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Should one expect a happy ending of mercosur-european union negotiations? The role played -or the threats placed- by trade and fiscal issues

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SHOULD ONE EXPECT A HAPPY ENDING OF MERCOSUR-EUROPEAN UNION ONGOING NEGOTIATIONS? THE ROLE PLAYED –OR THE THREATS PLACED- BY TRADE AND FISCAL ISSUES

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1. INTRODUCTION

After 18 years of negotiations so far conducive to nowhere, MERCOSUR and the EUROPEAN UNION (EU) seem now closer to an agreement if news transpiring from the ongoing discussions reflects in fact the actual situation. Let however be stated that trade is not the only matter being negotiated so far as foreign investment facilitation (via elimination of unnecessary regulations), services and public procurement regulations and excessive over protection to the agricultural sector are also present in the discussions.

The process for reaching an agreement sustainable in time demands that certain issues that could endanger or obstruct negotiations be addressed, particularly if those issues become sources of serious distortions to trade. In this connection, problems may arise because of the negative impact of tax and spending instruments included in fiscal national and subnational structures of MERCOSUR countries (although this situation cannot either be ruled out in European countries´ regional or local fiscal structures), not to mention the negative effects of modifications in exchange rate regimes that very often take place in Latin American economies[1].

The case of tax and spending instruments emphasizes that, by seeking to meet jurisdictions´ budget constraints important negative effects may be imposed on economic agents by creating artificial advantages or barriers to firms engaged in external trade or investment. Should this be the case, changes in existing fiscal tools would be required in order to resort to no damaging tax and spending instruments which in turn address firms´ microeconomic requirements for progress within the integration.

By considering the fiscal matters highlighted above and their responsibility in making any reached agreement sustainable in time, the paper´s declared objective is to revise the set of used tax and spending tools, both in MERCOSUR and the EU and suggest the necessary corrections or changes in case they are likely to bring about negative effects or distortions upon trade and investment flows. In responding to the objective, the paper critically surveys national, sub-national and local fiscal structures of Argentina, Brazil, Paraguay and Uruguay and of six European countries selected on the basis of their greater economic links to MERCOSUR[2] (France, Germany, Italy Portugal, Spain and the Netherlands); the analysis involves the scrutiny of specific tax instruments as well as the existence of spending packages in so far as these could impact on the trade of goods and services or upon investment flows, for what this review permits to ascertain whether a fair fiscal treatment of export of goods and services (in either direction) prevails or whether determined tax and spending tools should be eliminated, modified or replaced in order to avoid the possibility of creating artificial advantages or disadvantages which may, in turn, discourage free trade among the parties; in addition to the above mentioned revision, presented stylized facts help to show the actual reach of integration.

In line with the ideas summarized above, the paper is organized as follows: Section 2 states the objectives, scope and content of the paper: section 3 includes a critical review of fiscal structures in Argentina, Brazil, Paraguay and Uruguay and in six selected European countries; in Section 4 stylized facts inform about good and

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[1] Let however be said that whatever effect the exchange rate regime may cause upon trade and investment flows, the matter falls in the domain of macroeconomic policies set to respond to objectives other than favouring trade flows (as for instance boosting domestic economic growth).

[2] As known the United Kingdom, one of the biggest European economies, is now in the process of exiting the EU, following the triumph of the Brexit Referendum on June 23, 2016.

services traded and the investment flows, classified by country; Section 5 develops the econometric treatment of the trade and investment flows and of the estimation of the panel data model and Section 6 concludes.

2. OBJECTIVES, SCOPE AND CONTENT OF THE PAPER

On the verge of parties converging to a Free Trade Agreement, and considering the fiscal matters highlighted above; in particular, their responsibility in making any reached agreement sustainable in time, the paper´s declared objective is to revise the main used tax and spending tools, both in Mercosur and the EU and to suggest the necessary corrections or changes in case they are likely to bring about negative effects or distortions upon trade and investment flows.

In responding to the objective, the paper critically surveys national, subnational and local fiscal structures of Argentina, Brazil, Paraguay and Uruguay and of six European countries selected on the basis of their economic relationship to Mercosur countries (France, Germany, Italy Portugal, Spain and the Netherlands); the analysis involves the scrutiny of specific tax instruments as well as the design of spending packages in so far as these could impact on the trade of goods and services or upon investment flows.

This review permits to ascertain whether a fair fiscal treatment of export of goods and services (in either direction) prevails or whether determined tax and spending tools should be eliminated, modified or replaced in order to avoid the possibility of creating artificial advantages to some countries or sectors which may, in turn, discourage free trade among the parties.

In support of the above revision, stylized facts are presented in order to show the depth of integration. For this, trade figures are supplied for relevant goods including an estimation of the tax content and impact within the main traded goods; stylized facts also inform about the services traded and investment flows, classified by country.

3. ECONOMIC AND FISCAL SCENARIOS IN MERCOSUR AND THE EU

3.1 ECONOMIC AND FISCAL SCENARIOS IN MERCOSUR

The economic space known as MERCOSUR includes two of the three largest Latin American economies (Argentina and Brazil both also G-20 members) plus Paraguay and Uruguay; according to the World Bank data, its GDP of 2,600 billion current US dollars (in 2016) places the area as the sixth largest world economy. Officially established by the 1991 Asunción Treaty, MERCOSUR is a free trade zone (although exceptions may be and are allowed among partners) and counts also with diverse schemes of industrial and productive cooperation. The economic integration is complemented by the social and cultural ones and also allows for the free displacement of its citizens throughout the area. There is a common external tariff towards other countries going from 0 to 35%; thus, duties of 0, 2%, 6%, 8%, 10%, 12%, 14%, 16%, 18%, 20%, 24%, 26%, 28% and 35% upon imported CIF values are raised, according to the type of good imported.

Conversely to the EU, MERCOSUR lacks a supranational structure designing and implementing policies; its highest decision making authority is the Common Market Council, composed by ministers of Foreign Affairs and Economy of the member states and every decision needs unanimity in order to be implemented. The Common Market

Group is the executive body its primary task being to implement decisions taken by the Council. The Group is also coordinated by the ministers of Foreign Affairs of the member states and for this reason is an intergovernmental body. The Trade Commission is the third decision-making body of the organization. It is - once again - integrated by representatives of each member state; its role is to review MERCOSUR external tariff when necessary and to solve trade disputes whenever they arise. In sum, all the three mentioned decision-making institutions are intergovernmental ones.

It is at this point worth emphasizing that apart from countries´ dissimilar size and economic and industrial diversification, that have so far thwarted governments´ efforts seeking to strengthen the area, the politico-institutional configuration of parties (Argentina and Brazil being federal whereas Paraguay and Uruguay unitary states) should also be accounted for as a noteworthy element making difficult internal harmonization or setting up common stances for dealing with economic and commercial potential partners. Let it be mentioned, in passing, difficulties faced by fiscal harmonization processes given that Argentine and Brazilian subnational and local governments enjoy greater financial autonomy and constitutional fiscal faculties compared to those of their Uruguayan and Paraguayan counterparts.

In this connection, and in view of progress in efforts to reaching a Free Trade Agreement between MERCOSUR and the EU, the attention must be directed to three important issues whose consideration will undoubtedly be crucial should one expect the agreement to be reached: in the first place, the treatment given to exports of goods in relation to which both parties exhibit tough negotiation positions as the case is for MERCOSUR exports of beef meat, agricultural products and biofuel whereas the UE expects a reduction in import duties in a number of goods (industrial and agro-industrial goods) exported to countries in MERCOSUR as well as some preferential access to the market of determined services (communications, internet, financial, transport and commerce services); in the second place, the role the rate of exchange could play either by favouring or discouraging trade flows. In taking into consideration that the European countries particularly involved in the trade with MERCOSUR have, since 2001, adopted the euro as their currency, and that the euro´s rate of exchange with other currencies responds to the so called floating or flexible exchange rate regime, the problem clearly resides in MERCOSUR whose members have back and forth switched from flexible to predetermined rates of exchange[3], not to mention the instances of dirty flotation. In the third place, and holding particular relevance for this research, there is the fiscal impact and effects of national and sub-national tax systems and public expenditures deserving a thoroughly consideration given their real possibility of creating distortions in the trade of goods and services and investment flows, as would be the case of artificial advantages or disadvantages in either party.

