ISSN:2148-2292

Akademik Tarih ve Düşünce Dergisi, 7 (1) İlkbahar 2020 ss 700-718

Academic Journal of History and Idea, 7 (1) Spring 2020 pp 700-718

Araştırma Makalesi
Original Article

The role of External Economic Incentives in times of Political Transitions and Consolidations

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Abstract

Development has become a buzzword in the field of political science and policy-making. This paper tries to answer why despite crucial political and economic similarities between European countries-Spain-Portugal and South American countries Argentina-Peru, South Americans constantly underperformed in terms of economic development in the last quarter of the 20th century? This study explored how external economic incentives can stimulate progressive economic reforms in times of democratic transitions. By understanding why South American states failed where Iberian ones succeeded, we can learn more about important intervening variables, and offer alternative answers to questions of political transitions and their impact on economic growth. Moreover, this research might have some practical value for policy-makers facing transition from authoritarian to democratic market-oriented states.

Keywords: Latin America, Political transition, Economic incentives

Received Date: 30/09/2019 **Accepted Date: 10/01/2020**

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Dış Ekonomik Teşviklerin Siyasi Geçiş ve Konsolidasyon Zamanlarındaki Rolü

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Öz

Kalkınma, siyaset bilimi ve politika yapımı kapsamında bir terimdir. Bu makale Avrupa ülkeleri, İspanya- Portekiz ve Güney Amerika ülkeleri ile Arjantin ve Peru arasında olan siyasi ve ekonomik benzerliklere rağmen, Güney Amerikalıların 20. yüzyılın son çeyreğinde ekonomik gelişme açısından neden daha düşük performans gösterdiğini ele almaktadır. Bu yazıda, dış ekonomik teşviklerin demokratik geçiş zamanlarında ilerici ekonomik reformları teşvik etmedeki rolünü de araştırılmaktadır. Güney Amerika devletlerinin İberya devletlerinin başarılı olduğu yerlerde başarısız olmasının nedenlerini anlayarak, önemli müdahale değişkenleri hakkında daha fazla şey öğrenebilir ve genel olarak politik geçişler ve kalkınma sorunlarına ve bunların ekonomik büyüme üzerindeki etkilerine alternatif cevaplar verebiliriz. Dahası, bu araştırma, otoriterden demokratik pazar yönelimli devletlere geçişle karşı karşıya kalan politika yapıcılar için de bazı pratik değerlere sahip olunabileceğini göstermektedir.

Anahtar Kelimeler: Latin Amerika, Siyasi geçiş, Ekonomik teşvikler

Gönderme Tarihi:30/09/2019 **Kabul Tarihi:10/01/2020**

Роль внешних экономических стимулов во времена политических перемен и консолидации

Резюме

Развитие одно из ключевых слов в политологии и политике. Эта работа исследует вопрос почему несмотря на важные политические и экономические сходства между европейскими странами — Испания и Португалия — и южноамериканскими странами — Аргентина и Перу, южноамериканские страны систематически уступали европейским странам в экономическом развитии в последней четверти двадцатого века? В этой работе исследуется роль внешних экономических стимулов в стимулировании прогрессивных экономических реформ во времена демократических перемен. Объяснив причины того как южноамериканцы провалились в том чём Иберийцы преуспели, мы сможем предложить интересные ответы на вопросы политических перемен, и их воздействия на экономическое развитие. Кроме того, это исследование может принести практическую пользу политикам во времена перемен с авторитарных режимов в демократические рыночные экономики.

Ключевые слова: Латинская Америка, политическая перемена, экономические поощрения

Получено: 30/09/2019 **Принято: 10/01/2020**

Introduction

Development has become a buzzword in the field of political science. Much has been written on this subject, and it has been analyzed from many different angles. This paper will try to contribute to the accumulation of knowledge in the field of development, and offer a distinctive outlook on the topic under study. The primary question this paper poses is – what is the single most important reason that despite crucial political and economic similarities between European countries – Spain & Portugal – and South American countries – Argentina & Peru, South Americans constantly underperformed in terms of economic development in the last quarter of the 20th century?

