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**The 'Malaysian Crisis': Political and Economic Implications**

By

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On 2 July 2015, the Wall Street Journal (WSJ) reported that almost US\$700 million (RM2.6 billion) from the 1Malaysia Development Berhad (1MDB) fund had allegedly been channelled into Prime Minister Najib's personal bank account. The allegation triggered the most serious political crisis that the Najib-led government has faced to date. The outcome of this episode will have a significant impact on Malaysian politics and the country's economy.

**A Prime Minister Beseched**

This latest 1MDB debacle is a culmination of political rivalry and economic mismanagement which can be traced to the start of PM Najib's premiership. Founded in 2009 by the Najib-led government, 1MDB is a state-owned company that manages funds for Malaysia's long-term economic development. PM Najib, who is also the Finance Minister, chairs the advisory board of 1MDB. Six years after its inception, 1MDB is plagued with controversies such as the Tabung Haji land deal and the role of Hong Kong-based tycoon Jho Low in the sovereign wealth fund. More seriously, 1MDB has accumulated a huge debt amounting to US\$11.73 billion (RM42 billion).

Calls from within the United Malays National Organisation (UMNO), the opposition, and the public for an explanation from PM Najib and his government on the problems of 1MDB went largely unanswered. Instead, PM Najib and his government remained dodgy over the nature of 1MDB's financial woes. This posture of evasiveness has provided an opportunity for politically motivated challenges against PM Najib and his government. As such, the 1MDB issue has become an arena of political contestation between PM Najib and his detractors.

Former Prime Minister of Malaysia Tun Dr Mahathir Mohamed voiced strident criticisms against PM Najib for the mismanagement of 1MDB. Although he has retired and no longer holds any public office, he remains an influential figure in Malaysian politics. In April 2015, Dr Mahathir wrote on his blog to warn leaders and members of UMNO that UMNO and Barisan Nasional (BN) will lose the next general elections if PM Najib continues to be the Prime Minister. In response, PM Najib has ignored and brushed aside Dr Mahathir's vocal questioning of the 1MDB scandal.

Another detractor was former Deputy Prime Minister of Malaysia and Deputy President of UMNO, Muhyiddin Yassin. Muhyiddin was often seen as the most likely successor to PM Najib. In March 2015, Muhyiddin did not attend the UMNO division chiefs' meeting. In fact, two days before the meeting, Muhyiddin openly objected to the use of public funds to bail out 1MDB and insisted that the Public Accounts Committee (PAC) conduct an independent inquiry into the unresolved issues of 1MDB. Although Muhyiddin explained that he could not attend the meeting due to prior commitments, it certainly gave rise to speculations that there was a widening gulf between himself and PM Najib. This open rivalry also indicated the presence of internal strife and division within UMNO.

Muhyiddin continued to express the need for more transparency and accountability in the government in managing the 1MDB issue. Muhyiddin was not alone in voicing his displeasure at PM Najib. Datuk Seri Hishammuddin Hussein and Khairy Jamaluddin also voiced similar concerns over the 1MDB issue. On 11 May 2015, in a bid to prevent a split in the top leadership, Najib had a “heart-to-heart” talk with Muhyiddin during the 69th anniversary of UMNO on key issues such as the 1MDB problem. On the same day, after the UMNO Supreme council meeting, all ministers and UMNO leaders pledged their support for PM Najib and accepted his explanation of the 1MDB issue. But this veneer of unity and reconciliation was temporal, and tensions rose after the revelation by the WSJ on 1MDB funds being transferred to PM Najib’s personal bank accounts.

### **Outflanking his Detractors**

Indeed, PM Najib is attempting to prolong his political survival by deflecting mounting pressure for him to step down from the government. On 28 July 2015, PM Najib sacked Muhyiddin in a cabinet reshuffle, along with four other dissenters in the cabinet, so as to preserve a “unified team” to contest the 2018 general elections. Malaysian authorities also removed Attorney General Gani Patail who was part of the special task force set up by the government to investigate the claims by the WSJ. Four members of the Public Accounts Committee (PAC) were moved into cabinet positions. The Malaysian government has also clamped down on public discourse on the scandal on both print and online media platforms. The Malaysia Anti-Corruption Commission (MACC) has declared publicly that the funds channelled into PM Najib’s personal bank accounts was a donation from the Middle East, not 1MDB funds. Furthermore, the special task force was disbanded before the investigations were completed. While these moves have secured Najib’s political survival at the least for the short term, they have raised more questions over concerns of political interference in the investigations of the 1MDB fiasco.