In order to illustrate some of the problems, let it be stated that the Argentina central government is responsible for collecting the Individuals and Corporations Income Tax, the Excise Taxes, the Value Added Tax and the Taxes on Liquid Fuels and Gas (whose yields are later subject to a revenue sharing regime with the provinces), plus export and import duties, social security taxes and the tax on financial transactions[4]; in turn, the provinces are responsible for levying the following four taxes:

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[3] In order to illustrate the point, let it be pointed out that Argentina decided in 2016 to resort to flexible exchange rates and to abandon the existing predetermined exchange rate regime. The Brazilian authorities decided for their part to discontinue in 1997 the regime of fixed exchange rates and to switch thereafter to flexible exchange rates; as of 2006, a similar decision was taken by Uruguayan economic authorities.

[4] As of the tax reform of December 2017 tax earnings, previously partially shared with provinces, are fully transferred to ANSES and finance pensions of the PAYG Regime.

Transaction Taxes, Real State or Property Taxes, Car Taxes and Stamps whereas local governments also collect their own transaction, car and property taxes.

This fiscal structure, apart from placing Argentina at the top of Latin American countries in terms of the tax burden (38% of gdp in 2016, including social security payments), still maintains the transaction tax (at the provincial and municipal level) which is by far one of main sources of fiscal inequity, due to its application ´in cascade´, its pyramidation effects on costs (as no tax credits are allowed) as well as its negative impact on exports (as the amount already paid is nonrefundable)[5]. Likewise, the mentioned national tax on financial transactions is also another source of distortions due to its heavy tax rate (1.2%) which impacts on firms´ costs and competitiveness and also deters agents from totally using the banking system, thus boosting the unregistered economy.

In respect of the Brazilian fiscal structure, the tax burden (34% including social security payments) is the second largest one in Latin America and the central government is in charge of collecting the Tax on Industrialized Goods, export and import duties, Personal and Corporation Income Tax, the Tax on Rural Estates and Taxes on Services whereas states are mainly responsible for the Taxes on Cars and Urban Property and for the so called ICMS (value added tax on goods and services) whose yield is by far the largest one when consolidated fiscal revenues (union, states, municipalities) are taken into account. Finally, local governments levy taxes on urban property and services (except those taxed by the ICMS). The Brazilian tax structure is also a source of fiscal distortions, in this case stemming from the application of VAT at the state level and due to the number of tax rates used for state and interstate operations[6] and for services which in turn prevents harmonization with the other countries where a unique VAT rate exists.

Apart from their own tax resources, and the unconditioned funds from the revenue sharing regimes, Argentine and Brazilian subnational and local governments also receive important earmarked[7] and discretionary transfers from the central government which in turn enhance states, provinces and municipalities´ capability of incurring in greater public spending. Particularly relevant to the paper´s analysis is the case of discretionary transfers to Brazilian municipalities which were in cases used to attract and subsidize industrial investment irrespective of competitiveness or technological requirements, not to mention detrimental effects caused upon alternative locations[8].

The fiscal situation is rather simpler in Paraguay and Uruguay as the political unitary feature applies also to their fiscal structure, with the main taxes under the control of the central government whereas their tax burden is lower than in the two previous cases (It reaches in Paraguay only 13.5% of GDP). As stressed above, the Paraguayan central government is responsible for collecting most of the main taxes: VAT, Corporation Income Tax, Income Tax from Small Taxpayers, Customs Duties, Selective Taxes on Consumption and Fuel Consumption, whereas the Local Tax

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[5] Let it however be pointed out that in 2017 the provinces accepted, within the framework of a comprehensive Fiscal Consensus reached with the National Government, to gradually decrease Transaction and Stamp Taxes in order to reach, within five years- an actual burden curtailment equivalent to 1.5% of GDP.

[6] Different fiscal treatments applied to operations within the states compared to interstate operations is an important source of fiscal fraud, one of whose variants is the so called *passeio da nota fiscal*.

[7] In general earmarked funds are used to defray Education, Public Health and Social Welfare spending and, in some cases, public capital formation.

[8] For Fiscal Wars in Brazil see Mattos, Rocha and Maluf Junior (2017) and De Mello (2007).

Structure mainly relies on Property Taxes and taxes on diverse municipal services. Needless to say, local governments´ ability to defray public spending is highly dependent on transfers of all kind received from the central government.

Uruguay exhibits a tax burden of about 30% (including social security taxes) but, similarly to Paraguay, revenues are basically collected by the central government under the form of VAT, Corporation and Individual Income Tax, Excise Tax, Export and Import Duties and Taxes on Assets. The central government also levies a property tax whose yield is subsequently shared with local governments. As in the three preceding cases, local governments also receive national transfers for diverse spending purposes and uses.

3.2 THE FISCAL SCENARIO IN THE EUROPEAN UNION

The empirical analysis on the possible success of the MERCOSUR - EU ongoing negotiations, as well as the correct identification of the series of variables to be resorted to in the purported econometric exercise makes it necessary that a fiscal survey of national, regional and local taxation and expenditures be carried out for the EU considering at least the case of the following countries France, Germany, Italy, Portugal, Spain and the Netherlands, selected on the basis of the greater relevance of their trade, foreign direct investment and capital flows with MERCOSUR.

Contrariwise to MERCOSUR, there is in the EU a stronger supranational framework rather than intergovernmental bodies. Member states of the EU have given prerogatives to European institutions which are not under their direct control. The EU parliament is directly and democratically elected by the citizens of the member states ever since 1979[9]. Its executive organ, the European Commission, can also be considered a supranational institution as, although its members are nominated by member states, once selected they have the freedom to act independently. Even the Council of the EU (the second legislative body of the Union), which is considered intergovernmental body because it is composed by the ministers of the member states, needs a qualified majority to make decisions instead of a unanimous agreement in an increasing number of policy spheres. This is important because a lot of the EU legislative acts which these institutions agree upon are binding for all member states, regardless of the way their representatives voted during the Council sessions. Thus the EU has become a political entity rather than a mere custom union.

The EU-28 had a GDP of more than 16,400 billion of current US dollars (IMF, WEO October 2017)[10]. Given its supranational feature, the sources of funding of the EU budget are noteworthy and listed below:

1) Custom duties from outside the EU and sugar levies.
2) Value Added Tax. A standard percentage is levied on the harmonized VAT base of each country. The VAT base to be taxed is capped at 50% of each country’s GNI;

[9] MERCOSUR also created its own Parliament which started functioning in 2007. The first representatives were nominated by the member states but, as of 2015, the election of MERCOSUR MPs was merged with the general elections. In MERCOSUR, the Parliament is not allowed to take binding decisions but, Interestingly, both EU and MERCOSUR have implemented a Regional Policy with the objective of financing the least developed regions and countries, thus trying to create more cohesion between member states.

[10] Without the UK, the EU-27 had a GDP of about 13,600 billion dollars. The euro area constitutes the bulk of the EU with a GDP of 11,900 billion dollars in 2016.

3) Own resources based on GNI. A uniform percentage is levied on each EU country's GNI. This is used to balance revenue and expenditure, i.e. to fund the part of the EU budget not funded by the other sources of income;
4) Other revenues from taxes levied on staff salaries, contributions from non-EU countries to implement certain programs, fines on companies which breached EU competition rules.

According to Eurostat[11], tax revenues (social contributions included) accounted for 39.7% of the EU-27 GDP (UK not included) in 2015 and 41.2% of the euro area's. In 2016, tax revenues plus net social contributions reached 40.4% of GDP in Germany, 42.9% in Italy, 34.1% in Spain, almost 48% in France (2015), 39.3% in the Netherlands and 36.9% in Portugal.

In Germany, the federal government and security funds collect slightly more than two thirds of the tax revenue plus social contributions, while the remaining third is collected by the *Länder* (States) and local governments. The German fiscal structure is composed of taxes whose yield directly accrues to the federal government, such as duties on mineral oil, insurance, tobacco, coffee, electricity, the Solidarity surcharge and others whose revenue is shared among the central government, the *Länder* and the local governments (Corporate Income Tax, Income Tax and Value Added Tax. The States have in turn a set of taxes of their own as the Inheritance and Gift Tax, the Real Property Transfer Tax (similar to a stamp duty whose tax base is the declared purchase amount), Motor Vehicle Taxes and Fire Protection Tax. Finally, main local governments´ taxes are the Real Property Tax and the Trade Tax (whose tax base is business earnings net of permitted allowances). There are also social employers' and employees´ contributions. The real estate taxation has a regional differentiation while the net wealth tax is not used.