In the mid-70s, all of the above-mentioned countries where authoritarian dictatorships characterized with poor economic performance. Important economic indicators, such as GDP/capita, economic growth and inequalities, unemployment and etc., were roughly similar in all these countries. In the late 70s and early 80s these countries experienced democratic transitions, and by the end of the twentieth century they had been democracies for at least a decade.[1] But countries that started off from similar economic and political base ended up in quite disparate positions, in terms of economic development, just after quarter of a century. It is noteworthy that in 1975 Portugal and Spain had GDP/capita of approximately 2,000 and 3,000 dollars, respectively.[2] At the end of the millennium these numbers grew to 11,000 and 28,000 dollars. In the same period Peru and Argentina which started out with GDP/capita of approximately 1,000 and 3,000dollars reached the numbers of 2,000 and 8,000 dollars, respectively.[3] The numbers show that European countries' growth rate was consistently higher than that of their South American counterparts.[4]

In the course of this paper, we will briefly review the schools of thought that have contributed to the topic of development. In this light, the most prominent theories of

[1] "Argentina and the IMF," IMF, https://www.imf.org/en/Countries/ (12.12.2019).
[2] "Peru and the IMF," IMF, https://www.imf.org/en/Countries/ (10.12.2019).
[3] "Portugal and the IMF," IMF, https://www.imf.org/en/Countries/PRT (10.12.2019).
[4] "Spain and the IMF," IMF, https://www.imf.org/en/Countries/ESP (10.12.2019).

development, such as modernization, the dependency, and world system theories, will receive fair coverage. But unconvinced with the explanation these theories have to offer, we will move to theories of democratic transition/regime change as possible sources of explanation. Here, the subject of inquiry will be the sharing of power by elites of the previous authoritarian regime and new elites, and importantly what effects such power-sharing – in the process of democratic transition – might have on economic development. Having analyzed, the contributions of the above-mentioned scholarships and their relevance to the question of different economic growth rates in European countries and their South American counterparts,we will offer our own hypothesis – the role of external economic incentives for drastic economic policies in times of democratic transitions.The importance of understanding the cases of Iberian and South American countries lies in their ability to offer alternative answers to the questions of political transitions and development in general, and their impact on economic growth. By understanding why despite crucial similarities South American states failed where Iberian ones succeeded, we can learn more about important intervening variables, missing from previous explanations. Moreover, this research might have some practical value for policy-makers facing transition from authoritarian to market-based democracies.

Literature Review

This section provides an overview of the existing body of literature in comparative politics on the subject of development. The reader will have an opportunity to get acquainted with competing explanations on economic development, and assess their relevance to explaining the disparity in economic growth between European and South American countries.

Modernizations theories

For the purposes of this study, it is important to ascertain, if the sociological explanation of development can explainwhy, at the end of the twentieth century, South American countries under analysis had evinced slower economic growth. Evolutionary and Functionalist theories, both part and parcel of modernization school, explain the development of societies through "unidirectional social change," suggesting that societies invariably move from primitive to advanced state.[5]

But in the cases at hand, the modernization school fails to provide a satisfactory answer on at least two accounts. First, the evolutionary school of modernization assumes that the rate of social change is slow, gradual and piecemeal –that is evolutionary, not revolutionary.[6] But it is not clear how long the slow change is. Is the change in the time period in our analysis -25 years- slow change, or does 25-year period mean the same for South American and European countries given internal social dynamics and external influences? Unless these questions are answered, it is hard, if not impossible to apply the assumptions of modernization school to our research. But importantly, modernization school is silent about external factors, though it carefully singles out internal/domestic variables that pinpoint the difference between modernized and non-modernized societies.

Levy offers a long checklist of domestic variables which could be explored for the purpose of this research. Among the most important we should mention degree of specialization, high level of self- sufficiency, cultural norms and traditions, particularism and cultural diffuseness, the degree of bureaucratization, flow of goods and services between towns and villages, degree of centralization.[7] Relevant data can confirm that South American and Iberian countries scored similarly on cultural norms and traditions from1975 to 2000. And importantly, this assumption has strong implications for the research question, it discards the relevance of cultural and traditional elements to explain the given phenomenon.

