

# ISIS FOCUS



• PP 5054/11/2012 (031098)

• Issue No. 10 • October 2013



- ♦ *Is the European Union Still Viable? ..... 1*
- ♦ *RPGT — Are We Hoping for Too Much ..... 7*



INSTITUTE OF STRATEGIC AND INTERNATIONAL STUDIES (ISIS) MALAYSIA  
[www.isis.org.my](http://www.isis.org.my)

Limited Circulation



## ABOUT ISIS MALAYSIA

The Institute of Strategic and International Studies (ISIS) Malaysia was established on 8 April 1983, in realization of a decision made by the Malaysian Government to set up an autonomous, not-for-profit research organization that would act as the nation's think-tank. ISIS Malaysia was envisioned to contribute towards sound public policy formulation and discourse.

The research mandate of ISIS therefore spans a wide area. It includes economics, foreign policy and security studies, social policy, and technology, innovation, environment and sustainability.

ISIS Malaysia today fosters dialogue and promotes the exchange of views and opinions at both national and international levels. It undertakes research in collaboration with national and international organizations, in important areas such as national development and international affairs.

ISIS Malaysia also engages actively in Track Two diplomacy, fostering high-level dialogues at national, bilateral and regional levels, through discussions with influential policymakers and thought leaders.

## RESEARCH

### Economics

Research in this area is generally aimed at promoting rapid and sustained economic growth and equitable development in the nation. We study specific (rather than generic) issues that concern the nation's competitiveness, productivity, growth and income. Areas of research include macroeconomic policy, trade and investment, banking and finance, industrial and infrastructure development and human capital and labour market development. The objective of all our research is to develop actionable policies and to spur institutional change.

### Foreign Policy and Security Studies

The primary aim of this programme is to provide relevant policy analyses on matters pertaining to Malaysia's strategic interests as well as regional and international issues, with a focus on the Asia-Pacific Region. These include security studies, foreign policy, Southeast Asian politics and military affairs.

## Social policy

Demographic and socio-cultural trends are changing Malaysian society and the social policy programme was established to respond to these developments. Research in this area is concerned with effective nation building, and fostering greater national unity. In particular, we look at issues involving the youth, women and underprivileged communities. In conducting its research, ISIS Malaysia networks with non-governmental organizations and civil society groups.

## Technology, Innovation, Environment & Sustainability (TIES)

The TIES programme provides strategic foresight, collaborative research and policy advice to the public sector, businesses and policy audiences, on technology, innovation, environment and sustainable development. Its focus includes green growth as well as energy, water and food security. Towards this end, TIES has been active in organizing dialogues, forums, policy briefs and consultancies.

## HIGHLIGHTS

ISIS Malaysia has, among others, researched and provided concrete policy recommendations for:

- Greater empowerment and revitalization of a national investment promotion agency;
- A strategic plan of action to capitalize on the rapid growth and development of a vibrant Southeast Asian emerging economy;
- A Master Plan to move the Malaysian economy towards knowledge-based sources of output growth;
- The conceptualization of a national vision statement;
- Effective management and right-sizing of the public sector; and
- Strengthening of ASEAN institutions and co-operation processes.

ISIS Malaysia has organized the highly regarded Asia-Pacific Roundtable, an annual conference of high-level security policymakers, implementers and thinkers, since 1986.

## INTERNATIONAL NETWORKING

As a member of the Track Two community, ISIS Malaysia participates in the following networks:

- ASEAN-ISIS network of policy research institutes;
- Council for Security and Cooperation in Asia and the Pacific (CSCAP);
- Network of East Asian Think Tanks (NEAT); and
- Pacific Economic Cooperation Council (PECC).

It is also a partner institute of the World Economic Forum (WEF).

