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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	**INTELLECTUAL CAPITAL AND BANKING SECTOR OF PAKISTAN** *MUHAMMAD KHALIQUE, DR. ABU HASSAN MD. ISA & MOHAMMED ALKALI*	1
2.	**ASSESSMENT OF ENTREPRENEURSHIP INTENTION AMONG AGRICULTURAL STUDENTS OF RAZI UNIVERSITY** *ABDOLHAMID PAPZAN, KOBRA ARKAVAZI & MALIHE SADAT AKHAVAN KAZEMI*	5
3.	**THE IMPACT OF OVERCROWDED CLASSROOM ON THE ACADEMIC PERFORMANCE OF THE STUDENTS AT SECONDARY LEVEL** *JEHANGIR SHAH & DR. HAFIZ MUHAMMAD INAMULLAH*	9
4.	**MICROFINANCE EFFICIENCY AND FINANCIAL SUSTAINABILITY: EVIDENCE FROM RURAL MFIs IN TANZANIA** *GANKA DANIEL NYAMSOGORO*	12
5.	**EFFECTS OF MACROECONOMIC VARIABLES ON GROSS DOMESTIC PRODUCT IN BANGLADESH** *MINA MAHBUB HOSSAIN & SAYEDUL ANAM*	18
6.	**DETERMINANTS OF FOOD INSECURITY AMONG HOUSEHOLDS IN ADDIS ABABA CITY, ETHIOPIA** *GIRMA GEZIMU & GIRMA BEREHE*	26
7.	**PERFORMANCE EVALUATION OF SPECIAL ECONOMIC ZONES IN INDIA** *SHAHAZADI BEGUM SHAIK, R. VIJAYA & A. NARASIMHA RAO*	33
8.	**JOB -STRESS OF FACULTY MEMBERS IN PRIVATE PROFESSIONAL COLLEGES LOCATED IN NCR, DELHI** *SWAPAN KUMAR BISHAYEE*	37
9.	**ARBITRAGE PRICING THEORY TESTED IN INDIAN STOCK MARKET** *DR. BAL KRISHAN & DR. REKHA GUPTA*	40
10.	**AN ANALYSIS OF REGIONAL DISPARITIES IN THE PERFORMANCE OF SARVA SHIKSHA ABHIYAN (SSA) IN INDIA** *DR. M. INDIRA & R. PRASAD*	48
11.	**IMPACT OF SOCIAL COMPETENCE ON DEVELOPMENT OF YOUNG TECHNOCRATS: AN APPENDAGE TO ONESELF** *DR. RUCHI SINGH & DR. RUCHI SHARMA*	54
12.	**RURAL WOMEN IN GROUP ENTERPRISES** *DR. K. VIDYAVATHI*	60
13.	**RELATIONSHIPS ARE EASY TO GET INTO.... BUT DIFFICULT TO GET OUT OF!' – A CASE OF EU AND GREECE** *DR. GIRIJA NIMGAONKAR*	65
14.	**PURCHASE BEHAVIOUR AND INFLUENCE OF SOCIO ECONOMIC FACTORS WITH REFERENCE TO ORGANIC FOOD PRODUCTS** *DR. P. SANTHI*	68
15.	**WOMEN-IS THEIR PERSPECTIVE REALLY CHANGED? (A RESEARCH PAPER BASED ON WOMEN PERCEPTIONS ABOUT WOMEN)** *DR. SUMAN NASA*	74