While cultural and tradition variables fail to explain the case at hand, economic indicators proposed by modernization school to measure modernization, will reveal that economies of South American and Iberian countries which started from similar base in 1975, took different growing path in the last quarter of the 20th century. In the following section, we analyze the contributions of dependencia theorists to the topic of economic development.

[5]Alvin, So, *Social Change and Development*, Sage Publications, London, 1990, 24-27.
[6]So, *Social Change and Development*, 24-27.
[7]So, *Social Change and Development*, 25.

External variables, they pay attention to explain domestic economic development, might provide some insight for the question under research.

Dependencia theories

Unlike modernization theories which assume that factors inherent to countries hamper their progress, dependencia theories blame the historical experience of colonialism, its aftereffects, and positioning of a country in the global economy for its underdevelopment. The countries of interest in this paper will be analyzed from the position they play in the global economic structure.

For the purpose of this paper the effects of colonialism and foreign domination are discarded. This is done because countries under analysis have been independent for over a century and extractive methods of colonial domination are not present. In the last quarter of the 20th century, all of these countries were independent military dictatorships with no colonial power exploiting them. And importantly it has been convincingly shown by Jeffrey Frieden, in his Global Capitalism, that until Great Depression South American countries, with few exceptions, were benefiting from international division of labor and global trade.[8] Specialization of Argentina and Peru in agriculture and natural resources was an important source of economic growth. Thus, if anything, colonialism and its economic legacy was actually beneficialfor the South American states. But the breakdown of golden standard, devastation of WWII, universal suffrage and resultant need to accommodate economic policies to public demand, along with many other factors influenced the nature of economic exchange between the states. Taking all these factors into consideration, it would be too deterministic to claim that colonialism was the single most influential factor influencing the economic development of South American states.

One more argument of dependencia theorists needs to be addressed below: the possibility that the positioning in the global economic structures of countries under analysis influenced their economic development. Dependency, as such, is seen as incompatible with

[8]Jeffry A. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century*, New York: W. W. Norton-Company, 2007, 42.

development.[9] According to dependency school, development is impossible at the periphery. Minor developments are possible during periods of isolations, such as global crises, but genuine development in the periphery is highly unlikely because of the continual flow of surplus to the core. But a careful analysis of the situation in the mid-70s will reveal that Spain and Portugal started to develop faster only after they opened up to foreign trade. With regard to their economic indicators, these countries started out with roughly similar economic parameters in 1975. However, by the end of the century Iberians were much ahead in terms of economic growth. Dependencia theorists might respond, that disparate economic growth was conditioned by the fact that Iberian countries moved to the core and engaged in unequal economic exchange with the periphery, while South American countries plunged into periphery after they opened up their economies. But a brief look on Iberian countries' trade indicators reveals that they trade primarily with other European, so-called core countries. If anything, Iberian countries were supposed to be exploited by their European partners, but surprisingly they adapted and experienced huge economic growth in the last quarter of the 20th century. Similar, statistics for South American countries reveals that their main trading partners are neighboring countries that can hardly be categorized as core countries. Moreover, they both enjoy regular trade surplus. Thus, given current economic state of affairs of Iberian and South American countries, it is rather inaccurate to describe them as being exploiters or victims of the global economic exchange regime.

Due to the abovementioned factors dependencia theories fail to explain why Iberian countries were able to develop, or using the logic of dependencia theorists to extricate themselves from their positioning in the periphery, while at the same time their South American counterparts were to remain bogged in the periphery. Moreover, the abovementioned arguments tried to demonstrate that the definition of core and periphery is not enough to explain the nature of current economic exchange. Wallerstein's categorization of states into core, periphery and semi-periphery will try to address this problem.

[9]Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century*, 105.

World system theorists, on the other hand, and among them Immanuel Wallerstein may hold a key to the abovementioned theoretical predicament. According to Wallerstein the world cannot be categorized into two neat categories of core and periphery. There are many nations that do not fit into these categories – Wallerstein terms them as semi-periphery. But more important in Wallerstein's theory is his argument that nations can potentially move from the periphery to semi-periphery, or to core and vice versa. They can do so in two distinct ways, either by seizing the chance, or by engaging in semi-peripheral development by invitation. Wallerstein explains that

> At moments of world-market contraction, where typically the price level of primary export from peripheral countries goes down more rapidly than the price level of technologically advanced industrial exports from core countries… solution is import-substitution… aggressive state action that takes advantage of the weakened political position of core countries and the weakened economic position of domestic opponents of such policies.[10]

But a preliminary analysis would reveal that none of the countries under study engaged in import-substitution policies on the large scale, in the last quarter of the 20th century; moreover, government involvement in their economies had on average decreased in the same period.

