THE FINE MEMO

Due Diligence, Institutional Capacity and Power Asymmetry in the EU–Mercosur Agreement

Supply Chains, Governance Capacity and Strategic Trade Governance

Thematic pole : RIDS – Relations internationales, Défense et Sécurité
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1.Executive Summary

Sustainability regulation adopted by the European Union increasingly governs global supply chains linking European markets with Mercosur agricultural production. Recent initiatives, particularly the EU Deforestation Regulation and the Corporate Sustainability Due Diligence Directive, extend regulatory obligations across transnational supply chains connecting European markets with Mercosur economies. These instruments effectively convert market access into regulatory compliance obligations systems in which traceability, risk management, and compliance monitoring become central conditions of market access.

The effectiveness of these regulatory mechanisms depends on the alignment between regulatory architecture, domestic enforcement capacity, and regulatory distance. While sustainability provisions aim to strengthen environmental governance, implementation outcomes will vary significantly across Mercosur countries due to differences in institutional capacity and economic structure.

Without coordinated implementation strategies and targeted capacity-building mechanisms, due diligence obligations risk reinforcing existing power asymmetries within agricultural supply chains rather than promoting credible sustainability governance.

Policy Thesis : As the European Union extends sustainability regulation across global supply chains, the success of the EU–Mercosur partnership will depend on aligning regulatory ambition with the uneven enforcement capacities of Mercosur member states.

2.Policy Problem

Recent EU sustainability regulations extend governance obligations across transnational supply chains linking European markets with agricultural production in Mercosur countries. However, these initiatives create a structural tension between the regulatory ambition embedded in EU sustainability governance and the heterogeneous enforcement capacities of partner economies.

This challenge can be understood as a **regulatory demand–institutional capacity gap**. As sustainability provisions expand the regulatory obligations associated with market access, domestic institutions must develop the monitoring, enforcement, and coordination mechanisms required to operationalise these commitments across complex supply chains.

While these regulatory instruments aim to strengthen environmental governance, their implementation requires institutional capacities that vary significantly across Mercosur member states. As a result, a structural tension emerges between the regulatory ambition embedded in EU sustainability governance and the heterogeneous enforcement capabilities of partner countries.

If this gap remains unaddressed, sustainability provisions risk producing fragmented implementation across supply chains and reinforcing existing power asymmetries in global agricultural markets.

At the core of this challenge lies an **alignment problem between regulatory demand and institutional capacity**. Sustainability-oriented trade governance increasingly imposes complex regulatory requirements—such as supply-chain traceability, due diligence obligations, and environmental monitoring mechanisms—on partner economies. The effectiveness of these commitments depends on the ability of domestic institutions to translate regulatory obligations into operational compliance systems.

Implementation outcomes therefore depend primarily on the alignment between **governance intensity**—the density and complexity of regulatory commitments—and **enforcement capacity**, understood as the institutional ability to monitor, investigate, and enforce these obligations across supply chains.

However, the challenges of implementation are further amplified by **regulatory distance** between EU sustainability standards and the domestic regulatory frameworks of Mercosur countries. Differences in institutional structures, monitoring infrastructures, and legal enforcement mechanisms increase the adjustments required for compliance.

Understanding these implementation risks therefore requires analysing the interaction between regulatory ambition, institutional enforcement capacity, and regulatory divergence across partner governance systems.

3.Why This Matters

The EU–Mercosur agreement represents one of the largest trade frameworks connecting European markets with South American agricultural production. Through this partnership, European consumer markets are linked to complex transnational agricultural supply chains that are increasingly governed through sustainability obligations.

Key agricultural commodities—including soy, beef, sugar, and biofuels—form the backbone of these trade relations. These commodities move through multiple stages of production, processing, and distribution before reaching European markets, creating governance challenges across geographically dispersed supply chains.

Recent EU sustainability regulations have significantly expanded the governance obligations associated with these supply chains. In particular, instruments such as the EU Deforestation Regulation and the Corporate Sustainability Due Diligence Directive extend environmental and due diligence requirements to companies operating across global production networks.

These regulatory initiatives require firms to trace the origin of commodities, assess environmental and social risks, disclose supply-chain information, and establish mechanisms to address potential violations of sustainability standards.

As a result, trade governance between the European Union and Mercosur increasingly operates through **supply-chain regulation rather than traditional tariff-based trade policy**. Market access is no longer determined solely by tariff concessions or quotas, but also by the ability of firms and producing countries to comply with complex sustainability requirements.