16.	**TALENT MANAGEMENT: IMPORTANCE, PROCESS, RETENTION AND STRATEGIES FOR BUSINESS ORGANIZATION** *DR. KUMUDHA & SENTHILKUMAR*	78
17.	**EVOLUTION OF IT SERVICES OUTSOURCING MODELS IN THE e-BUSINESS ENVIRONMENT** *DR. VENKATESH.J & AARTHY. C*	85
18.	**THE LAW AND THE CRISIS MANAGEMENT IN A HOSPITAL SETUP VIZ A VIZ CONSEQUENCES ON HEALTH CARE DELIVERY- A CASE STUDY OF JEHOVAH'S WITNESSES** *DR. PRAKASH.K.N, DR. CYNTHIA MENEZES & S. HARISH BABU*	89
19.	**A COMPARATIVE STUDY OF CORPORATE GOVERNANCE DISCLOSURE PRACTICE OF SELECTED BANKING UNITS** *PAYAL J. THAKAR, JAIMIN H TRIVEDI & RIDDHI A TRIVEDI*	92
20.	**BUSINESS ENVIRONMENT IN INDIA AND CHINA: KEY INDICATORS AND GROWTH OF ECONOMY** *AMITA MAXWELL*	95
21.	**EMPLOYEE ABSENTEEISM ITS IMPACT ON PRODUCTIVITY WITH REFERENCES TO SUKJIT SCRATCH MILLS AT NIZAMABAD** *CH.R.S.CH.MURTHY*	103
22.	**A STUDY OF THE IMPACT OF MACROECONOMIC VARIABLES ON STOCK PRICE MOVEMENTS FOR THE PERIOD 1993- 2010** *ZOHRA ZABEEN SABUNWALA*	107
23.	**ROLE OF LAW IN WOMEN EMPOWERMENT** *DR. SANGEETA NAGAICH & PREETI SHARMA*	111
24.	**WORK LIFE BALANCE FOR BANKING EMPLOYEES: A COMPARATIVE STUDY** *DR. DIVYA NEGI & SEEMA SINGH*	115
25.	**SAVINGS AND INVESTMENT PATTERN OF SCHOOL TEACHERS -A STUDY WITH REFERENCE TO UDAIPUR DISTRICT, RAJASTHAN** *DR. DHIRAJ JAIN & PARUL JAIN*	119
26.	**AN EXPERIMENTAL STUDY ON PERCEPTION OF CELEBRITY ENDORSEMENT BY VIEWERS** *JATIN PANDEY, NEEMA ARJUN BATHIJA & ANUPAMA SUNDAR*	128
27.	**GENDER BUDGETING AS A TOOL FOR WOMEN EMPOWERMENT** *R.ARUNAJAYAMANI*	138
28.	**AN CONTRASTING ASSESSMENT OF THE ATTITUDE FUNCTIONS OF CONSUMER TOWARDS DURABLES- FMCG, A STUDY AMONG URBAN WORKING WOMEN IN KERALA** *ANILKUMAR. N*	141
29.	**A STUDY OF CONFLICT MANAGEMENT STYLES USED BY MBA FACULTY TO ADDRESS CLASSROOM CONFLICTS** *PADMA S RAO*	146
30.	**THE DICHOTOMY BETWEEN CORPORATE CRIMINAL LIABILITY AND DIRECTORS' INDIVIDUAL CRIMINAL LIABILITY: AN APPRAISAL OF TWO JURISDICTIONS (THE PEOPLE'S REPUBLIC OF CHINA & UNITED KINGDOM) VIS-A-VIS THE SCENARIO IN INDIA** *ABHISHEK TRIPATHY*	150
	REQUEST FOR FEEDBACK	156