The opposition has been active in criticising PM Najib and his government over the 1MDB corruption scandal and will continue to do so in order to gain political mileage at a time when the opposition is also in disarray. In early June 2015, the Pan-Malaysian Islamic Party (PAS) held its annual *muktamar*, or congress. The conservative faction, the Ulama, overwhelmingly defeated the Progressive faction in party elections. On 16 June 2015, PAS severed ties with the Democratic Action Party (DAP) while seeking to remain in the opposition coalition, Pakatan Rakyat (PR). This effectively signals the end of the PR movement.

The PR was formed in 2008 after the 12<sup>th</sup> General Elections in Malaysia, where the opposition made astounding political inroads during the elections. This opposition coalition comprised Parti Keadilan Rakyat (PKR), DAP, and PAS. The ultimate aim of the coalition was to consolidate opposition gains on the Malaysian political scene with the eventual goal of ending BN’s rule. PR achieved another political milestone when it won the majority vote, for the first time, during the General Elections in 2013. It did not, however, win the majority of parliamentary seats.

The PR was formed out of political expediency but it lacked internal coherence due to competing ideologies and differing political agendas from the component parties. There were disagreements and tensions between Anwar Ibrahim, the leader of the opposition coalition, and Hadi Awang, President of PAS. During the Selangor Menteri Besar Crisis in 2014, PKR and PAS clashed over who would be appointed as the new Chief Minister of Selangor. Both the DAP and PAS differed sharply on *hudud*, or “crimes against God”, implementation in Malaysia, with the former having serious reservations about the latter’s Islamist vision for Malaysia. This tense disagreement was one of the key reasons behind the severance of ties between DAP and PAS.

Though PR was a loose coalition that faced much internal incoherence, it managed to maintain its unity due primarily to the charismatic leadership of Anwar Ibrahim from PKR and the partnership of PAS’ highly influential spiritual leader Nik Aziz Nik Mat. These two men were instrumental in holding the opposition together in spite of substantial ideological divides and different political agendas. However, the united front ceased to exist once Anwar Ibrahim was convicted and sentenced to five years in jail in February 2015 on charges of sodomy with his former aide. This was followed by the death of Nik Aziz Nik Mat in the same month.

The PR was officially declared as dead with the formation of a new opposition alliance, Pakatan Harapan (The Alliance of Hope) comprising the PKR, DAP and the newly formed Parti Amanah

Negara (PAN) or Amanah, a breakaway party of PAS. PAN is a moderate Islamic party which calls for the strengthening of Malaysia's multi-ethnic and multi-religious social fabric. For PAS leaders, PAN is just a front for the Democratic Action Party (DAP) — the opposition's ethnic Chinese party. PAS today views the DAP as a bigger threat than UMNO. In an internal study conducted by PAS recently, the party concluded that the DAP is seeking to undermine the Malaysian government by dividing Malay votes. The study noted that there are as many as 85 seats in the country that have at least 40 per cent Chinese voters. These are seats that the DAP could capture if the Malay votes are split.

### **Reaction of the Malaysian Public**

In general, Malaysians have been expressing their increasing displeasure towards PM Najib and his BN government. The Bersih 4 rally, held mainly in Kuala Lumpur from 29 to 30 August 2015, saw a large crowd which gathered in Kuala Lumpur to call for the resignation of PM Najib in view of the current spate of political scandals and economic problems plaguing the country. Compared to the past three Bersih demonstrations, this year's rally was the most peaceful with minimal incidents. Not surprisingly, PM Najib and UMNO leaders criticised the rally as being illegal.