This shift transforms trade relations into forms of **transnational regulatory governance**, where compliance systems, monitoring infrastructures, and institutional enforcement mechanisms become central elements of international trade. These developments raise an important analytical question: how do sustainability regulations translate into effective governance across heterogeneous partner economies?

4. Key Analytical Insight

Implementation outcomes in sustainability-oriented trade governance depend on the alignment between regulatory architecture, enforcement capacity, and regulatory distance. Governance-intensive trade agreements increasingly transform market access into systems of regulatory compliance. Sustainability provisions, supply-chain traceability requirements, and corporate due diligence obligations extend regulatory authority beyond national borders and embed governance obligations directly within global production networks.

In this context, the effectiveness of sustainability-oriented trade governance depends on the relationship between regulatory ambition and the institutional capacity available to implement these commitments. Capacity building should therefore be understood not merely as financial assistance or technical cooperation, but as the strengthening of the institutional architecture required to operationalise regulatory obligations.

This institutional architecture includes several interconnected dimensions: legal mandates enabling regulatory enforcement, administrative coordination across agencies, monitoring and traceability infrastructures, sanctioning authority, and mechanisms for societal accountability. Together, these elements determine whether formal regulatory commitments can be translated into effective governance practices across supply chains.

The regulatory demand–institutional capacity gap identified above can be analysed more systematically through the interaction between three structural dimensions: regulatory architecture, enforcement capacity, and regulatory distance.

When regulatory obligations expand faster than institutional capacity, domestic governance systems may experience **implementation overload**. In such contexts, compliance risks shifting from isolated cases of non-compliance to patterns of fragmented enforcement or symbolic compliance. Capacity building therefore operates as a structural response to this imbalance, aimed at aligning regulatory commitments with the institutional capabilities required to enforce them.

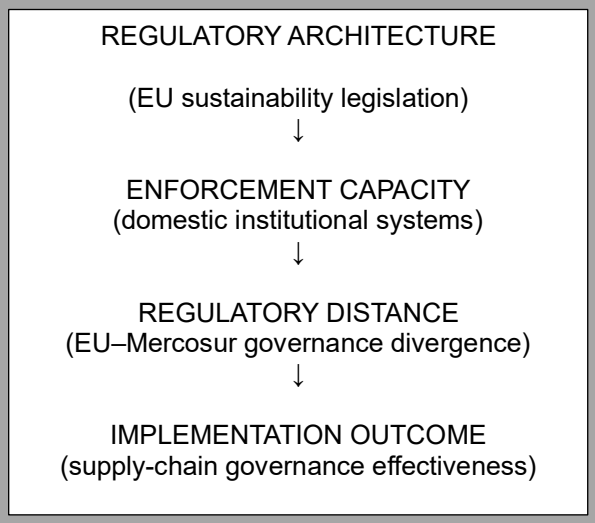
To analyse these dynamics more systematically, implementation outcomes in sustainability-oriented trade governance can be conceptualised through the interaction of three structural dimensions: **regulatory architecture**, **enforcement capacity**, and **regulatory distance**. Regulatory architecture refers to the density and operational design of regulatory commitments embedded in trade agreements and sustainability legislation. Instruments such as the EU Deforestation Regulation and the Corporate Sustainability Due Diligence Directive illustrate how EU sustainability policy increasingly relies on complex regulatory architectures extending across transnational supply chains.

Enforcement capacity captures the institutional ability of domestic governance systems to operationalise these regulatory commitments through monitoring, investigation, sanctioning, and compliance management across supply chains.

Regulatory distance refers to the degree of divergence between EU regulatory standards and the domestic governance systems of partner countries. Differences in institutional design, monitoring infrastructures, and legal enforcement mechanisms increase the adjustments required for compliance with sustainability-oriented trade governance.

The interaction between these three dimensions determines the implementation outcomes of governance-intensive trade agreements. Implementation outcomes in sustainability-oriented trade governance depend on the alignment between regulatory architecture, enforcement capacity, and regulatory distance across partner governance systems. Figure 1 illustrates the analytical framework used in this memo.

Figure 1. Sustainability Governance Implementation Model



Source: Author's conceptual framework.

Figure 1 illustrates the analytical framework used in this memo. Implementation outcomes in sustainability-oriented trade governance depend on the interaction between regulatory architecture, domestic enforcement capacity, and the regulatory distance separating EU rules from partner governance systems.

When regulatory architecture becomes highly complex while enforcement capacity remains limited and regulatory distance between governance systems is significant, implementation gaps are likely to emerge. These gaps may manifest through selective enforcement, symbolic compliance, or fragmented governance across supply chains.