In France almost 88% of the tax revenue plus net social contributions is collected by the central government and social security funds (according to 2015 figures). In this connection, the central government is responsible for the collection of the Value Added Tax, the Tax on Petroleum Products, Succession and Gift Taxes, Stamps Acts or duties and the Corporate and Personal Income Tax (the family is the tax unit in the latter), the General Social Welfare Contributions (CGS) and the Welfare Debt Repayment levy; as of 2017 taxes on wealth were abolished. With respect to local governments and authorities, direct taxation prevails over the indirect one (62.3% and 31.7% respectively) the main taxes being Professional Taxes (taxing basically the self-employed labour), the Residence Tax, to what owners, renters and occupants for free are subject and the Land Tax (*taxes fonciéres sur les propriétés bâtis et non bâtis*).

In Italy, similarly to the above mentioned cases, 86% of tax revenues and social contributions are collected by the central government and the social security funds. The four main taxes[12] levied by the central government are the Personal Income Tax[13,] (individual declaration but joint declaration possible for married people), the Corporate the Corporate Income Tax[14], the Value Added Tax (all these taxes shared with subnational governments) and Taxes on Natural Resources. Regional governments are assigned some taxes as well: the tax on motor vehicles, the Regional Business Tax, a surcharge on the national Personal Income Tax and diverse charges. Finally, local governments can levy, apart from user fees, the Property or Real State Tax

[11] http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en
[12] The high threshold of the Inheritance tax results in only a minority of the population being reached.
[13] Unlike the cases of Germany and France, there are regional and local surcharges on this tax.
[14] Professional and business incomes are also subject to a regional tax which funds regional healthcare (Imposta regionale sulle attività produttive).

allowing for municipal differentiation (the dwelling residence being exempted); it is also possible that municipalities raise a surcharge on Personal Income Tax. There is also a national real estate transfer tax whose assessment basis is the selling price as stated in the sale contract and a net wealth tax (stamp duty on bank accounts and financial assets).

In the Netherlands, the central government and security funds collect 96% of the tax revenue plus social contributions, including the Personal and Corporate Income Tax, the Value Added Tax, the Motor Vehicle Tax (this is an environmental tax), the Inheritance and Gift Tax and the Transfer Tax (paid by buyers when they purchase a property or a business) whereas local governments are in charge of municipal property taxes (allowing for regional differentiation) and of a set of user charges. Holland does not have a net wealth tax.

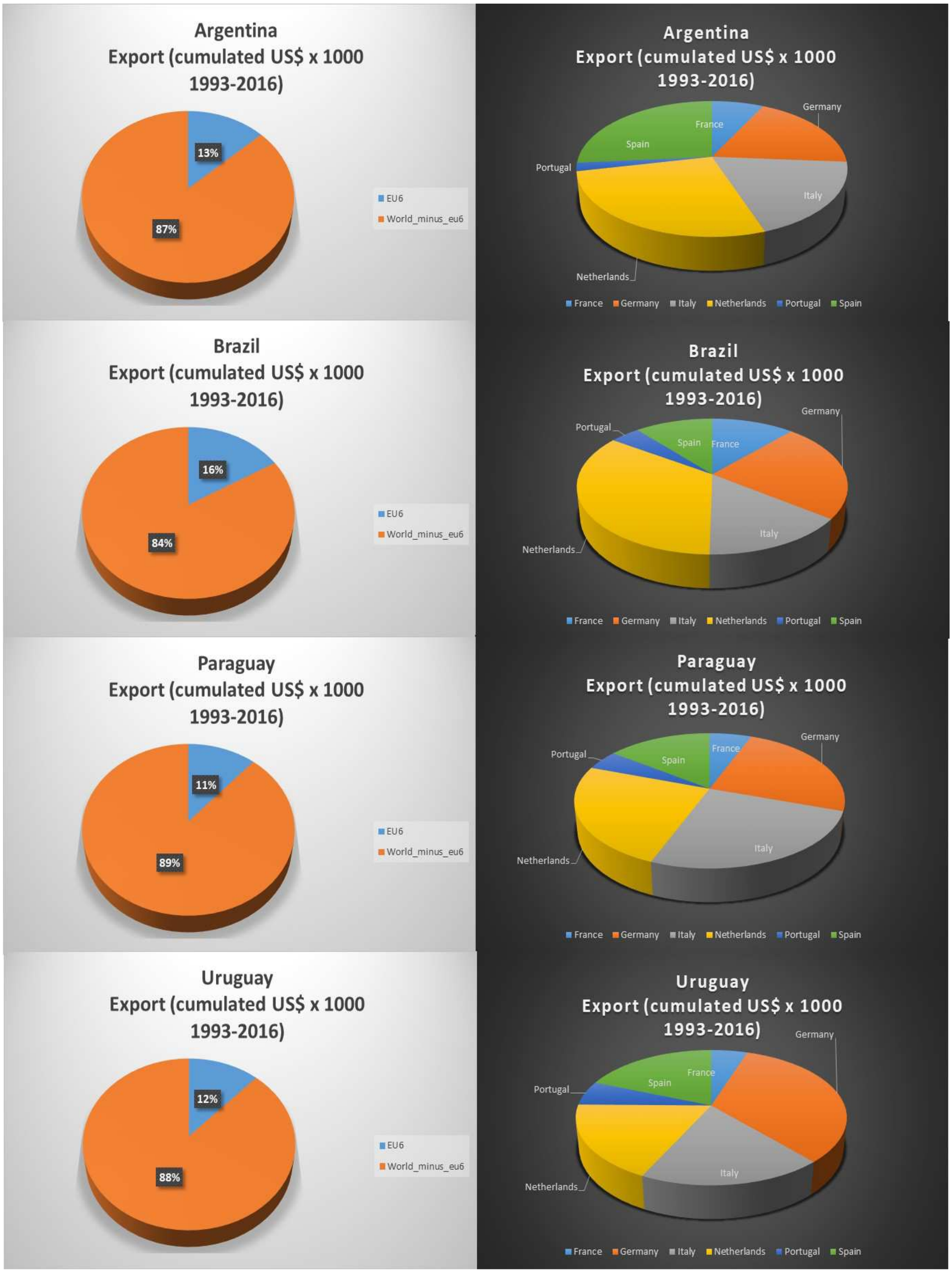
Also in Portugal, 92% of the tax revenue (social contributions included) is collected by the central government and security funds, mainly from the Personal and Corporate Income Tax and from the Value Added Tax while there is no wealth tax. Portuguese Local Governments have scarce fiscal autonomy and they heavily rely on transfers from the central government. Suffice it to say, in this connection, that local taxes, fees and user charges only account for one third of municipal revenues; let alone municipalities´ small power to manage property tax´ rates, the real estate tax has in Portugal a regional differentiation and primary dwellings are not taxed.

In Spain, about 90% of tax revenues and social contributions are collected by the central government and security funds. The Spanish fiscal history has to be considered in the light of political events that occurred after 1978 when a constitution and a constitutional political regime were established. From the fiscal viewpoint, some taxes were at the start ´ceded´ to the 17 autonomous communities, with the central government still holding some power regarding their management, until 1997 when these definitely became to be considered as communities own taxes. In sum, the Spanish fiscal structure counts with a number of taxes collected by the central government as for instance the Corporate Income Tax, the Personal Income Tax, the Value Added Tax, excise duties, the Electricity Tax and the Tax on insurance premiums (the latter five are revenues shared with the Communities). Communities also have the so called ´ceded´ and now own taxes whose collection they are responsible for: Personal Income Tax, Net Wealth Tax, the Inheritance and Gift Tax, Capital Transfer Tax (Stamp duty) , Gaming Taxes, Vehicles Excise Taxes and Hydrocarbons Retail Sale Tax. Municipalities are in turn responsible for levying the Property Tax, the Local Business Tax, the Vehicles Tax, the Tax on Increased Urban Properties Values and diverse user charges (e.g. Tax of Construction Facilities and Infrastructure). Let it be mentioned in passing that two autonomous communities (The Basque Country and Navarra) are allowed to raise their own taxes by the Constitution of 1978 (the so called *Foral* Regime).