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RELATIONSHIPS ARE EASY TO GET INTO.... BUT DIFFICULT TO GET OUT OF!' – A CASE OF EU AND GREECE

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ABSTRACT

The future of international trade will be determined not by multilateral trade mechanism but by the process of regional economic integration. In the last few decades, the regional factors have played a vital role in the global transformation and regional integration has become a prominent issue in many of the disciplines. Of all the regional trading blocs, European Union is considered as the most advanced form of regional integration with 27 member nations and unified economic policies. However, this process of unification of Europe has come to a halt because of the failure of some member nations such as Greece in following the fundamental economic principles. The crisis in Greece has created ripples all over world and no solution seems to be plausible in the current scenario. The case of Greek economy clearly emphasizes that the economic fundamentals are the key determinant of the success of regional integration process. Any neglect on this part may trigger crisis in the regions with long -term effects on rest of the world.

KEYWORDS
Regional economic integration, European Union, Economic crisis.

INTRODUCTION

Regional integration has emerged as one of most important developments in world the Politics and Economics. In the last few decades, it is observed that the regional factors are playing a vital role in the global transformation and regional integration has become a prominent issue in many of the disciplines. The multicultural, multifactor and multidimensional character of regionalism (Hettene, 2005) is being discussed, assessed and analyzed from various perspectives in disciplines such as comparative politics, political economy, international economics, international relations and international business management.

CONCEPTUAL AND THEORETICAL UNDERPINNINGS OF REGIONAL INTEGRATION

The concept of region can be looked upon from various perspectives. The regions, from geographical perspective, are sub-national entities –either historical provinces or more recently created nations. In international relations, regions are supranational subsystems of the international system having their own dynamics. In a broader sense, a region consists of 'states which have some common ethnic, linguistic, cultural, social and historical bonds.' They can be differentiated from each other in terms of social, political and economic cohesiveness.

Often a particular region is mixed up or linked with a particular regional organization which tries to shape 'its' region by promoting cooperation among states and other actors. Such kind of regional cooperation covers any interstate activity, which involves interest of all the partners and differs from regional integration, which is a trans-local process. Regional integration involves some changes in terms of sovereignty (Hettene *ibid*). As it encompasses too many desperate phenomena, it is generally broken down into regional social integration, political integration and economic integration.

Regional economic integration implies the economic and political agreements among countries that give preference to member countries in commodity trading. This is, basically, to facilitate intra-regional trade. The preferential treatment given to the member countries of a trade group affects the competitiveness of goods in international markets. Thus, the regional integration is preferred over multilateral trading agreements because of their shorter duration, political and geographical considerations and similarities of interests of countries belonging to a particular region (Joshi, 2009).

Political analysts discuss regional integration from functional (Mitrany, 1966) and inter-governmentalism (Tayler, 1982) approaches where the focus is on institutions and processes. The Economic theory considers the welfare implications or effects of discriminating mergers of markets in a region. Viner (1950) in his seminal contribution to Customs Union theory has stressed on the trade creation and trade diversion effects of economic integration. The theory of Optimum currency area (Mundell, 1963) looks at integration with a focus on understanding the conditions under which it is economically efficient to create a union.

The empirical experiences in regional grouping suggest that the regional economic integration helps bridge the development gaps among the members (Salvatore, 2007). It helps Less Developed Countries to take advantage of global market access opportunities. Regional economic integration schemes help optimal deployment of region's natural, financial, human and technological resources. This can be attained through several forms of regional integration such as preferential trade agreements (PTA), Free Trade Areas (FTAs), Customs Union (CU), Common Market (CM) and Economic Union (EU) culminating into Political Union (PU).

Regional economic integration is a complex phenomenon, which involves various political, social, financial and economic implications for the particular region. The first full-fledged attempt towards regional integration was made by Europe with 27 member nations and was considered as one of the landmarks in the economic history of the world.

REGIONAL INTEGRATION IN EUROPE - HISTORICAL PERSPECTIVE

The first major voluntary regional integration initiative appeared in the nineteenth century when in 1828 Prussia established a customs union with Hesse-Darmstadt (Mattli, 2001). This was followed successively by various forms of integration in European nation states. However, during 1950s, the idea of European integration was re-invented and the process of merging European nation- states into one prosperous economy and stable polity began.

The creation of the European community is difficult to be captured in a theoretical framework. It can be called as a phenomenon *sui generis.* The process of integration in Europe can be better understood if we consider the preconditions that laid the foundations of this process. After the Second World War, Euro-communism was on rise. Countries were suspicious about whether the complete sovereignty should be provided to Germany considering the political and military threat it may pose to the neighboring countries. However, a strong Germany was also essential for the security of the western countries in Europe. Thus the need for a new European institution was felt which would cement the economies of member countries into an interdependent maze out of which independent aggressive action by a single country (such as Germany) would be impossible (Mattli *ibid*). The first step towards this direction was constituted by the Schuman plan, which laid the foundations of European Coal and steel Community (ECSC).