The second way in which countries from periphery can move upwards is by engaging in semi-peripheral development by invitation, which is only possible during times of global economic expansion. In this stage countries from periphery compete with one another to attract multinational investment from core countries. But interestingly there was only one considerable economic boom, that in the mid-90s. But even then, the comparison of the GDP/capita of Iberian and South American countries will clearly reveal that economic indicators of these countries were already significantly different from each other. Thus, while the economic boom might have some explanatory value, it does not explain the underlying cause behind the disparate economic growth.

[10]Terence K. Hopkins and Immanuel Maurice Wallerstein, World-systems Analysis: Theory and Methodology, Ann Arbor, MI: U.M.I. Books on Demand, 1993, 148.

Democratic transition and economic development is a broad synthetic category I will use as shorthand to incorporate, on the one hand, the analyses of prominent theorists on democratic transitions, and on the other hand, the analyses of theorists who relate the transition period to subsequent economic development. The primary purpose of this artificial alloy will be to showcase whether prior political arrangement and transition process to democracy can explain the difference in economic growth between Iberian and South American countries under analysis.

J. Linz and A. Stephan classify states prior to their subsequent democratization as totalitarian, post-totalitarian, authoritarian and sultanistic depending on the role governments play in politics, economics, social, religious, and other important aspects of everyday life. They define authoritarian regimes as "political systems with limited, not responsible, political pluralism, without elaborate and guiding ideology, but with distinctive mentalities, without neither extensive nor intensive political mobilization, except at some points in their development, and in which a leader or occasionally a small group exercises power within formally ill-defined limits but actually quite predictable ones".[11] Under their categorization all the countries under analysis fall into authoritarian camps before democratic transition. Because authoritarian group is so broad, it encompasses too many cases and leaves little room for productive theorizing.To avoid this pitfall Linz draws four distinct categories of authoritarian regimes depending on the institutional character of those in control of the state apparatus: (1) a hierarchical military, (2) a nonhierarchical military, (3) civilian elite, and (4) sultanistic elites. In our case all countries fall under the category of military regimes, which has important political implications. The officer corps, taken as a whole, sees itself as a permanent part of the state apparatus, which has an interest in a stable state, and a stable government.[12]According to Linz previous regime type, when it happens to be a military regime, does little if anything to hamper the future economic

[11]Stepan, Alfred, and Linz Juan, *Problems of Democratic Transition and Consolidation*, Baltimore: John Hopkins University, 1996.

[12]Alfred Stepan and Juan Linz, *Problems of Democratic Transition and Consolidation, 38.*

growth unless it undermines the stability of the state. This conclusion leads to another question, if prior regime type cannot explain the trend of economic performance after democratization in countries under the analysis, can the transition process itself be explained? Linz, Stephan, Landman, Whitehead, Haggard, and many other prominent scholars have written on the topic of transition. And interestingly they almost unanimously agree that in times of transition government policies have an impact on future economic development. However, the failure to implement the policy leading to economic growth is often categorized under old and well-known categories of collective action, distributive conflicts and time horizons. Each of these categories represents an important political-economic problem. However, what is left out from the analysis is the fact that in times of political –economic transitionsoftentimes drastic economic policies are required to set the economy on the path of development. As rational vote-maximizers governments will necessarily abstain from implementing harsh economic policies. The effect of such policies is long-term while elections are always on the horizon. By implementing such policies incumbent governments risk losing upcoming elections. As a result, drastic economic reforms will not be introduced and economic growth will remain sluggish. Iberian states were able to escape the aforementioned cycle of rationality-induced despair. In the 80s and 90s, Iberian states had to abide by stringent economic criteria induced by European Union – the incentive was joining the European Union (EU), justification for harsh policies was the appeal and long-term benefits of being a member of EU. Unlike, the Iberian countries incumbent governments in South America had no incentives to implement harsh policies. Unlike, the EU which disciplined potential exuberances of foreign borrowing in Iberian countries, nobody was there to discipline South American states, until they were in a debt crisis because of the hike in interest rates, after the contagion from the default of Mexico in the 80s and importantly, because of imprudent economic policies in the previous decade.In this light, we want to suggest (and test in the research)the hypothesis that incentives or their absence played a crucial role in shaping domestic economic policies of Iberian and South American states, and the level of their development at the end of the 20th century.