4. THE PRESENTATION AND ANALYSIS STYLIZED FACTS

Given that the deepening of trade relations and intensified inflows of direct investments, following a successful conclusion of undergoing negotiations, rank higher among expectations of both MERCOSUR and the European Union, the graphic analysis of the performance of exports and imports (Figures 1 and 2) is a necessary exercise in so far as this sheds light over the actual trade relation during the period considered and also provides hints that can help to draw future trade policies in both parties.

FIGURE 1



Source: Own elaborations on the basis of data from WTIS database, nomenclature NACE rev 1.

In this connection, two main features are worth pointing out, suggested by the inspection of the above diagrams: In the first place, and notwithstanding that export figures are important during the period, the European Union fell short of being

Mercosur´s main trade partner; this assertion is availed by the fact that the 13% is well behind exports to Asia, let alone the relevance of intra Mercosur exports[15].

Let it however be clearly stated that the actual volume of exports from Mercosur was greater as the United Kingdom still was a full member of the EU in the period 1993-2016, let alone the fact that the above quoted ;participation does not include some minor exports to the rest of EU' countries.

In the second place, diagrams reveal that economic scale and economic diversification matter and also explain why Argentina and Brazil have stronger trade relations with the EU, compared to their partners Paraguay and Uruguay.

As for markets to what exports are directed, the analysis may not be devoid of ambiguities if one only considers what the figure 1 indicates for Germany and the Netherlands, as the following explanation intends to show: groundnut seeds, edible oil, foodstuff beef meat and biofuel exports, making up an important share of Mercosur economies, normally reach the ports of Rotterdam and Hamburg and from there other final consumption markets, for what the shares of the mentioned countries may be subject to a statistical overestimation.

Nevertheless, the possible statistical bias in favour of the two mentioned countries does not conceal the fact that Germany and the Netherlands, together with France, Italy and Spain stand as the main consumption markets to Mercosur exports.

Does Figure 2 reveal worth stressing features or distinct patterns for Mercosur imports from the UE, different to these above mentioned for exports? To begin with, diagrams below clearly show that 11.5% Mercosur´s share of EU imports is smaller than that of exports, for what the balance of trade of South American integration reached a superavit of almost 3 percent points in the period 1002-2016[16].

A second worth mentioning feature is the greater concentration of imports in the two largest Mercosur economies whose exports and imports to and from the EU respectively represented 55.6% and 67.3% in the period under analysis. This is bringing out again the role of the scale and also the fact that the more diversified economic structures of Argentina and Brazil impact in turn in their foreign demand of capital goods, spare parts and inputs for their important industrial sectors.

It deserves also to be pointed out, in the third place, the overwhelming importance of Germany as the main import origin for Argentina, Brazil and Paraguay, explained in part for the demand of German industrial firms, in the two former countries and by similar economic links with the Paraguayan agricultural sector (e.g. soybean producers). Nevertheless, trade relations with other EU economies are by no means minor, as shown by Figure 2 with relation to France and Italy, mainly explained by the motor vehicle sector whereas semi manufactured goods and Equipment prevail in imports from Spain.

In analyzing stylized facts involving foreign direct investment flows accruing to Mercosur economies, the idea is here advanced that they positively impact on Mercosur exports to the EU, as hypothesized by Equation 1 in the next section which includes FDI net inflows as an exogenous variable.

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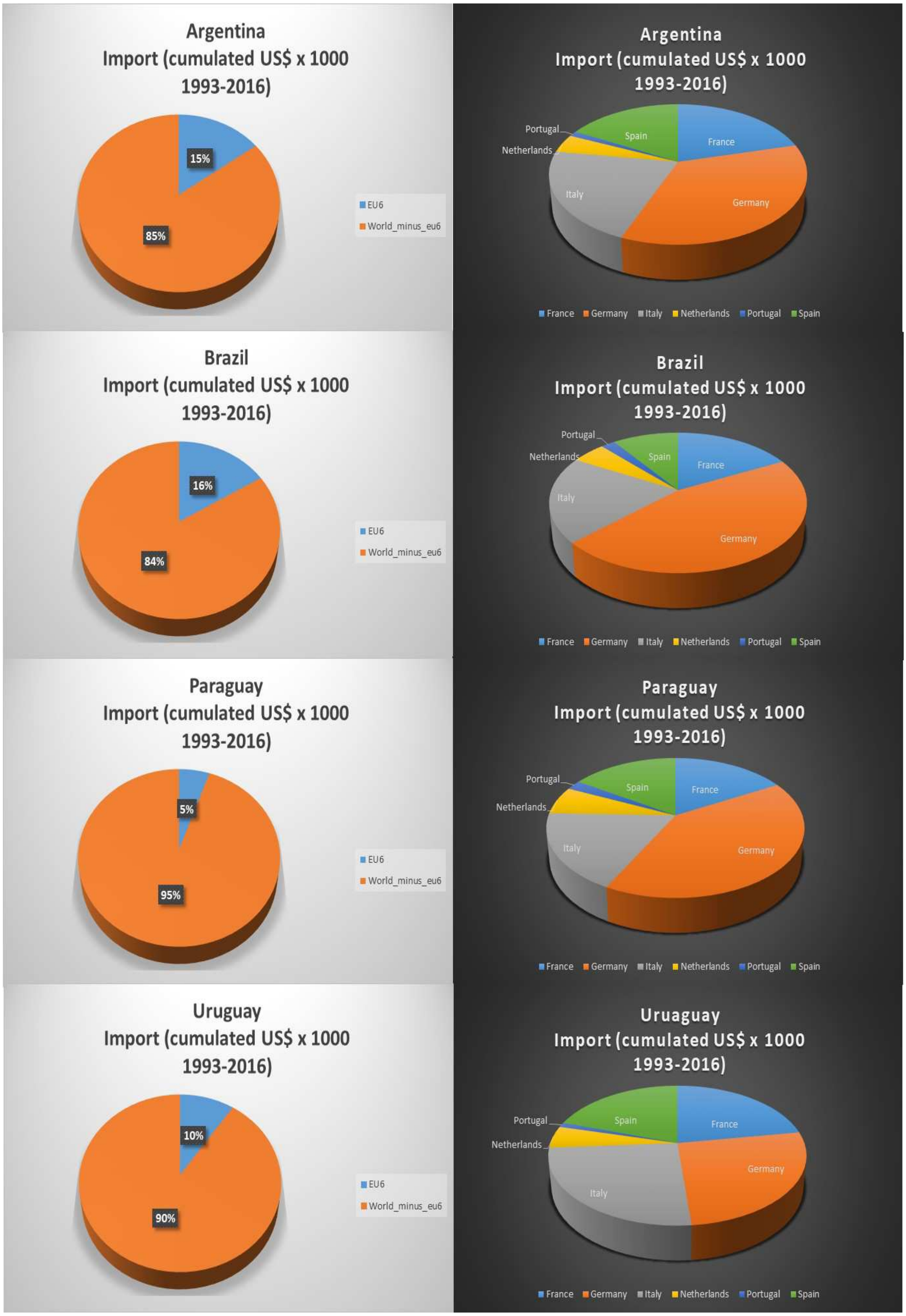
[15] Particularly between the Argentine and Brazil.

[16] Needless to say, the case of the U.K. and trade with other EU economies also apply to Mercosur´s imports.