During 1950s to 2010, the European nations went through various phases of regional integration. In the first phase during 1957, the process was strengthened by the Treaty of Rome signed by six European countries. During 1960s, there was removal of trade barriers amongst the member nations and agreement over the joint control over agricultural production was signed. It is known as the Period of Economic Growth. During 1970s and 80s many more European nations joined EU and there was initiation of the process of single market with a free flow of trade across EU borders. In 1990s, the single EU market was created with four freedoms of movement of goods, services, people and money. During this period, the Maastricht treaty was signed determining the criterion for accession to European Union.

On January 1, 2002, Euro as a common currency came into existence. The membership of European Union reached to 27 nations. The treaty for establishing European Constitution was also signed by these members reflecting a move towards political integration.

However, in the year 2010 the process of regional integration in Europe came to a halt when four member nations Greece, Portugal, Italy and Spain were found to be vulnerable due to high government debt levels and rising fiscal deficit to GDP ratio. Of all the four economies, Greece became the weakest link in the Union in March 2010 when the country was observed to be on the verge of debt crisis.

GREECE- THE COUNTRY PROFILE

Greece, also known as Hellenic Republic, was the first country in the Europe where advanced early civilization emerged. The emergence of City-states resulted into the great prosperity and unprecedented cultural boom under the democratic environment.

The country is located in the South Eastern Europe situated on the southern end of the Balkan Peninsula. With a population of 10,964,020, the country shares the borders with Albania, Macedonia, Bulgaria and Turkey. The country is a parliamentary republic with a system of distribution of power between executive, legislative and judiciary branches. Table 1 reflects the key economic indicators of the country for the year 2009.

TABLE 1: KEY ECONOMIC INDICATORS FOR GREECE (YEAR 2010-11)

Sr. No.	Economic Indicators	Values
1	GDP (PPP based)	$318.7 Billion
2	GDP growth rate	-4.5
3	GDP Per Capita	$28189
4	Real value added by sector	
A	Agriculture	12.3%
B	Industry	-11.6%
C	Services	-5%
5	Current account balance	-10.4%
6	Unemployment rate	12.7%
7	Public debt	147.3% of GDP
8	Inflation Rate	4%
9	Government Deficit	-10.4%

Source: OECD, Country Statistical Profile, 2011

THE PROCESS OF INTEGRATION OF GREECE WITH EUROPEAN COMMUNITY

The relationship between Greece and EU dates back to the 1960s when country submitted the application for accession to the EEC in June 1959 which led to the Association Agreement between Greece and the EEC, signed in June 1961. This agreement was the first step towards the integration of Greece with European Community. However, with the establishment of dictatorship in Greece, the agreement was frozen in 1967 and was again reactivated in 1974.

Greek government was keen about the integrating the country with the EU as a full member and therefore it submitted the application for full membership in 1975. The major reasons which were put forward by the government ((Ministry of Foreign Affairs, Greece) while submitting the application were as follows-

1. European Union is an institutional framework, which will bring stability in the political system and institutions of Greek economy.
2. The accession will help Greece to enforce its independence and position within the regional and international systems and reduce its dependence on US.
3. It will help modernization and development of the economy and society.
4. Greek being a European nation wanted to have presence and impact on the process of integration.

The accession application from Greece was accepted by the European Community and Greek became a member nation of EU in 1981.

In the initial phases of accession, Greece requested economic support for restructuring the economy, which was accepted, and Integrated Mediterranean Program approved funds for Greece. The country introduced new structural policy – Delors Packet in 1988.

The economic reports by the Greek Government reflected that the economy was having strong foundations during 2002 to 2007 with a labor force of 4.9 million and it was the second most industrious country among OECD countries after South Korea. Annual Growth of Greek GDP surpassed the respective levels of most of its EU member nations. Greek's PPP adjusted Per capita income was world's 26th highest (Ministry of Foreign Affairs, Greece).