Theoretical model

It is important to note that this study is not using an existing theory to explain a new case. In Eckstein's terminology, this study is a heuristic study used as a building block for theory development. As such, a number of supplementary case studies need to be conducted to confirm the validity of the proposed theory and its explanatory scope.

Controlled comparison: Case studies

The research design of this study is deliberately chosen to be in the form of a case study. This study is *heuristic* in its nature – it attempts to confirm the validity of the proposed theory and hypothesis. Should the preliminary research confirm the validity of the theory, it will warrant the conduct of large-scale quantitative study. Such a study will inform the research of the statistical significance of the finding, and expose deviant observationswhich can be studied in separate case studies for the purpose of refining the theory. Next section will be devoted to the explanation of the proposed theory, its concepts, assumptions and deduced hypotheses/logical expectations. These hypotheses will be tested in the case study to confirm their validity.

1) Specification of the theory:

Incumbent governments will implement drastic economic policies in times of democratic transitions only if encouraged with external economic incentives. Important assumption, corroborated with real-life empirical evidence, is that market reforms are necessary in times of transition from centrally controlled to market economy, to guarantee the medium to long-run economic growth. This study does not attempt to make broad overarching claims regarding every type of democratic transition. Transitions in this study signify change of the form of government from military controlled regime into democracies. The selection of the cases in this manner was performed to ignore the potential effects of other forms of pre-transition governments on post-transition policies. This study leaves out of the analysis, the effects of ethnic/religious divisions, civil wars and class differences. To control for the effect of other important variables this research concentrates on states that are consolidated political entities, with established government bureaucracy employing the monopoly of force over their territory. Rational actor model: The major assumption of this study is the vote-maximizing behavior of governments. Governments care to be re-elected, as a consequence they will not implement drastic economic measures. Such measures strengthen the economy in the long-run, but in the short-run they lead to increased unemployment due to severe cuts in the public sector, privatization of public property, decreased government expenditure on social services, and etc. Because governments care to gain votes they will have no incentive to antagonize large segments of population and engage in drastic market-oriented policies. This study borrows heavily from the rational choice theory. Individuals are assumed to balance costs against benefits to arrive at action that maximizes their personal advantage. Interests of individuals are taken for granted and their preferences are transitive. The primary interest of a politician is to get re-elected, and in order to do so, he will implement policies that will gain him most voters. For the electorate, the primary interest is utility. The electorate elects politicians that are expected to bring more benefit.

2) Specification of variables:

Dependent variable (DV) – The study analyzes the conditions necessary for the government to implement economic reforms in times of transition. Economic reform is a broad concept, in this study it stands for the major decrease of government involvement in the economy. A proxy variable for such a decrease will be the loss in monetary value of jobs and social compensation after government cuts the funding for the private and public sector, expressed as the percentage of GDP. Independent variable (IV)–A proxy variable for economic incentives offered by foreign countries is the monetary value of jobs created in the short- to medium run from implementing market-oriented policies, which can be approximated by the percentage of GDP gained from foreign incentives. That is the number of jobs created and social compensation from foreign incentives, expressed as the percentage of GDP. It is assumed that as incentives from abroad increase, it becomes easier for governments to introduce difficult reforms. The time frame short--to- medium term is chosen because people are assumed impatient, and expect incentives to be provided in the proximate time-period. For this study, the time frame is maximum two election intervals from the point of the implementation of reforms. This stipulation assumes that electorate will forgive the incumbent for the inability to deliver on their promise only ones, ceteris paribus.Other variables – As mentioned before an important variable in this study is the nature of the regime prior to the democratization. It will be held constant, to concentrate on the explanatory value of the main independent variable. Moreover, it is important to control for such variables as external shocks similar to OPEC crisis. Because these variables might themselves be a cause for drastic economic reforms.