This rally was organised by the Coalition for Clean and Fair Elections (Bersih). Bersih also means 'clean' in the Malay language. Indeed, since its founding, Bersih's aim is to promote democratic reforms in the Malaysian electoral system to ensure clean, free and fair elections. Issues such as the rising cost of living, the introduction of the Goods and Services Tax (GST), a weakening economy and the 1MDB scandal have fueled public discontentment towards the government. Thus, while Bersih rallies will not topple the government, such demonstrations provide an avenue for the masses to express their discontent against the ruling party.

The pro-government rally — officially called Himpunan Rakyat Bersatu — was a direct counter to the Bersih rally late last month. The Bersih rally was seen by the "Red Shirt" organisers as a Chinese-led protest against the leadership of UMNO. Notably, the police estimated that some 35,000 turned out for the "Red Shirt" rally, far less than the 100,000-plus turnout claimed by Bersih. Prior to the "Red Shirt" rally, politicians from both sides of the political divide had expressed concerns that it could stoke racial tensions. Despite this, PM Najib did not criticise it, and said that UMNO would not prevent its members from attending. The presence of a number of top UMNO leaders, including former ministers Annuar Musa and Noh Omar as well as former Malacca chief minister Ali Rustam, were clear indications of tacit support by the party for the event. While the rally was ostensibly organised to show support for UMNO leaders, there was little doubt that it was also aimed at asserting Malay dominance. The event saw incendiary remarks and racially charged banners and placards. Riot police used water cannons on protesters who had attempted to breach the barricades to gain access to Petaling Street, also commonly known as Chinatown.

### **BN's Sustainability as a Coalition**

Another factor in Malaysia's present and future political trajectory concerns the sustainability of BN, of which UMNO is the mainstay party, as a viable coalition. BN, together with its predecessor, Perikatan, has thus far always been the ruling coalition in the Malaysian federal government. Presently, BN is composed of 13 political parties – UMNO (Malay majority with some other Sabah bumiputeras), MCA (Chinese), MIC (Indian), Gerakan (non-racial but Chinese majority) and PPP (non-racial but Indian majority) in West Malaysia; PBB (Sarawak bumiputeras), SUPP (Chinese majority with some Sarawak bumiputeras), SPDP (Sarawak bumiputeras majority with some Chinese) and PRS (Sarawak bumiputeras) in Sarawak; PBS, UPKO, PBRs (all three Sabah bumiputeras majority with some Chinese) and LDP (Chinese majority with some Sabah bumiputeras).

Of the 133 parliamentary seats (out of a total of 222) held by BN, UMNO possesses 89, with the remaining 44 coming from the other BN coalition parties. With the current parliamentary majority being 112, this would mean that in stark contrast to the scenarios before 2008 (the year in which BN lost its conventional constitution-amending two-third majority in the general election), UMNO could not form the federal government alone. Thus, UMNO, at least in theory, must count on the goodwill and loyalty of its BN coalition partners to do so.

Looking at the sustainability of BN, despite the less than favourable post-2008 scenario, UMNO has retained its firm and absolute grip on BN's leadership. By tradition, UMNO's president (and therefore

prime minister of Malaysia), deputy president (and therefore deputy prime minister of Malaysia, except Muihyiddin who was stripped of his ministerial position in the latest cabinet reshuffle) and secretary-general also assume their respective corresponding positions in BN. The BN supreme council, which comprises two representatives from each coalition party, theoretically makes policy decisions for the coalition, but in actuality is little more than a forum where policies already adopted by UMNO are disseminated to the various coalition parties. Successive UMNO leaders assume their paramount leaderships over BN as automatic, and other coalition parties also pay due reverence to UMNO's supremacy in BN.

With these realistic observations in mind, the recent series of controversies involving 1MDB and PM Najib are astutely viewed by BN coalition party leaders as nothing but an expression of the latest power struggles within UMNO. These controversies are certainly not a possible precursor to a regime change, as UMNO still retains an iron grip on the back of support by rural voters (whose constituencies continue to proliferate). They feel that ambitious forces within UMNO have been seething to replace PM Najib, who led BN into the worst electoral setback and employed similar excuses to bring about his predecessor Abdullah Badawi's resignation. In their minds, 1MDB is nothing but the latest, albeit most serious, trigger for these UMNO internal power plays. Even if PM Najib is eventually replaced as UMNO president, UMNO's dominance of BN will remain. Therefore, there is little incentive for the other BN coalition parties to prefer one UMNO leader over another.