FAILURE IN CONFORMING EU PHILOSOPHY

However, throughout the process of integration, in spite of the membership of EU, Greek suffered from poor macroeconomic performance because of the expansionary fiscal policies. When Maastricht treaty was signed in 1991 Greece was far away from meeting the convergence criteria. The fulfillment of the integration criteria remained only on the papers. It was revealed that Greek governments always misreported or falsified the country's official economic statistics. The country was consistently spending beyond the means and was hiding the actual deficit from the EU overseers. Greek never achieved the targets related with inflationary levels, interest rates, internal debt and fiscal discipline in the stipulated time span though it was a precondition for joining the common currency area.

Fiscal Deficit: In case of Greece, successive governments run large deficits to finance public sector jobs, pensions and other social benefits. The currency was devalued to help finance the borrowings. In the initial phases after the introduction of Euro, Greece was able to borrow due to lower interest rates. However, this raised Greek budgetary deficit substantially at around 9% of GDP in 1985 and 12.7% in November 2009.

Government Debt: Since the joining of Euro, the Debt to GDP ratio in Greece remained above 100%. Further, the global financial crisis in 2008 affected the Greek economy severely as two of the country's major industries- tourism and shipping were badly affected by the declining revenues. There was tripling of Debt to GDP ratio from 34.7% in 1987 to 120% in 2010. During this period, the interest payment on debt accumulated reached almost 12% of GDP.

Inflation: The economy experienced high inflationary pressures because of populist policies pursued by politicians. The average inflation rate in Greece was 19.8%, which was thrice the EU average. All beyond the threshold permitted by the rules of EMU. The huge expenses on Olympics also contributed to high inflationary pressures and increased government expenditure. Greek was somehow able to retain the control over growth rates during this period.

In 2010, again the economy experienced financial expansion because of populist government policies. The EU policy guidelines demand reduction in the role of Government and agricultural sector in the economy. However, Greek government followed completely opposite policy within the scope of vote hunting and populism. For Instance, a job that now pays 55,000 Euros in Germany pays 70,000 Euros in Greece, even with the fact that Germany is a more productive nation. As Lewis writes, "To get around pay restraints in the calendar year the Greek government simply paid employees a 13th and even 14th monthly salary -- months that didn't exist". The necessity of reducing the Government was constantly overlooked by the politicians and the number of government workers was multiplied just to please the voters or as a part of rhetoric on solving unemployment problem. The practice of unwisely decreed high wages, generous retirement and medical benefits led to long term economic imbalances.

The inevitable result of this practice was shifting of this burden of increased government expenses to markets, increasing the taxes and borrowings. Further, the process of privatization was carried out in such a manner that it created more debt for government and more pressure on markets. This delayed the investments and the solution to unemployment was again sought in government expansion. The socio-political factors also contributed to the crisis and the economy was on the verge of bankruptcy.

The Crisis: In the first quarter of 2010, the excessive national debt created anxiety amongst the investors who demanded higher interest rates from the nations with high debt levels or deficits. However, the governments were not in a position to finance the deficits and service the high debt levels with higher interest

rates. There was a crisis of confidence, which widened the bond yield spreads and in other EU member states including Germany. In Greece, the government requested the bailout package of $ 61 billion from EU and IMF for the repayment of Greek bonds.

The major problem with Greece, and for the matter with Spain and Portugal was, the high percent of their debt in the hands of foreign creditors. They had a credibility problem due to low growth rate, high deficit and less foreign direct investment. Ultimately, in April 2010 the economy experienced lowering of its AAA rating along with three other nations by the Standard and Poor to junk status.

The banks that had generously invested in AAA gilts experienced devaluation of their holdings and the European sovereign debt crisis began to spread all over the world. The country being a part of Common Currency area, the macroeconomic pressures started affecting the common currency- Euro. The concerns over the ability of Greece to tackle its deficit spread to Spain and Portugal, which have both been hit hard by a severe downturn in the property and construction industries. The fragile global growth recovery and huge debts carried by some countries made the investors to anticipate the debt crisis in EU. The cost to the investor of buying insurance against a default by Greece, Spain and Portugal jumped up as the stock markets across Europe fell. It was expected that if Greece economy is not rescued the whole EU might undergo the financial crisis just as if the Lehman brothers led the financial crisis in US.