FIGURE 2



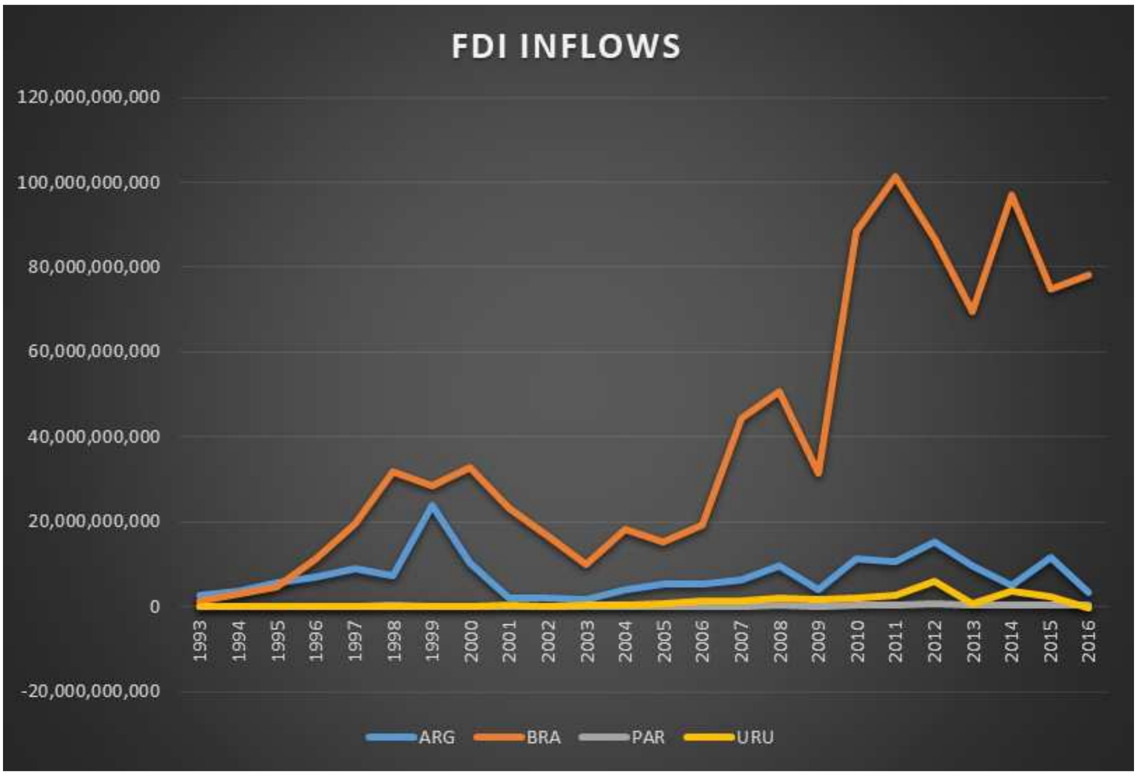
<u>Source</u>: Own elaborations on the basis of data from WTIS database, nomenclature NACE rev 1.

Needless to emphasize, the correlation between FDI and exports expressed in the preceding paragraph is by no means alien to the above carried out analysis in so far as a great proportion of European investment in Mercosur economies accrued to manufacturing sectors committed to meet the demand of abroad markets[17].

A visual inspection of the ensuing Figure 3 immediately shows the dissimilar pattern followed by constant FDI net inflows in each of countries during the period. This feature adds to the evidence that economies' size matters and to the fact that a marked cyclical behavior of FDI inflows prevailed all throughout the period considered.

The first of the above mentioned features is clearly backed by Figure 3, in which FDI inflows followed -in the Brazilian case- an increasing though cyclical trend whereas their more erratic path in Argentina included not only the cyclical behaviour but also a time span in which FDI flows first almost stagnated, slightly and temporally improved but recovered thereafter a downward tendency. In turn, the performance of FDI flows in Paraguay and Uruguay was characterized by very low and almost equal values year after year and by the lack of cyclical volatility (except for the case of Uruguay since 2011 mainly).

FIGURE 3



Source: Own elaborations on the basis of data from WTIS database.

The obvious relevance of size in Mercosur goes hand in hand with the fact that the two largest countries (Argentina and Brazil) happen also to be the two more diversified economies and, apart from their greater gross domestic products, their domestic manufacturing sectors result particularly attractive for foreign investors

[17] This mainly applies to the motor vehicle, agro industrial and foodstuff producing sectors.

seeking to participate in the benefits deriving from the enlarged supplies of countries' exportable goods[18].

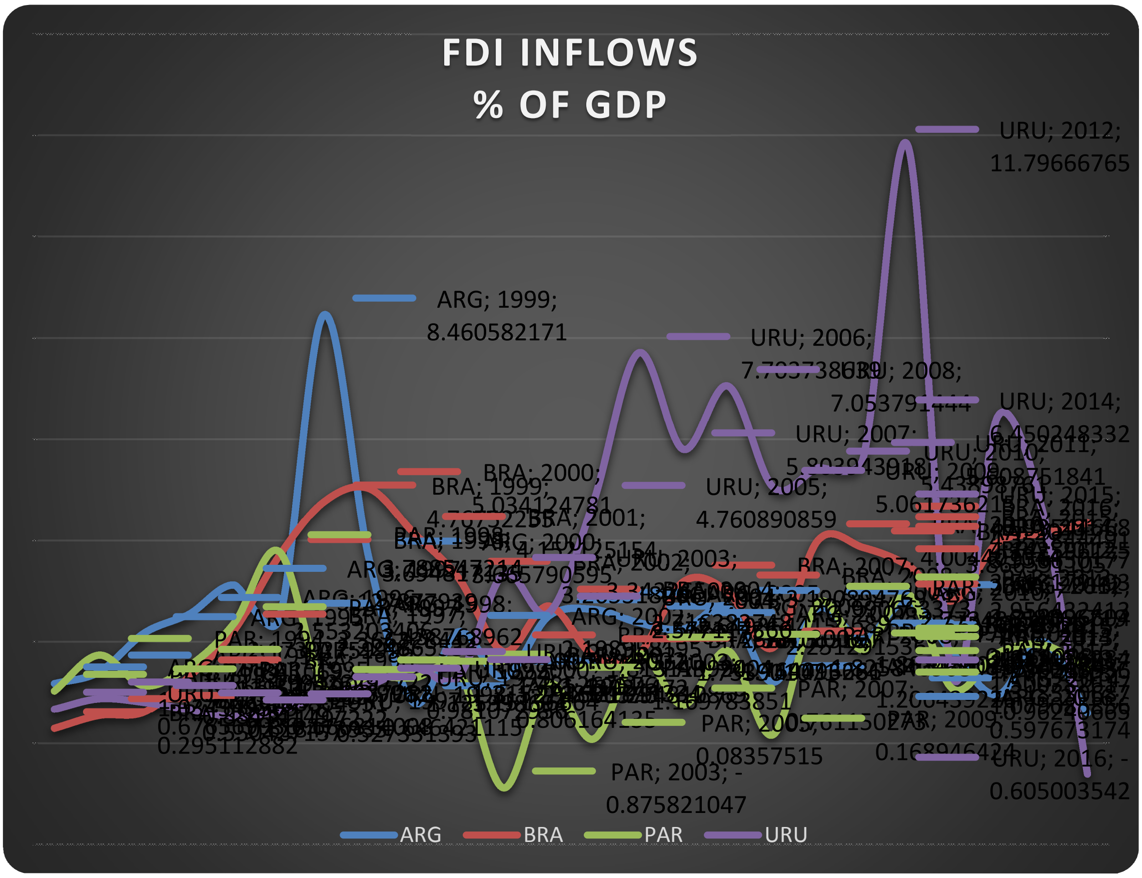
Explanations for FDI inflows' marked volatility are somehow more complex given that more than a single cause often laid behind, either independently or feeding on each other, as is shown by resorting to Figures 3 and 4. Argentina stands as a good example of what is being suggested in so far as FDI volatility responded in the period both to external and domestic situations. In this connection, Figure 3 shows that FDI flows slowly but steadily grew from 1993 through 1998, when the tendency is changed in response to the Asian crisis; after reaching a new peak in 1999, FDI flows reversed the trend following a deep domestic recession that anticipated the end of the convertibility regime and reached a trough during the 2001-2000 crisis when the country lose almost 15% of its gross domestic product. It is worth here mentioning that in the rest of the period (up to 2016) FDI inflows to Argentina practically replicate the volatile pattern of its GDP (see Figures 3 and 4) resulting from foreign crises (e.g. the developed countries crisis of 2008-2009)[19] but also from wrong domestic policies that included trade regulations, banning of benefits remittance and a total control of the exchange rate and exchange market[20].

[18] It has been already stressed in the analysis (see figure 1) the relationship between countries' level of exports and level of FDI.