## Editorial Team

Steven Wong  
Susan Teoh  
Thangam K Ramnath

## Design

Razak Ismail  
Jefri Hambali

## Photography

Jefri Hambali / Halil Musa

Published by

Institute of Strategic and International Studies (ISIS) Malaysia

No. 1, Persiaran Sultan Salahuddin

P.O. Box 12424, 50778 Kuala Lumpur, Malaysia

Tel: +603 2693 9366

Fax: +603 2691 5435

Email: [info@isis.org.my](mailto:info@isis.org.my)

Website: [www.isis.org.my](http://www.isis.org.my)

# Is the European Union Still Viable? A Reassessment of its Political Cohesiveness in the Wake of the Eurozone Crisis\*

**Mr Jacques Santer**, Former President of the European Commission, spoke at an ISIS International Affairs Forum on the viability of the European Union in the wake of the Eurozone crisis. The Forum, held on September 18, 2013, was chaired by **Tan Sri Dato' Seri Mohamed Jawhar Hassan**, Chairman & Chief Executive, ISIS Malaysia. The following is the text of Mr Santer's speech.\*

**T**he world is changing, and so is Europe. Europe will never be what it was – neither will the European Union (EU). The world-wide globalized crisis is structural and will bring irreversible change to Europe's organization of its economies, institutions and welfare systems. Disaffected citizens will continue to demand a political renewal of European institutions and policy, even if these populist and extremist movements may subside in coming years. The threat to a European social model by unguarded austerity measures is a key factor harming the credibility of the EU.

Globalization presents three main dangers for the European Union.

The first of these dangers is the relative weakening of European influence in the international arena. Although Europe is still the world's leading economic and trading power, it is suffering from a systematic erosion of its global importance. This shrinkage is firstly seen in the demography: in the 19th century, when it was at the height of its colonial expansion, Europe comprised 22 per cent of the world's population. This is China's percentage now, whilst Europeans now count for only seven per cent of the world's population. This decline contributes towards the general shrinkage of the West in globalization: in



*Jacques Santer*

2030, two out of three inhabitants in the world will be Asian.

Globalization is no longer and will no longer be fashioned mainly by the values, the power, the countries and the interests of the Western block. For Europeans, this demographic decline goes together with a net ageing of the population, unlike in the USA. In 2015 the number of deaths will be higher than the number of births in the EU, which runs alongside worrying prospects about tension in the labour market and the financing of retirement pensions.

*\* This speech has been edited for clarity*



*From left: Mohamed Jawhar Hassan, Jacques Santer, Jan Senkyr and Günter Georg Gruber*

Furthermore, the EU's share in world trade is declining, to the benefit of the emerging countries, especially China. It decreased from 19 per cent in 1999 to 16 per cent in 2010. The spectre of stagnation and even economic recession continues to haunt European performance, with growth prospects below three per cent over the last five years, and below 0.5 per cent in 2013. Finally, in terms of energy, the EU finds itself in a situation of alarming dependency: its economy is dependent, up to a total of 60 per cent, in terms of oil and gas supplies, on three of the most unstable areas of the planet — Russia, the Middle East and Africa. And the EU's ability to influence these three regions politically is extremely limited.

The second danger which Europe faces is that of increasing political marginalization, whether this implies international security management or the drafting of new world governance rules. On the one hand, the weakness of its political integration is preventing it from forming an effective hub of influence. As a Union it has no voice in major international, economic or political institutions, such as the UN, the IMF or the G20, except for within the WTO. But the member states that take part in these institutions have relatively little weight in comparison to the USA or China. The EU sends no less than eight

representatives to the G20, but this quantitative over-representation is recompensed by notoriously low political influence.

On the other hand, the absence of a common foreign policy prevents the EU from influencing the development of its own environment. The Europeans were divided over American intervention in Iraq in 2003. Likewise, they were unable to stand together in 2012 in acknowledging Palestine in the UN. France, the UK and Germany were divided over the military operation undertaken in Libya in March 2011. France and the UK on one side and Germany on the other.