Conversely, when regulatory architecture is supported by sufficient enforcement capacity and regulatory distance remains manageable, sustainability provisions can generate credible governance outcomes, including effective supply-chain monitoring and stable compliance cycles.

Within the EU–Mercosur trade relationship, this alignment challenge becomes particularly visible. While EU sustainability regulations significantly increase governance intensity across agricultural supply chains, enforcement capacity varies across Mercosur member states and regulatory distance between governance systems remains uneven. These asymmetries shape how sustainability provisions operate in practice across transnational supply chains linking Mercosur production systems with European markets.

5.Structural Asymmetries within Mercosur

These governance dynamics become particularly visible when examining the internal asymmetries within Mercosur. Mercosur member states occupy different structural positions within global agricultural supply chains, producing asymmetric responses to EU sustainability regulation.

These differences shape how sustainability-oriented trade governance is likely to be implemented across the region. Variations in economic scale, institutional capacity, and regulatory alignment with European standards create asymmetric responses to EU sustainability regulation.

These asymmetries can be understood through the analytical framework introduced above, particularly through differences in **enforcement capacity** and **regulatory distance** across Mercosur countries.

Brazil: Structural Power

Brazil occupies a structurally dominant position within Mercosur and global agricultural commodity markets. As the largest economy in the bloc and a major global exporter of soy and beef, Brazil possesses a diversified export structure and access to multiple international markets beyond the European Union.

This economic scale provides Brazil with greater strategic autonomy in responding to external regulatory pressures. While Brazil possesses relatively developed regulatory institutions in certain sectors, the regulatory distance between EU sustainability standards and domestic governance practices remains uneven. At the same time, Brazil's diversified trade relationships reduce its dependence on the European market.

As a result, Brazil's position within the EU–Mercosur relationship combines relatively significant enforcement capacity with substantial bargaining power in negotiations concerning sustainability standards and regulatory alignment.

Uruguay: Governance Responsiveness

Uruguay represents a contrasting governance profile within Mercosur. As a smaller and highly export-oriented economy, Uruguay is significantly more dependent on access to external markets, including the European Union.

At the same time, Uruguay has developed relatively advanced monitoring and traceability systems in key agricultural sectors, particularly in livestock production. These institutional features reduce regulatory distance between domestic governance structures and EU sustainability standards. In this context, sustainability regulations are less likely to be perceived as external constraints and may instead function as drivers of institutional upgrading and competitive differentiation within global supply chains.

Mercosur member states occupy different structural positions within global agricultural supply chains. These differences influence how sustainability-oriented trade governance is likely to be implemented across the region. Variations in institutional capacity, regulatory alignment with EU standards, and dependence on European markets create asymmetric responses to sustainability regulation.

The analytical framework developed in this memo highlights how these differences can be understood through two key dimensions: enforcement capacity and regulatory distance. Countries with stronger monitoring systems and lower regulatory divergence from EU standards may adapt more easily to sustainability requirements, while larger economies with greater market autonomy may experience different adjustment dynamics. Table 1 illustrates these governance profiles within Mercosur.

Table 1. Mercosur Governance Profiles

Regulatory Distance	**Low Enforcement Capacity**	**High Enforcement Capacity**
High Regulatory Distance		**Uruguay**
Low Regulatory Distance	**Brazil**	

Source: Author's analytical framework.

Table 1 illustrates the asymmetric governance profiles of Mercosur member states. Countries with stronger enforcement capacity and lower regulatory distance—such as Uruguay in specific sectors—are better positioned to adapt to EU sustainability regulation. Larger economies with greater market autonomy, such as Brazil, may experience different adjustment dynamics within global supply chains.

Implications for Mercosur Governance

These contrasting governance profiles illustrate how sustainability-oriented trade governance may generate differentiated implementation outcomes across Mercosur. Countries with stronger enforcement capacity and lower regulatory distance may adapt more rapidly to EU sustainability requirements, while larger economies with greater strategic autonomy may approach regulatory alignment more selectively.

As a result, internal asymmetries within Mercosur are likely to shape how EU sustainability regulation affects regional supply chains, influencing both the distribution of compliance costs and the evolving balance of power among agricultural producers.

Mercosur Governance Profiles

- High enforcement capacity + low regulatory distance → Uruguay
- Moderate enforcement capacity + higher strategic autonomy → Brazil

These asymmetries create distinct governance risks for agricultural supply chains operating between Mercosur and the European Union.