[19] For the negative impact of foreign crises upon Latin American economies see Rezk and Pérez Aguila (2015).

[20] Two clear negative outcomes of the mentioned public intervention in the private sector were the marked fall of the agricultural product and exports and, in turn, the negative impact upon the balance of trade and the gross domestic product. Let it be mentioned, in passing, that the Argentine GDP, in constant terms, practically stagnated as of 2011.

FIGURE 4



Source: Own elaborations on the basis of data from WTIS database.

The pattern of FDI inflows to Brazil departed from that of Argentina at least on one important account: they kept growing during most of the period analyzed (Figure 3) and increased therefore there participation in terms of GDP (Figure 4); nevertheless, they could avoid neither sharing with its neighbour the feature nor the causes for volatility

In this connection, Keynes´ words (in a letter to Jacob Winer) may nowadays be applied to emerging economies like Argentina and Brazil when the economist said that “experience showed that what actually happened were situations for what one was unprepared…” and, this, in the case of Brazil, meant that the exposure to external shocks was excessive, As figure 3 shows, Brazil, as many other emerging economies, left behind the negative impacts of crises that took place in the last part of the twenty century and implemented pro-growth economic policies explaining in part the permanent increase of net inflows as of 2003. This pattern was abruptly interrupted, both in constant values and in terms of the GDP (Figures 3 and 4) as a consequence of the so called developed countries´ crisis of years 2008.2009 which, despite emerging economies´ solid macroeconomic fundamentals, transmitted their negative impacts via a marked reduction of world demand which in turn hit domestic manufacturing sectors in countries like Brazil and also Argentina.

Conversely to what was mentioned in the preceding paragraph, causes for the volatile pattern and reduction, both in constant value and in terms of GDP (Figures 3 and 4), of FDI inflows in the last part of the period must be sought at the persistent domestic recession affecting the Brazilian economy, as of 2014, resulting from high interest rates, an appreciation of the domestic currency, low investment rates and dwindled exporting dynamics. Let it be mentioned, in passing, that the Brazilian GDP fell around 3.8% in 2015 and the unemployment rate climbed to 11.8% in 2016[21].

5. THE ECONOMETRIC TREATMENT OF TRADE AND INVESTMENT FLOWS

In seeking to support both the surveys´ graphical and analytical conclusions and the policy recommendations, an econometric panel model is estimated encompassing the economic impact of different exchange rate regimes and of determined tax and spending tools upon exports, imports, and investment flows. The panel model seeks also to assess the likely effects of a free trade agreement (boosting not only trade but also direct investment flows) upon the economic activity of countries involved and on their populations´ welfare (identified here as macroeconomic expansion and improvement in private consumption and employment).

The panel model tentatively includes a set of endogenous and exogenous log variables given that the key feature expected to be highlighted by the econometric estimation is the sensitivity or elasticity of endogenous variables to changes in the exogenous one. As this is a two-step ongoing research, the first part to be presented at the Meeting consist on panels modeling the actual econometric impact on Mercosur countries of their economic relationship with the six mentioned European countries, for what not only trade will be considered but also performance of European net investment in Mercosur, acknowledging thus that trade and investment bear a positive impact upon economies´ growth and welfare. It is therefore important to stress that the estimation of the econometric model aims at throwing light on the role played by the fiscal instruments, the exchange regime and other variables upon the level of trade and of investment, for what lagged, endogenous, dummy and institutional variables are resorted to in the two stated equations.

As the econometric analysis extends over the period 1993-2016, statistical series for Mercosur´s exports, imports, net investment, average duties and fiscal incidence were mainly built on the basis of information from Statistical National and Provincial Offices, BADECEL/ECLAC, COMTRADE and WITS.

The possibility is also being considered of estimating incomplete panel models should annual information for a determined variable be unavailable.

Let it also be quoted that the second-step´s main empirical and econometric task will consist in assessing whether the mutual trade and economic relations would be enlarged in the light of the Agreement soon expected to be arrived at in Brussels, with information by then available relating the actual magnitude of preference margins for determined traded goods.

Following the scope and objectives quoted in section 2, and resorting to the set of above mentioned variables, the ensuing first panel model (denoted as equation 1) is computed[22]:

[21] The political unrest following President Rousseff´ s destitution should also not be underestimated as a possible source of negative signal for the economy.

[22] In their paper on the determinants of the foreign demand for Mercosur exports Jacobo and Barraud (2013) emphasized that while the aggregate level of exports reacted moderately to relative prices, their reaction with respect to trade competitors' prices was important.

$$(1)\ LX_{i,t} = \alpha_0 + \alpha_1 LX_{i,t-1} + \alpha_2 LEUGDP_{i,t-1} + \alpha_3 CGPM_{i,t-1} + \alpha_4 LFDI_{i,t-1} + \alpha_5 RE_{i,t} + \alpha_6 XFC_{i,t} + \alpha_7 EUSP_{i,t} + \alpha_8 ERR_{i,t} + \alpha_9 TT_t + \mu\, \mathrm{i,t}$$

In which Log of exports to the selected European countries **(LX)** stands as the endogenous variable, i depicting each of MERCOSUR countries, whereas .lagged, exogenous and dummy variables are in turn defined as follows:

LX_{t-1} is the log of the lagged endogenous variable.

LEUGDP stands for the (also lagged) log of selected European countries´ added GDP.

CGPM is the (lagged) ratio between capital goods and part imports over total imports, for each of MERCOSUR countries.

LFDI: is the log of constant foreign direct investment flows to each of MERCOSUR countries. In turn, we also use the variable **FDI** which stands as an alternative variable representing the ratio between constant foreign direct investment flows and gross domestic product, for each of MERCOSUR countries.

RE: Real effective exchange rate of exchange (domestic currency-euro) for each of MERCOSUR countries (source Bruegel rebased with 2005 as base year).

XFC[23]: Exports fiscal content (in percent) in the fob price of main MERCOSUR exports.

EUSP[24]**:** dummy taking value 1 for main MERCOSUR exported goods whose local production is domestically subsidized by the EU and 0 otherwise.

ERR: dummy taking value 1 when countries maintain predetermined or fixed exchange regimes and 0 otherwise.

TT: dummy taking value 1 when countries collect Export Duties and/or Transaction Taxes and 0 otherwise.

µ: stochastic term**.**

The second computed panel model includes in turn the ensuing equation:

$$(2)\ LFDI_{i,t} = \beta_0 + \beta_1 LFDI_{i,t-1} + \beta_2 GE_{i,t} + \beta_3 OPEN_{i,t} + \beta_4 RERV_{i,t} + \beta_5 PRP_{i,t} + \beta_6 + \alpha_7 IJP_{i,t}\alpha_8 + \ EDEM_{i,t}\alpha_9 \ + \ \varepsilon_{i,t}$$

in which the log of constant foreign direct investment net inflows to MERCOSUR **($LFDI_t$)** is held as the endogenous variable, i depicting each of MERCOSUR countries, whereas lagged, exogenous and institutional variables are defined below[25]:

$LFDI_{t-1}$ is the log of the lagged endogenous variable.

GE represents foreign investors´ growth expectations (in Mercosur) computed as the simple average of preceding three years´ growth rates.

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[23] XFC was not used in this preliminary version.

[24] EUSP was not used in this preliminary version.

[25] A dummy **FTT,** aimed at capturing the reaction of foreign investors to Mercosur economies´ fiscal treatment of foreign firms (in relation for instance to benefits remittance) will be included in the final formulation of Equation 2.

OPEN indicates the degree of trade opening computed as the ratio of (exports + imports)/gross domestic product, for each of MERCOSUR countries.

RERV stands for the volatility of the Real Exchange Rate, for each of MERCOSUR countries[26].

In order to assess the impact of the economic environment upon potential foreign investors, the following institutional and dummy variables are also added:

PRP is the Index of Property Rights Protection, for each of MERCOSUR countries[27]

ROL stands for the Rule of Law Index, for each of MERCOSUR countries[28].

IJP represents the Independence of the Judiciary Power, for each of MERCOSUR countries[29].

EDEM is the electoral democracy index, for each of MERCOSUR countries[30].

DEM stands for the level of Democracy, for each of MERCOSUR countries[31].