Causal relationship between IV-DV –

It is assumed that as the dollar value of jobs and services created from foreign incentives as percentage of GDP increases, the more likely it is for governments to engage in drastic economic policies, which create economic downturn and unemployment in the short-run, and stabilize the economy in the medium-to-long term.

Case Study

This part of the study will apply the methodology to the cases of Iberian countries – Spain & Portugal – and South American countries – Argentina &Peru. As noted before the main goal of this comparative study is to demonstrate from the cases of above-mentioned countries that external economic incentives were a major permissive condition for economic reforms. Without such conditions Spain and Portugal would produce reforms only under exceptional circumstances, such as for instance domestic or global economic crises. In this regard, Argentina and Peru are contrasting cases, where the absence of external incentives precluded the possibility of economic reforms, until it was too late and the countries were facing severe economic crises. It is important to keep in mind that in this model governments act as rational vote-maximizers, and as such they will abstain from taking decisions which will antagonize large segmentsof population. Structural economic adjustments in times of economic transitions are considered to be one of such decisions, as they tend to depress economy in short-to medium-term.Because economic growth takes time to kick in after economic reforms, incumbent governments face a huge risk of being defeated in elections should they undertake these reforms. In the following section, growth trends of Iberian and South American countries are compared in the framework of the rational-actor model. Rational actor theory of economic incentives will be used to provide the explanation for structural economic policies in the above-mentioned countries.

Growth trends

In 1975 South American and Iberian countries exhibited roughly similar GDP/capita and economic growth rates. However, at the end of the century Iberian states had far outperformed their South American partners. Spain started 80s in a severe economic state. When Spanish Socialist Workers' Party government headed by Felipe González took office in late 1982, the economy, inflation was running at an annual rate of 16%, the external current account was negative $4 billion, public spending was large, and foreign exchange reserves had become dangerously depleted. Gonzalez's government introduced a number of reforms but the most important among them were structural economic policies such as an industrial reconversion program and closing of large, unprofitable state enterprises. These austerity measures were largely unpopular, but the government had no choice but to introduce them if it wanted to join the European Community. European Community's conditionality clause required that Spain took under control its burgeoning public debt and inflation. Reforms paid off. The second half of the 80s and beginning of 90s saw unprecedented economic growth in Spain's recent history. Spain's real GDP grow by 3.3% in 1986, 5.5% in 1987, 3.8% in 1988 and of 3.5% in 1989, a slight decline but still double the EC average (World Bank databank). It is very plausible that without European incentives these reforms could have been indefinitely postponed.Portugal, at the end of 70s, experienced a protracted period of negative growth. The economic performance was so dire that it became an active pursuant of International Monetary Fund (IMF)-monitored stabilization programs in 1977–78 and 1983–85. The portion of government expenditure in GDP rose from 23 percent in 1973 to 46 percent in 1990. A surplus at the beginning of 70s, turned into a wide deficit of 12 percent of GDP in 1984, declining thereafter to around 5.4 percent of GDP in 1990. Main culprits for the dismal economic performance were massive transfers and subsidies to the public enterprises, increase in the bureaucracy and spending on social programs. In 1989, Prime Minister Aníbal Cavaco Silva managed to mobilize the required two-thirds vote in the National Assembly to amend the constitution, to permitdenationalization of the state-owned banks and other public enterprises.