A major question in front of EU was how to reduce the pressure on Euro to maintain the value of this common currency? Secondly, there was a need to devise a rescue plan for the weak member nations undergoing financial crisis. Though Greek Finance minister assured that the country would cut its deficit to 3% threshold allowed under EU stability rules by 2012, concern remained whether Greek public will be able to stomach the austerity measures required. On 2nd of May 2010, the Euro zone countries and the IMF agreed to a €110 billion loan for Greece, conditional on implementation of harsh Greek austerity measures. On 9th of May 2010, Europe's finance minister approved a comprehensive rescue package worth almost a trillion dollars, which aimed at ensuring financial stability across Europe and avoiding the spread of the crisis in the region.

However, by the end of 2010 it was realized that the accomplishment of targets was harder for Greek and it signaled a recession much harsher than expected. Again, in May 2011, there was a great protest in Greece against the austerity measures. Standard and Poor downgraded the country debt rating to CCC, the lowest in the world. The crisis sent ripples in the world with major stock exchanges exhibiting the losses. Euro zone along with IMF made efforts to help Greece by lowering the interest rates of EU loans to Greece and writing off Greece debt to EU.

There are three possible policy options available to European Union and Greece. European Union may write off the Greece debt completely, rescue the economy first and allow Greece to continue to be a member of EU. Some economists are of the view that though the huge rescue packages are having calming effect on the crisis situation for the time being, Europe may still suffer a meltdown in near future (Ayer, 2010). The fresh stimulation packages may solve the problem for the time being but it needs to be understood that each package entails additional government debt.

The second school of thought believes that the fundamental problem that Greece or for that matter many of the European economies are facing is 'living beyond the means' on the part of the government. Until the date, the structural reforms were supposed to be reserved for the Third World countries. The Greece crisis, however, has proved that long-term remedy for economic crisis can be found only through structural reforms and austerity measures. If Greece implements the austerity measures and reduce the debt GDP ratio to acceptable levels it may be allowed to function as a member of EU. However, such austerity measures in the face of depression is a bad idea and a millions of workers are already paying the price for the willful amnesia.

Some of the experts believe that the best possible option available for Greece and EU is to engineer an orderly default on Greece's Public debt. This will be followed by withdrawl of Athens simultaneously from the Euro zone and reintroduce its national currency drachma at a debased rate. However, this may lead to disintegration of EU as along with Greece there are other defaulters who deserve the same fate.

ISSUES RAISED BY THE GREECE CRISIS

Now the economists, political analysts and financial experts are trying to find out answers to the following questions pertaining to the regional integration –

What should be the prerequisites for joining a monetary union?

How to resolve the policy conflicts involved in national priorities and the predefined goals of the Union, which is a supranational entity?

What are the factors that play a critical role in the success of any scheme for regional integration?

What are the lessons that the other trading blocs such as ASEAN or NAFTA can learn from the experience of European Union?

CONCLUDING REMARKS

The crisis in Greek and Europe has many implications for the various regional blocs that have developed in last few decades as well as for all those economies that are lagging in terms of sound economic fundamentals. Paul Krugman, the renowned economist, has already pointed out that Britain is doing worse this time than it did during the Great Depression (Economic Times, 2012). The situation in Spain is much worse and if it fails down, no rescue fund, however large, would be able to drag it out. In Asia, India is staring at Rs. 1.5 lakh crore fiscal deficit which, if not contained in time, will affect the growth prospects adversely (TOI, 2012).

The experience of EU suggests that for the success of any integration scheme, the strong economic fundamentals is the key factor in integration process and any negligence on this front by even a single member nation may trigger the crisis and financial meltdown in the Union as well as in the rest of the world. Ultimately, one can conclude that the integration of Greece with EU has resulted into a kind of relationship, which is easy to get into but difficult to get out of !!!

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