The institutional variables used were interpolated with respect to time in case of missing data. Furthermore, an analysis of pairwise correlation was conducted (available upon request) which excludes cases of perfect collinearity.

ε stands for the equation´ stochastic error.

Building on Pesaran (2006) and Chudik and Pesaran (2015) we used a panel data dynamic common correlated effects method not only to take into account the presence of the lagged dependent among the RHS explanatory variables but also a

[26] Building on Varela (2007), REER volatility is based on ARCH/GARCH models. We computed the predicted monthly variances based on the Bruegel 47 monthly REER, and took the yearly averages of those variances. Due to term significance for Argentina, a Garch (2,1) has been chosen, for Brazil an Arch(2), for Uruguay and Paraguay an Arch(1).

[27] This factor variable has been taken from the Heritage foundation (2017). It scores the degree to which a country's laws protect private property rights and the degree to which the government enforces those laws. It also accounts for the possibility that private property will be expropriated. In addition, it analyzes the independence of the judiciary, possible corruption in it, the ability of individuals and businesses to enforce contracts. The less certain the legal protection of property is and the greater the chances of government expropriation of property are, the higher a country's score is. This factor ranges from 0 to 100 where the maximum constitutes the highest degree of property rights.

[28] This variable is from the World Bank Governance Indicators and includes perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, the enforceability of contracts. The higherits value the higher the goodness of rule of law (Kaufmann et al., 2010).

[29] A dummy variable coded 1 if there is an independent judiciary based on Henisz (2002).

[30] This index is formed by taking the average of, on the one hand, the some of the indices measuring freedom of association, suffrage, clean elections, elected executive (de jure) and freedom of expression; and, on the other, the five-way interaction between those indices. This is half way between a straight average and strict multiplication, meaning the average of the two. It is thus a compromise between the two most well-known aggregation formulas in the literature, both allowing "compensation" in one sub-component for lack of polyarchy in the others, but also punishing countries not strong in one sub-component according to the "weakest link" argument. For more information and details on the aggregation of sub-components see Coppedge et al, 2017 V-dem project.

[31] This scale ranges from 0 to 10 with 0 being the least democratic and 10 the most democratic (see Freedom House, 2018 for more details).

possible unobserved common factor loading $\boldsymbol{f_t}$ and a heterogeneous common factor loading $\boldsymbol{g_i}$ such that:

$$\varepsilon_{i,t} = f_t * g_i + u_{i,t}$$

where $\boldsymbol{u_{i,t}}$ is the usual iid error term.

Indeed, there is likely to be common movements in the four Latin American countries of Mercosur. Furthermore, in the dynamic panel data model, cross sectional means of the real effective exchange rate (REER) were used to approximate the unobserved common factors linking the MERCOSUR countries; in point of fact, it is highly likely that those factors can show up in the REER movements, mainly for their economic interlinkages. In that dynamic setting, the cross sectional mean had to be added with a particular number of lags in order to achieve consistency. According to Chudik and Pesaran (2015) this number should be:

$$p_T = \sqrt[3]{T}$$

which, in the case presented, the number of lags of the REER cross-sectional means added were 3[32]. This technique also allows the researcher to control for cross-sectional dependence thus mimicking spatial econometric analysis results.

Stata´s DCCE[33] were resorted to in order to regress the panel model whereas the recourse to variables in log was intended to highlight the reaction of the endogenous variable to changes in lagged and exogenous variables given that the latter´s coefficient stood in this case for the respective elasticity[34].

The ensuing table 1 shows regression results corresponding to the estimation of equation 1´s coefficients, for what LFDI and FDI and RE and ERR were alternatively resorted to:

[32] i.e. cubic root of 24 equaling 2.88 rounded to 3.

[33] DCCE stands for Dynamic Common Correlated Effects.

[34] Safe of course if the coefficient were a ratio or a percentage, in which it would stand for the endogenous variable´s semi elasticity with respect to the endogenous variable.

TABLE 1

	Regression Equation 1	Reqression Equation 2
	b/se	b/se
Log explag1	-0.891***	-0.700***
	(0.06)	(0.16)
Log gdp EU6lag1	6.356***	7.885*
	(0.62)	(3.75)
FDI over gdp	0.044*	
	(0.02)	
log const FDI		0.072**
		(0.07)
TT	-53.004	-56.168
	(53.00)	(56.17)
REER	0.002	
	(0.00)	
ERR		-0.309***
		(0.09)
Const	-118.878**	-167.541
	(41.12)	(123.378)
CD statistic	2.49***	28.58***
R^2	0.82	0.73
N	86	77

Dependent variable: yearly export growth: * for p<.05, ** for p<.01, and *** for p<.001. Standard errors in parenthesis below coefficients.

The above table 1, exhibiting regression outcomes for specifications 1 and 2, shows that quite similar results were reached as for the lagged dependent variable, the FDIs and the EU6 GDP. For truth's sake, when the contemporaneous FDI over GDP variable was used, its positive sign was more significant than the log of constant FDI contemporaneous inflow level (p-value 0.021 versus 0.179 of the lagged correspondent, not shown in the table). Anyhow, the results show that at least the (log of the) constant contemporaneous FDI inflows[35] mainly and unsurprisingly privileged economic sectors with acknowledged export potential. Moreover, the elasticity of Mercosur exports to changes in EU6 total GDP was particularly high in the period considered. In other words, the EU6 sustained demand for imported goods seemed to have been fuelling exports flows from Mercosur.

The REER effect was found to be not statistically significant while that of the ERR (both when the log of constant FDIs and FDIs over GDP were used) was found unsurprisingly strongly negative. As for the former variable, surprising as the positive not significant coefficient might result, two possible explanations would be at hand to explain it; in the first place, Mercosur countries (except Argentina) maintained for most of the period a flexible exchange rate regime and, in the second place, an important proportion of Mercosur exports fell in the category of commodities, whose prices were determined in the main world markets. Oppositely, the ERR, i.e. the dummy variable

[35] The attempt to evaluate the effect of the FDIs first lag on Mercosur exports found negative significant statistical significance. We explain this with a sort of mean reverting mechanism at work, meaning that the positive effect of FDIs on export was limited only to the very short run.

standing for the exchange rate regime, exhibited the above mentioned significant, negative coefficient. This result would fall more in line with the received macroeconomic theory asserting that fixed exchange rate regime tend to overvalue the domestic currency and this, in turn, tends to favor imports and to discourage exports.

Also, and as broadly expected, the TT variable (duty levied on exports and domestic transaction taxes), was found to have the expected negative sign but this was not significant. It surely has a particularly negative effect on MERCOSUR exports[36], but this concerns mainly Argentina which stands as an example of what TT´s negative and significant coefficients revealed: the country´s main exports are still subject to export duties whereas the provincial tax yield mostly rests upon a variation of the classical transaction tax, well known for the so called ´cascade´ impact and ´pyramidation´ effects[37]

Finally, both the panel models accounted for a strong cross-sectional dependence, suggesting the goodness of the methodological choice which accounts for that type of dependence.

The presentation shown by the ensuing Table 2 differs from those in the preceding ones in that the variable **CGPM,** standing for the ratio between Capital goods and Part Imports and Total Imports, was now included in the equation 1, aiming at ascertaining whether exports had a better performance in Mercosur countries when imports revealed preeminence of the mentioned items with in relation to consumption goods.

The **CGPM** variable was in itself not significant for what it was not expect that the sign and size of the other coefficients to be changed much: thus, the lagged FDI over GDP showed the expected, significant and positive sign.[38] The same occurred - even more strongly- with the first lag of the log of constant FDI inflows; in this case its

[36] Its not significant and negative sign was not affected by the contemporaneous or lagged FDIs' specifications.

[37] It goes without saying that although exports are not subject to the tax, its negative impact still persists as tax rebates are not allowed for the tax amounts corresponding to the domestic stages of production, commerce and manufacturing.

[38] Its lagged levels were not found significant.

contemporaneous levels were also positively significant at 5% (not shown in table 2). The ERR showed the same negative sign as in table 1.