And when the division is not clear, it is simply the lack of vision which prevails: the Israeli-Palestinian Peace Process, the development of Russia, the future of the Arab Revolution, that of Afghanistan and Iraq after the American withdrawal, and the future of nuclear Pakistan are all major issues on which the Europeans prefer to be silent and to align with American decisions. Indeed in many cases, the Euro-American partnership, embodied by NATO, serves as an alibi for the Europeans to avoid strategic responsibilities, and for delegating the permanent management of their regional security as well as global stability to the US.

Together, these dynamics have added to the major crisis experienced by Europe at present. The crisis is primarily that of the European model as a whole. Originally, at the time of the Rome Treaties in 1957, the political project for European integration seemed clear: it was about Franco-German reconciliation and the return of prosperity to Western Europe. It was also clear when communism collapsed: it meant reconciliation between the two halves of Europe and helping towards the democratization of the former communist countries. The project in the 21<sup>st</sup> century still lacks a major mobilizing narrative. The two major issues for the future of Europe are still without an answer: does the European project still make sense in the context of globalization? Is



**... Europe's GDP is 19 per cent of the world's, which makes it the world's leading economic power**

growth still the pivot and the inevitable horizon for the economics of the West?

For an answer to these questions we have to analyze the real assets of the EU.

The *first of these assets* is of course the EU's economic power. Even in these times of major crisis, Europe's GDP is 19 per cent of the world's, which makes it the world's leading economic power. With nearly half a billion inhabitants, its demographic weight is much less than Asia's, but it represents a much bigger market than the US or Japan do. Since its enlargement to 28 members, it has become the biggest area of democratic stability on the planet, with revenue per capita of nearly US\$30,000. As for the Eurozone, it alone accounts for 20 per cent of world trade, and if we include intra-community trade, the percentage rises to 42 per cent.

The EU's *second asset* is that its power of attraction is still considerable. From the monetary point of view, the euro has become the world's second reserve currency, capturing about 24 per cent of the reserves in world trade in 2012 compared to 18 per cent when it was launched. The EU's ability to produce standards and its legal know-how also makes it a player well-adapted to the complexity of world economic competition. From a political point of view, the number of candidates for membership enlargement is growing constantly: in July 2013, Croatia became the 28th member state of the Union whilst five other countries are on the candidate list (Iceland, Montenegro, Macedonia (Former Yugoslav Republic of Macedonia), Serbia, Turkey). The

Eurozone crisis seems therefore to be one of public finances in some member states and not a euro crisis or a crisis of the attractiveness of the European project.

The *third asset* is that the EU's mode of governance is striking because of the modernity of its principles: power sharing between all members, minimal redistribution of wealth between the rich and the poor, and permanent negotiations in the quest for a legal order: these are the basic rules that have governed the functioning of Europe since 1950, and this is how the driving principles of new world governance should be. In spite of their internal crisis, Europeans have the key to restructuring the international system, adapted to the complexity of globalization, to the multiplication of the players involved, and to the need for legitimate, effective institutions. If they were determined enough, their power of influence in the debate over world governance might be considerable.

The *fourth asset* is the modernity of the principles of the EU's actions.

First and foremost, the case from an economic and financial point of view is for a more moderate acceptance of the omnipotence of the markets, the need for a certain amount of political regulation in world trade, minimal supervision of financial operators, together with a role for the



*Steven Wong posing a question*

State in the form of protection and social cohesion – these are the factors of the European model for economic and social development which, with the crisis, have become more pertinent than the ultraliberal model put forward by the Anglo-Saxons.

This is also true from a strategic point of view: the European vision of global security, proclaimed from 2003, in the European security strategy, continues to be confirmed by facts from across the world: that democracy cannot be forced upon a population; that military power is neither the only nor the leading instrument of crisis management; that dialogue with all forces, as well as multilateral negotiation is vital for the prevention of conflict; and that poverty in the world is as destabilizing as the violence of terrorism – this catalogue of common sense is indeed at the heart of the EU's strategic approach.