Privatization, economic deregulation, and tax reform were the primary concerns of public policy for Portugal at the beginning of 90s as the country prepared to join EC's single market. Thus, once again, similar to the case of Spain, external incentives were critical in producing drastic economic reforms, and importantly for justifying them to the constituency. Argentina, found itself in dire economic conditions in 1983. This was the year when military junta transferredpower to the democratic elected government. Alfonsin's government facing hyper-inflation, huge interest rates on foreign debt and importantly $2 Billion annual losses to state-owned enterprises resigned in 1989. At one point Alfonsin's government considered the privatization of state-owned enterprises but it backed off. Understanding the public uproar,it would have caused and realizing that it was the only solution to keep the economy afloat, Alfonsin resigned and his government fell. When President Carlos Menem took office on July 8, 1989, the economy of the country was in shambles: Argentina had amassed US$ 65 billion external debt; domestic credit and the monetary base were practically non-existent. Inflation, which had averaged over 220% a year during the 1975-88 period, reached 5000% in 1989. GDP per capita had fallen from its 1974 peak by nearly a fourth and real median wages by around half(World Bank databank). Given the criticality of the situation the President had to embark on a path of trade liberalization, deregulation, and privatization.Peru, a thriving economy in 1948, was ravished by import substitution policies of military dictators in 50s, 60s, and 70s.However, the situation did not change much when the democratic government of Fernando Belaúnde Terry was elected president. He instituted lukewarm liberalization efforts but these were not enough to resuscitate the economy from bouts of hyper-inflation, humungous public deficit and fleet of foreign investment from the country. Similar to the case of Argentina, the democratic governments of Peru did little to reform the economy until it was too late. In 1990, Alberto Fujimori ran on the platform of implementing structural economic changes. Fujimori undertook a process of economic liberalization which put an end to price controls, discarded protectionism, eliminated restrictions on foreign direct investment and privatized most state companies.

Conclusion

While the nature of this study is in no way conclusive, it seems from this preliminary study that there is a common theme running in all of these cases. Iberian and South American counties picked in this study started out with similar economic indicators, had contemporaneously experienced democratic transition, yet, at the close of the 20th century they ended up with vastly disparate economic indicators.As this study tried to demonstrate the difference in economic growth stemmed from the rational vote-maximizing behavior of the governments. Governments would not engage in painful reforms not to antagonize their electorate. As a consequence no structural economic reforms would be implemented, until the country finds itself plunged in the economic precipice. This study also suggested that the only way out from the rationality induced logic of responsibility is economic incentives provided by foreign actors. Governments can justify their harsh economic policies to their electorate with future economic gains from them. However, conclusions of this research can be challenged on different grounds. Below are few methodological suggestions on how to make this study more empirically valid:

a) It can be criticized for the fact that the hypothesized relationship between economic incentives and reforms is valid only in countries in democratic transition from military dictatorship. However, to remedy the selection bias, the applicability of the theory to countries in transition from other regimes can be tested in complementary studies.

b) One of the great weaknesses of the study is that the dependent and independent variablesbarely vary in the case of South American countries. These countries were given no or almost no incentive, and they produced no or almost no reform. However, this weakness can be remedied by employing Mill's method of difference and agreement. Given that ceteris paribus condition holdsthe difference in the value of dependent variable should normally be caused by the difference in explanatory variable. But this method does not reveal the nature of relationship between explanatory and dependent variable, whetherit is linear, curvilinear or etc. It might quite be that the effect of the explanatory variable kicks in after a certain threshold. For all these reasons, it is important that a number of case studies be conducted and the exact nature of relationship between independent and dependent variable be discovered.

c) This study assumes that political changes in the above-mentioned countries – transition from military regime to democracy - took place for political reasons. The validity of the study will be undermined if it is proven that regime change in any of these countries was economically motivated. If this is so than an incumbent party has a mandate to produce economic reforms regardless of foreign incentives. This problem is commonly known as the omitted variable bias.

d) It is crucial to supplement this study with single case studies of Spain and Portugal to account for the sources of the regime change in these countries. However, even if the economic effects are discovered to be important, they can be controlled, which will allow the estimation of the impact of incentives. As long as these two variablesare not correlated they will not bias the estimates of the effects of each one of them on the dependent variable.

e) And finally, it might be objected that the study suffers from the endogenity problem. That, economic reforms might actually prompt foreign actors to give reformist governments more incentives. For this purpose, a small operational trick can be performed to dissect the explanatory variable – economic incentives – into two separate variables. One variable would represent incentives provided for performed economic reforms, and second variable will be incentives for future economic reforms.In this case it is crucial to employ the method of process tracing, and single out government expenditures conducted without conditionality clause from foreign actors from government expenditures stipulated by foreign actors.Such process-tracing involves careful analysis of the briefs of economic department and parliament bureaus, and scrupulous analysis of archived documents. Unfortunately, material and temporal scarcitiesat the moment do not allow for a more comprehensive analysis.

Vol.7 /Num.1
March 2020

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