TABLE 2

	Regression Equation 1	Reqression Equation 2
	b/se	b/se
Log exp lag1	-0.883***	-0.568***
	(0.10)	(0.15)
Log gdp EU6 lag1	6.430***	
	(1.26)	
Log_gdp_EU6		6.442*
		(1.72)
FDI over gdp	0.044*	
	(0.02)	
Log constant FDI lag1		-0.157***
		(0.04)
TT	-70.045	-69.059
	(70.05)	(69.06)
REER	0.002	
	(0.01)	
CGPM lag1	-0.019	-0.019
	(1.90)	(0.83)
ERR		-0.380***
		(0.07)
const	-104.043***	-108.802***
	(36.63)	(52.47)
CD statistic	3.26**	6.52***
R^2	0.82	0.64
N	85	77

Dependent variable: yearly export growth: * for p<.05, ** for p<.01, and *** for p<.001. Standard errors in parenthesis below

As mentioned above, Equation 2 was drawn with the purpose of shedding light on the main determinants of Mercosur's FDI net inflows from EU's countries, resorting for this not only to economic but also to institutional variables such as countries' level of democracy, judiciary power independence, degree of democracy, private property protection and rule of law. Econometric results are presented in the ensuing Table 3 which includes in turn three alternative formulations for the Equation 2, the first of which is static while the latter two dynamic[39].

A first conclusion shown by the regressed equations is that the sign and econometric significance of coefficients of the economic variables fell short of

[39] In the chosen econometric methodology, cross sectional averages used to approximate unobserved common factors were those of the institutional variables.

being unambiguous; this was particularly true for 'openness' whose coefficients were respectively negative and positive (depending on whether the model chosen is static or dynamic), but also for the variable representing foreign investors' growth expectations 'movavggr3' although coefficients' statistical significance was much lower in this case and significant only at 10%. Again the choice of a static or a dynamic model (that is, inclusion or exclusion of the lagged dependent variable) is absolutely fundamental in this change of sign. Intriguing as it may result, as it seems to run counter the received macroeconomic theory, the negative coefficient of the variable 'openness' had somehow been anticipated in Section 4 where the feature was pointed out of an important share of FDI inflows accruing to the Argentine and Brazilian motor vehicle industry, and other industrial and manufacturing sectors, whose main consumption markets were the Mercosur area[40] itself and also associated economies such as the Chilean, Bolivian and Peruvian ones.

A second worth mentioning observation is that the volatility of the real exchange rate did not seem to have influenced too much foreign investors' behaviour during the period considered since the variable sq_h always had not significant coefficients. As surprising as the performance of economic variables may appear, the results are somehow, and indirectly, endorsing stylized facts' conclusions (see the analysis of Figures 3 and 4) in that the pattern and volatility of FDI inflows were mainly explained by domestic and external crises[41].

TABLE 3

	Regression Equation 1	Reqression Equation 2	Regression Equation 3
	b/se	b/se	b/se
log const FDI lag 1		-0.858**	-0.640**
		(0.37)	(0.32)
Mov avg gr 3 yrs	-0.838+	0.128+	0.065
	(0.45)	(0.07)	(0.27)
openness	0.101***	-0.004	-0.239**
	(0.02)	(0.04)	(0.08)
REER volatility	0.040	0.079	0.009
	(0.03)	(0.10)	(0.02)
Level of democracy	1.898		-1.43685
	(2.99)		(1.18)
Independent judiciary	1.205		1.338
	(1.21)		(1.34)
Electoral democracy index	0.287		
	(3.66)		
Property rights		0.026	0.027
		(0.08)	(0.10)
Rule of law		-1.745	
		(3.88)	
Constant	-130.89	-19.768	-47.031
	(74.2025)	(16.97)	(34.99)

[40] This favoured in turn by the markedly protectionist Mercosur Common External Tariff.
[41] Actually, the impact of economic crises is not taken in Equation 2.

CD statistic	-0.56	0.94	0.65
R^2	0.89	0.75	0.95
N	78	77	77

Dependent variable: yearly FDI growth: + for p<.10, * for p<.05, ** for p<.01, and *** for p<.001. Standard errors in parenthesis below coefficients.

Nevertheless, the most striking result shown by Table' 3 estimated regressions was the almost nil role played by the institutional variables as highlighted by their positive (except in one case) but not statistically significant coefficients[42]. In addition to the above mentioned argument that FDI inflows in part responded to investors' decision to strengthen or expanding already existing economic undertakings, the explanation for the no incidence of institutional variables may perhaps be sought at the overwhelming role that domestic and external economic crises played all throughout the period analyzed[43] (see Stylized Facts, Section 4).

Finally, the CD statistic appears not show any cross sectional dependence unlike equation 1: this result is not surprising, as FDIs' inflows decision depend not only on the receiving countries (which in the case of an economic block can behave quite similarly) but mainly on non-resident subjects. In other words, foreign investors "pick" individual opportunities in Mercosur countries thus letting researchers think of quite a rational attitude: they do not have a herd behaviour and do not clump: for them, Mercosur countries are not equal one another.

6. CONCLUSIONS

In view of the ongoing negotiations between Mercosur and the European Union, seeking to substantially advance in the fields of trade and foreign investment facilitation, the paper´s objective consisted in identifying those situations, matters and instruments that, by causing negative effects upon the bilateral relationship, would have to be revised or corrected.

The analysis of stylized facts revealed that, apart from the balance of trade superavit maintained by Mercosur throughout the period considered, the scale, economic diversification and previous integration between domestic and industrial and manufacturing sectors in the EU mainly accounted for the flow of Mercosur exports and imports. It is also important to stress the relationship found between trade and foreign direct investment, as the latter mainly accrued to Mercosur manufacturing sectors committed to meet the demand of abroad markets.

It is also worthwhile to point out that the cyclical pattern and high volatility shown by foreign direct investment inflows (mainly in Argentina and Brazil) clearly reflected their marked sensitivity and negative response to both domestic and external crises that took place during the period considered.

[42] We have already mentioned the correlation analysis performed on this indexes/factors (available upon request). Here we can add that only the correlation between rule of law and property right protection (in equation two) is quite high (0.85).

[43] A variable standing for the negative impact of external and domestic crises upon FDI inflows was not included in this preliminary estimation but will be considered in the revised version to this paper.

The two econometric panel models drawn for ascertaining the degree of responsiveness (elasticity) of both Mercosur´s exports and FDI inflows to changes in exogenous variables yielded in turn valuable results, despite the fact that most of estimations are still preliminary.

In connection with the assertion in the above paragraph, suffice it to say that apart from the clear response to changes in EU consolidated gross domestic product, Mercosur exports also confirmed the positive impact caused by changes in FDI inflows and the negative impact of fixed or predetermined exchange rate regimes[44], as the received theory asserts.

It could not however be proved, in this preliminary estimation, the impacts of capital goods and spare parts imports and of domestic harming taxation as, contrariwise to expected, coefficients were negative and no significant in the first case whereas the expected negative coefficients denoted in turn a clear situation of collinearity[45].

With respect to the estimation of the equation in which FDI inflows was the endogenous variable, results showed to be significant even though coefficient´s sign differed depending on the specific formulation chosen for the equation. That was the case for the variables respectively standing for investor´s growth expectations and the degree of trade opening, whose positive and negative coefficients resulted both statistically significant. Odd as this may appear, negative coefficients could be somehow reflecting, with respect to investors´ expectations, the up and downs of growth in Mercosur economies during the period considered whereas a negative sign for the ´degree of trade openness´ coefficient could also be reflecting the protectionist bias of the integration.

The almost nil role played by the institutional variables with respect to FDI inflows, reflected in their not statistically significant coefficients, apart from reasons that perhaps exceed the present paper´s scope, could have in part responded to investors' decision to strengthen or expanding already existing economic undertakings while, at the same time, the explanation for the no incidence may be sought at the overwhelming role that domestic and external economic crises played all throughout the period. Let it be anticipated that an, in revising the paper´s preliminary results, a specific variable standing for the effects of economic crises will be added to the equation.

Finally it is worth recalling that the results presented in this preliminary version corresponded to the already mentioned first stage of a two-step ongoing research. Apart from what already mentioned, the second stage is expected to include trade simulations once more precise advancements in Mercosur - EU negotiations be available.

[44] Needless to emphasize, it accounts for that the actual possibility of the domestic currency revaluation.

[45] As known, collinearity refers to a situation of exact linear relationship between two predictor variables.

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