, there should be technology transfers among the private sectors such as the exchanges and crypto wallet providers regarding safety and security in order to prevent cyber attacks which may happen anytime. For example, Binance, a Chinese cryptocurrency exchange which moved to Japan, is considered to be the safest and secured according to Coinsutra can transfer or give license to other exchanges based in APT member countries. Japan and China can offer their technology to create a safer and more secure cryptocurrency market in APT member countries. Owen (2013) argued that since the ASEAN countries are characterized by low governance performance, the plus three members should provide better governance in regards of regulatory quality and government efficiency. The technology held by the plus three members will surely assist the regulatory qualities in term of cryptocurrency industries. The so-called +3 scenarios also comprise a number of "club" members with stronger national governance performance[11]. Owen also stated that many ASEAN countries could be major beneficiaries, provided such a larger regional cooperative frameworks were to target the upgrading and convergence of national governance standards. Thus, the exemplary policy formation shown by the plus three members regarding their stances in regulating cryptocurrency may upgrade the national governance as well as the ASEAN standards.

6 CONCLUSION

As ASEAN has its own unique approach to multilateralism, non-interference, minimal institutionalization, consultation, consensus, and non-confrontation, responsibility for policy action on the APT rests almost exclusively with member states and there is no mechanism exists to compel member states to comply with APT commitments. There is also a mechanism where sub-group of members can act on policy without waiting for all to do so. Those that cannot or do not want to proceed follow later, but set their own timeframes to act[12]. Its volatile nature and high deregulations make

[8] APT Cooperation Work Plan 2018-2022

[9] See https://www.express.co.uk/finance/city/902517/ISIS-Bitcoin-terrorist-attack-deadly-weapons-funding-cryptocurrency-money-laundering

[10] See https://news.detik.com/berita/d-3377708/rekrutmen-teroris-beralih-ke-medsos-kapolri-pendanaannya-pakai-bitcoin

[11] ADBI Working Paper 425

[12] US-ASEAN Business Council Digital Economy, 2015

cryptocurrency as a risky investment for business. Government and media should be able to warn and educate the people who aimed to make huge money by investing in cryptocurrency and keep emphasizing that they should not invest the amount they cannot afford to lose. The report from Time also predict the scenarios in which the bursting of the bitcoin bubble may bring down the entire stock market such as by declining the investors' confidence, companies jump on the bitcoin bandwagon before a crash, and by creating a Wile E. Coyote effect[13]. These scenarios development should be more carefully observed by AMRO since they impede the APT work plan 2018-2022 to maintain financial market stability in the region.

Countries which do not ban cryptocurrency-related activities should begin to seriously address the issue by obligating the real world chokepoints such as exchanges, brokers, and dealers to implement KYC protocols and report them to the local authorities in order to prevent the wrong actors in using cryptocurrency as their facilitator to do illicit activities. The authors think that South Korean banks policy which have enforced a real-name trading system for cryptocurrencies and banned the use of anonymous bank accounts in transactions to prevent virtual money from being used for money laundering and other illegal activities is a realistic move to make. This move should be followed by the banks in other countries so that the authority will be able to verify the cryptocurrency investors' identities. APT as a whole can also establish an AML/CFT team specializes in virtual currencies including cryptocurrencies to monitor any suspicious activities. If there are too tight regulations in one country, the activities can move to other countries. Even if all countries in the world ban cryptocurrencies (which is unlikely), there is still underground economy. Overall, as ASEAN citizens become more digitalized, the time is now to stop leaving this issue in the grey area even though the decision to do it exclusively falls upon each member countries. Regional governance can be established if there are standardized norm and rules before the negative impacts become unavoidable. However, the minimal interference conducted in the regional community will always be the main obstacle for the effective regional governance to take shape.

[13] See http://time.com/money/5105912/bitcoin-bubble-stock-market/

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