Above all, the EU's major asset in globalization is its mass effect through the union of nations. Not that these have become obsolete in terms of identification and political legitimacy – but in terms of collective, sustainable efficacy, their pretention to self-sufficiency is contradicted by the facts every day. Whether this entails climate change, future pandemics, global issues that emerge with the globalization process or solutions that can solve the economic crisis, or finally, the response to major political strategic issues of the 21<sup>st</sup> century – the conditions for international security, support for the Arab revolutions, the fight to counter terrorism or nuclear proliferation – no solution is within the reach of one State, even if it is the most powerful one on earth.

Globalization sacralises nation-states as legitimate players in international relations but it also shows their real inefficacy. Conversely, the EU because of its coherence, its size and its functioning structure, seems more promising in responding to the challenges of globalization, starting with the economic crisis itself.



*Another question from the floor*

The main question today is: How can we give value to these European assets?

Beyond the economic situation and the necessary adjustment policies in the member states, different initiatives seem to govern the revival of a consensual, dynamic European project.

The leaders of Europe have learnt the lessons of the crisis: they are not only attempting to restore the pre-crisis model, but they also advocate a comprehensive strategy to reshape European integration. They are quite aware that the serious problems affecting Europe at present are not the result of a simple economic and financial crisis: they come from geo-economic change and a major world geopolitical transition.

The time has come to move onto another stage in the European project: establishing a centre of power and influence in a polycentric world.

The conclusions of the European Council of Heads of States of December 2012 devote two pages and six paragraphs to the common security and defence policy, observing that the EU is already playing a regional and global role in the civil-military management of external crisis: 'in a changing world, the EU is called to assume greater responsibilities in peace-keeping and international

***... the serious problems affecting Europe at present ...come from geo-economic change and a major world geopolitical transition***

security in order to guarantee the security of its citizens and for the promotion of its interests.'

The common strategic and geographic priorities should include:

- The upkeep of European strategic autonomy in terms of security (access to raw materials, security of maritime and land trade routes) and stock flows (vital networks and infrastructures);
- The drafting of a long-term plan for positive interaction with all neighbouring geopolitical entities (enhanced and symmetrical cooperation with Maghreb, support for the transitions in the Mashriq, action that will promote European anchorage in Russia);
- An integration strategy for middle-emerging countries (China, Brazil and India apart) in the international system, via strategic dialogue;
- A 'third party' facilitating strategy in the half of the world extending to the east of Ormuz, in a part of Asia whose economic ascension is clearly visible and in which the EU has more than just trade interests; the EU cannot just content itself with an improbable duopoly between Washington and Beijing to co-manage future crises in regions which do not have any collective security structures, and for which neither the colonial period (Japan, China, Korea) nor the Second World War (Japan, Russia), nor the Cold War (Korean Peninsula) are over;
- Continued action in support of cooperation and development (11 bn euro in 2011). The EU is the first provider of development aid in the world: the aim is not primarily humanitarian

but a contribution towards the long-term stabilization of neighbourhoods;

- The promotion and protection of trade interests. The aim is to protect and promote our industrial capabilities.

The European political model does have a global reach. Based on the rule of law and the joint exercise of sovereignty in some areas, it will increasingly become a reference point in the eyes of other regional entities in their quest for organizations (like ASEAN, where thought is being given to a collective security framework for 2015, the African Union, whose support and external model are clearly European, and South America, where the EU's experience is followed closely for domestic use).

The Europeans have to be aware that their future depends on a choice: if the EU sees itself as a sub-section of the West and accepts this division of tasks, its added value will not be worth much. On the other hand, if it believes that it is one of the centres of a multipolar world, and that it is taking on global interests, then it will enjoy real added value.