6. Risks for Supply Chain Governance

When complex regulatory architectures interact with uneven enforcement capacities and significant regulatory distance between governance systems, sustainability-oriented trade governance may generate unintended outcomes across global supply chains. In the context of the EU–Mercosur relationship, these dynamics create several potential governance risks.

Governance Convergence

In a favourable scenario, sustainability regulations may encourage the expansion of traceability systems and monitoring infrastructures across supply chains. Under these conditions, compliance with environmental and due diligence requirements may become a source of competitive advantage for producers able to demonstrate transparent and verifiable production practices.

This dynamic can promote gradual regulatory convergence between EU sustainability standards and domestic governance systems in partner countries.

Supply Chain Fragmentation

However, complex regulatory requirements may also generate uneven compliance costs across supply chains. Smaller producers and small and medium-sized enterprises often face greater difficulties in meeting traceability, monitoring, and reporting requirements.

If institutional support mechanisms remain limited, these actors may face barriers to accessing European markets, increasing the risk of fragmentation within agricultural supply chains.

Power Concentration

A third possible outcome concerns the consolidation of market power among large commodity exporters and multinational trading companies. Firms with greater financial resources and administrative capacity are better positioned to absorb compliance costs and implement sophisticated traceability systems.

As a result, sustainability-oriented trade governance may unintentionally reinforce existing concentration patterns within global agricultural commodity markets.

7.Policy Implications and Recommendations

The governance risks identified above highlight the importance of aligning sustainability regulation with institutional realities across partner economies. If implementation gaps persist, sustainability provisions may fail to achieve their environmental objectives while simultaneously generating unintended distortions within global agricultural supply chains.

Effective sustainability governance requires policy approaches that address regulatory distance, strengthen enforcement capacity, and improve coordination between trade and sustainability instruments. To ensure that sustainability regulation supports both environmental objectives and cooperative trade governance, EU policymakers should prioritise three strategic areas of action.

Differentiated Implementation Pathways

EU sustainability regulations should recognise the heterogeneous economic structures and institutional capacities across Mercosur member states. Uniform compliance requirements may generate disproportionate adjustment costs for smaller economies or producers with limited administrative capacity.

Developing differentiated implementation pathways can help reduce adjustment pressures while maintaining the credibility of sustainability standards.

Recommended actions

- Introduce phased compliance timelines that account for differences in institutional capacity across Mercosur countries.
- Develop sector-specific implementation guidelines tailored to different agricultural supply chains.
- Institutional Capacity Partnerships
- Effective implementation of sustainability-oriented trade governance depends on the ability of partner countries to develop monitoring systems, traceability infrastructures, and enforcement capabilities.
- Capacity building should therefore focus on strengthening the institutional foundations required to operationalise sustainability commitments across supply chains.

Recommended actions

- Support the development of digital traceability systems enabling producers to comply with EU sustainability requirements.
- Provide technical assistance programmes aimed at strengthening regulatory monitoring and enforcement mechanisms.
- Establish joint EU–Mercosur technical platforms to facilitate regulatory cooperation and information exchange.

Integrated Supply Chain Governance

Greater coordination between EU sustainability legislation and trade cooperation frameworks is necessary to avoid regulatory fragmentation and overlapping compliance obligations. Integrating trade and sustainability governance instruments can help ensure that environmental objectives are pursued alongside stable trade relations.

Recommended actions

- Align EU due diligence regulations with trade cooperation frameworks within the EU–Mercosur agreement.
- Establish EU–Mercosur regulatory cooperation platforms to coordinate monitoring standards and supply-chain governance practices.

8.Strategic Conclusion

Sustainability regulation increasingly structures trade governance between the European Union and Mercosur by extending regulatory authority across global supply chains. Through due diligence obligations and traceability requirements, market access increasingly depends not only on tariff conditions but also on the capacity of partner economies to comply with complex governance frameworks.

The effectiveness of these regulatory instruments ultimately depends on the alignment between regulatory architecture, domestic enforcement capacity, and the regulatory distance separating governance systems. Where these dimensions remain misaligned, sustainability provisions risk generating fragmented implementation and reinforcing existing asymmetries within agricultural supply chains.

Ensuring credible sustainability governance will therefore require policy approaches that combine regulatory ambition with institutional cooperation. Addressing capacity gaps and internal asymmetries within Mercosur will be critical to transforming sustainability regulation from a source of compliance pressure into a driver of stable and equitable supply-chain governance.

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