This nonchalant attitude from the BN coalition parties with respect to the latest series of political controversies can best be witnessed in the most perfunctory critical statements made by their respective leaders. To hedge against the perceived anger from their voter base, junior or youth party leaders were occasionally arranged to make slightly more daring statements. This also exhibited a semblance of their intra-coalition autonomy.

Perhaps ironically, it is precisely this de facto lack of party autonomy on the part of most of the other coalition parties which constitutes the main factor that would continue to sustain BN as a coalition. Besides, at least two other factors also play significant roles toward the same trend.

First, there is almost absolute dependence by most of the other BN coalition parties, and especially their respective leaders, on UMNO for their political survival. As the automatic choice for prime minister, the incumbent UMNO president is in the enviable position of marshalling the resources of the whole nation to dole out the most amount of largesse and political favours. Nonsupport of the incumbent UMNO president in particular, and UMNO in general, would almost necessarily imply the cutting of projects and positions to most of these BN coalition parties. This would sound death knell in terms of grassroot support of their respective leaders and the latter's considerable personal enrichments.

Moreover, with minimal non-Malay voter support already a reality in the past two general elections, many of these BN coalition parties, especially those based in West Malaysia and Sabah, would have to put up their electoral candidates in parliamentary and state seats either with a Malay majority or a mixed profile to have a fighting chance of winning. These same seats are often coveted by potential UMNO candidates, and only a firm directive by the incumbent UMNO president could redistribute them to other BN coalition parties. The political reality of Malaysia is such that parties with few or no parliamentary seats are hardly taken seriously by both the elites as well as general society. Again, many of these BN coalition parties simply cannot afford to part ways with UMNO.

Second, in dealing with its BN coalition partners, UMNO employed a somewhat "divide and rule" policy. For example, a typical non-Malay community is "represented" by more than one BN coalition party (see description of their respective membership compositions above). This creates a sort of unhealthy "competition" among BN coalition parties with their memberships largely drawn from any one given non-Malay community to curry favours with UMNO. This will ensure that any largesse or political favours earmarked for that community could be most channeled through one or many of them. Examples include the papered-over but incessant bickering between MCA and Gerakan in West Malaysia and Sabah (with LDP throwing in its hat in Sabah too), between MCA and PPP in West Malaysia, and between the various bumiputeras-majority BN coalition parties in Sabah and Sarawak. The ultimate result of these perhaps perverted political contests is curiously a more cohesive BN undisputedly led by UMNO.

There are two plausible game changers that would disturb the sustainability of BN as a coalition. First, the perceived “flirting” between UMNO and the opposition PAS and their eventual union as an enlarged Malay-Muslim political entity. Their joint, predictable Islamisation policies frighten most non-Malay voters and may make many of the other BN coalition parties think twice about the suitability of their continued coalition with UMNO. Second, the long-awaited awakening of the Sabah and Sarawak voters as to their constitutionally guaranteed rights and privileges have over time been overlooked by the UMNO dominated federal government. A louder East Malaysian voter voice could conceivably persuade some of the East Malaysian BN coalition parties to take a second look at their future viability in BN. But the lesson of SAPP, which broke away from BN in 2008 to champion Sabah state rights but has since diminished in political relevance, is perhaps still fresh in the minds of many of the BN coalition parties.

As such, it can be argued that despite the current political predicament faced by UMNO, BN is likely to remain a viable political coalition in Malaysia for a long time.

### **Economic Impact of the Current Crisis**

Malaysia’s current economic predicament is a result of several issues. After China devalued its currency for three days in a row in early August, the Malaysian ringgit rose above RM 4 per US dollar for the first time since the 1997 Asian Financial Crisis, alarming foreign investors and Malaysians alike. For months before, the ringgit had been on a downward slide despite the Malaysian government’s efforts to prop up the currency by spending its foreign reserves. While Malaysia’s economic fundamentals should theoretically place it in a far better position today to handle the external challenges hampering growth, the protracted political crisis over 1MDB makes it more vulnerable relative to its neighbours; as evidenced by the ringgit’s dismal performance. Heightened economic woes can aggravate the discontent over recent implementation of domestic economic policies that impact the cost of living. In such an uncertain economic climate, Malaysia needs a strong and credible leadership to boost investor and consumer confidence. Yet, the unwillingness or inability of the government to resolve the political impasse over 1MDB risks exacerbating the country’s economic challenges.