## **Conclusion**

For the last four years, priority has been given to settling the economic crisis, and at first this was understandable. To recover sovereignty over the markets and thereby the ability to decide their future, European States, notably those in the Eurozone, understood that they had to form a more coherent entity. Hence stricter common

***The EU is the first provider of development aid in the world: the aim is not primarily humanitarian but a contribution towards the long-term stabilization of neighbourhoods***

rules have been adopted in budgetary matters and the European Stability Mechanism (ESM) has entered into force. Furthermore, the project for a banking union has moved forward over the last few months.

During the European Council of December 2012, President of the Council Herman van Rompuy presented a roadmap which was drafted together with the President of the European Commission, the European Central Bank and the Eurogroup, for the achievement of a real economic and monetary union. The economic strategy was clarified: on the one hand, macro-economic and financial supervision should be exercised Europe-wide, with the necessary corrective tools, in order to be credible and effective; on the other hand, the Eurozone should have its own means of preventing and settling the crisis, as any one State would not be able to withstand the crisis alone. This long-awaited clarification was indeed very welcome.

Given the transfer of competencies that the common measures imply, the issue of political union cannot be avoided. European decisions have to enjoy adequate legitimacy in the eyes of the citizen, and decision-making mechanisms must be sufficiently simple and clear for them to be effective and transparent. Without this, economic union will not receive the citizens' support and questions will continue to be raised about the political vision which justifies European decisions and therefore their legitimacy.

No member state is now in a position in which its citizens 'blindly' trust their elites to manage optimally their best interests in European

*It is about making virtue out of necessity; about turning a dramatic story of crisis into a positive story about regeneration*

matters. Citizens want to have their say. This has been clear for several years, and it is all the more so with the crisis. If we ignore the need for a clear political contract, economic integration as a whole will be weakened, and even threatened.

It is time to open up this debate without conditioning it according to the content of the policies themselves. Europe should not be seen as more democratic and clearer because it takes integration further. It should be more democratic and clearer because it is good for the EU and the Eurozone whatever the perimeter of its competencies. The extension of competencies alone is enough to make the present deficits in legitimacy and clarity even greater. We have no time to waste.

For Europe, it is time to use the opportunity for a self-critical and constructive appraisal of the EU's strengths and weaknesses, with the aim of presenting itself to the world as a renewed and unique polity, willing and equipped to address the challenges of the 21<sup>st</sup> century, regardless of its 'power' status. It is about making virtue out of necessity; about turning a dramatic story of crisis into a positive story about regeneration. For that to occur, Europe and Europeans will have to take a close look at their standing in today's rapidly changing world, adjust and adapt to new global realities and learn to project their still considerable assets in a more attractive manner.

*European decisions have to enjoy adequate legitimacy in the eyes of the citizen ...*



## RPGT — Are We Hoping for Too Much?\*

*Mazlena Mazlan*

*Researcher, ISIS Malaysia*

Two years after Addressing the Cost of Living was introduced as the seventh national key result area, food and fuel prices have stabilized fairly well, save for the usual festive season hikes and the recent reduction in fuel subsidies. House prices, however, have not stabilized. The cost of housing is still mind-boggling to many, especially in the large cities of the Klang Valley, and in Penang and Johor Bahru.

In 2011, houses were 10 per cent more expensive than during the preceding year. Last year, the figure jumped to 12 per cent, despite the announcement in the 2012 Budget of an increase in the Real Property Gains Tax (RPGT) from five per cent to ten per cent for disposal of properties within two years of purchase. In the first quarter of this year alone, houses were 11 per cent more expensive than they were a year before.

The government's affordable housing initiative, through the establishment of PR1MA, is undeniably commendable, but time lag and capacity issues limit PR1MA's ability to completely rein in house prices. Construction of PR1MA houses will take a few years to complete, and at the time of completion, no one can be certain about the country's economic and housing market conditions. Will house prices stabilize by then? In the meantime, the middle income group will still have to spend a significant amount of money on rentals sunk expenditure on homes that they do not own.

The 2013 Budget, tabled on 28 September last year, further raised the RPGT rate to 15 per cent and 10 per cent for disposals within two and five years respectively. To many quarters, the increase was meagre and insufficient to deter speculators, widely believed to be the main



*The cost of housing is still mind-boggling to many*

culprits and beneficiaries of escalating prices. A further hike in RPGT was called for. The National House Buyers Association, in particular, has urged for a reinstatement of the pre 2007 rates. The table (pg. 8) shows the RPGT from pre 2007 to the present.

There is indeed a basis for the above argument. Current RPGT rates seem to have not been able to cool down the property market. Signs of spillover to the secondary and the rental markets are beginning to manifest. The secondary housing market, or the sub sale market, is already out of the reach of most middle income people, even after 'flipped' properties are taken into account. It will not be long before people cannot even afford to rent, as landlords of newly bought properties set their rents at rates that can cover their instalment payments.

An arbitrary demand for the return of past rates, however, when economic and housing market conditions are no longer similar, can be damaging. It is unclear whether the pressure groups have backed their demands with carefully crunched data, instead of making a haphazard recommendation. On the other hand, some analysts have argued that raising the RPGT will exacerbate the situation as investors will raise their prices to maintain their profits.

*\*Originally published as "Right policy mix to cool house prices" in the New Straits Times, 6 September 2013.*

Real Property Gains Tax in Malaysia	Disposals on Oct-95 to Mar-07	Disposals on Apr-07 to Dec-09	Disposals on Jan-10 to Dec-11	2012 Budget	2013 Budget
Disposal in 1st year	30%	0%	5%	10%	15%
Disposal in 2nd year	30%	0%	5%	10%	15%
Disposal in 3rd year	20%	0%	5%	5%	10%
Disposal in 4th year	15%	0%	5%	5%	10%
Disposal in 5th year	5%	0%	5%	5%	10%
Disposal in 6th year and beyond	0%	0%	0%	0%	0%

Source: *savemoney.my*

Deciding the right tax rate is not an easy task. Policymakers should consider well researched recommendations. On one hand, the government would certainly want to avoid a burst in the property bubble (if there is a bubble at all), or a stagnating housing market. On the other, does it have a target growth rate for house prices?

Or is it searching for a solution to a problem that is increasingly getting out of hand, without a clear view of the desired end point? It must learn from the experience of our neighbour down south in which even seven rounds of cooling measures turned out to be insufficient.

Various demand factors are at play and must be considered as the government formulates the next Budget. (As of the time of writing, Budget 2014 has not yet been announced). Skyrocketing house prices are not caused solely by speculative activities. The swelling middle income group is a crucial demand factor. In addition, the even more ridiculous house prices in the neighbouring country referred to above have pushed their citizens to find homes that are more affordable on our land, worsening our situation. It will not get any better as long as property developers in our major cities continue their race to build the more

expensive bungalows and three storey semi detached homes that are clearly not in the affordable range. Pledges to build more affordable houses have not been manifested in concrete actions.

The financial authorities have been decisive in tightening lending guidelines. To a large extent, these have worked in dampening demand, but have had little impact on cash rich speculators, particularly foreign investors purchasing largely on a cash basis. Despite rising land and construction costs, little has been heard about measures to cool down prices in these markets. The uptake of the Industrialized Building System, or the use of prefabricated building materials, which was expected to drastically reduce construction costs, has been disappointing.

As in any other market, measures to correct current imperfections in the housing market should be comprehensive. Supply side measures should be included. RPGT would not be the right tool to address the cost factors outlined above. Nonetheless, it has to be included in the package. The question is, what is the right rate to set?

## *NOTES*



INSTITUTE OF STRATEGIC AND INTERNATIONAL STUDIES (ISIS) MALAYSIA  
No. 1, Persiaran Sultan Salahuddin  
PO Box 12424, 50778 Kuala Lumpur  
Malaysia  
Tel : +603 2693 9366  
Fax : +603 2691 5435  
Email : [info@isis.org.my](mailto:info@isis.org.my)  
Website : [www.isis.org.my](http://www.isis.org.my)