### **External Economic Challenges**

Malaysia has to contend with three main external economic challenges. First, as a net commodities-exporting country, Malaysia has been especially hit with declining commodity prices, which in turn contributes to the weakening of its currency. Since June 2014, global crude oil prices have plunged by more than 50 per cent due to oversupply and weak demand. Even though Malaysia is a net oil importer, oil-related industries account for a third of its state revenue. Palm oil prices are likewise on the decline; and Malaysia is the world’s number two producer of palm oil. Both oil-gas related products and palm oil constitute at least 28 per cent of Malaysia’s total exports, significant enough to narrow the trade surplus over the last few months.

Second, the slowdown in China’s economic growth has worried the Chinese government enough to devalue its currency as a means of making its exports price-competitive. Prior to this, China has been trying to shift its export-driven growth to consumer spending, but evidently this has not been smooth sailing. Just two months prior to China’s currency devaluation, its stock market plummeted 30 per cent and it took government intervention to halt the sell-off. Individuals constitute a large majority (80 per cent) of investors on China’s stock market; the sell-off taken together with an overall decline in domestic consumption is indicative of waning Chinese consumer confidence.

Third, there have been foreign capital outflows sparked by an impending interest rate hike in the U.S.. Investors appear to be moving away from investing in risky economies to relatively stable economies like the U.S. This does not bode well for Malaysia, especially with concerns about their future political stability. Malaysia has so far seen outflows in equities and bonds totalling approximately USD \$7.6 billion.

At the height of the 1MDB allegations against PM Najib, Malaysia’s foreign reserves dived by almost 5 per cent in two weeks as the central bank unsuccessfully attempted to maintain the ringgit at RM 3.8 per US dollar. Additionally, the sharp decline in foreign reserves coincided with the increasing publicity over 1MDB’s troubles. Malaysia’s foreign reserves now stand at below USD\$100 billion,

raising concerns over its ability to defend against further currency shocks. Financial analysts also suggest that capital outflows will further weaken the ringgit.

### **Domestic Economic Challenges**

The ringgit's diminished value affects Malaysians' purchasing power. Malaysians would have to pay more for goods when the prices of Malaysian exports fall below its prices of its imports. Inflation is also a concern. From January to July, consumer prices rose 1.7 per cent, and inflation is forecasted to reach 3.5 per cent by the end of the year.

To compound inflationary pressures, Malaysians have to deal with two other domestic policies that further impact the cost of living: removal of fuel subsidies in December 2014 and the implementation of a 6 per cent GST in April 2015. From a long-term perspective, these policies are advantageous because it reduces government expenditure and raises revenue. However, wages have simply not grown enough to compensate for increases in the cost of living, and people are starting to feel the pinch.

There is also the added pressure of private household debt. Malaysia has the highest ratio of household debt to GDP in the developing world; it was debt, not wage growth that drove domestic consumption's 52 per cent contribution to the GDP in 2014. Therefore, increases in cost of living and the economic slowdown will inevitably limit domestic spending as Malaysian households are already significantly over-leveraged in debt. This would only further hamper Malaysia's economic growth.

### **Shift Political to Economic Focus**

When 1MDB's debt troubles first emerged, it was largely framed as a political issue in people's minds. After all, it was highlighted by PM Najib's fervent opponents, such as Dr Mahathir, who was responsible for bringing down another prime minister six years ago. But 1MDB was quickly positioned as an economic issue in people's minds as more serious allegations emerged amid the ringgit's rapid decline and the worsening global economy; the fallouts of which would directly impact both investors and consumers alike.

The possibility that 1MDB's debt troubles are indicative of larger financial mismanagement issues is critical to the concerns faced by investors and consumers. The lack of transparency over 1MDB coupled with recent governmental actions that suggest interference does not assuage such fears. If a skeptical (and nervous) populace is to be reassured, the Najib-led government will have to offer credible and transparent solutions to steer the country through its looming economic challenges.

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