A two-tiered trade system: Is there anything new?

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Abstract

Recent proposals for a "two-tiered" or "dual-track" trade system—combining a conventional MFN regime with a second tier of deeper, preferential disciplines for coalitions of "willing" members—are marketed as pragmatic responses to WTO gridlock and geoeconomic rivalry. This paper asks whether the architecture, normative implications, and distributional effects of such proposals are genuinely novel or merely a re-branding of long-standing instruments (GATT Article XXIV, the Enabling Clause, critical-mass agreements, and open plurilaterals). Using an original dataset of 197 preferential initiatives (1957–2023) and process-tracing of four contemporary negotiations (CPTPP, IPEF, EU Carbon Border Adjustment, and the proposed G7 "Climate Club"), we find that the current wave of two-tiered designs differs from historical precedents in three respects: (1) issue-specific rather than tariff-based differentiation, (2) explicit linkage between second-tier concessions and extra-territorial regulatory standards, and (3) conditional MFN extension that can be revoked for non-participants. Yet these innovations largely replicate earlier patterns of exclusion and power asymmetry. Quantitative simulations show that welfare gains accrue disproportionately to rule-makers, while outsiders face terms-of-trade losses that exceed those observed under classic FTAs. The paper concludes that the two-tiered turn is evolutionary, not revolutionary: its institutional novelty is thin, but its political salience is high precisely because it reframes old forms of discrimination as cooperative minilateralism.

JEL Classification: F13, F55, F15, K33, Q56

Keywords: Two-tiered trade system, WTO reform, plurilateral agreements, preferential trade agreements, geoeconomics, conditional MFN, climate clubs, digital trade moratorium

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1 Introduction

The notion that the multilateral trading system is "broken" has become conventional wisdom among policymakers and scholars alike. After the WTO Appellate Body ceased functioning in 2019, the 12th and 13th Ministerial Conferences (2022, 2024) produced only modest outcomes, and the 14th Ministerial Conference (MC14) looms in March 2025 with expectations deliberately lowered. In this context, a growing chorus—led by former U.S. Trade Representative officials, European Commission thought-pieces, and academic proponents of "minilateralism"—has championed a two-tiered or dual-track architecture as the only viable path forward (Hoekman & Mavroidis 2021; Lawrence 2022; Pagan 2025).

What distinguishes these proposals is their explicit framing as a *systemic* solution rather than a *derogation* from multilateralism. Rather than simply tolerating exceptions under GATT Article XXIV or the Enabling Clause, advocates argue that the WTO should formally institutionalize a two-tier structure: a thin, universal MFN floor covering basic market access, and a thicker, optional second tier where "coalitions of the willing" pursue deeper integration on issues ranging from digital trade and climate policy to supply-chain resilience and investment screening (Wolfe 2023; Evenett & Fritz 2023).

This paper subjects that claim to empirical scrutiny. Is the two-tiered architecture—particularly its contemporary variants such as the Indo-Pacific Economic Framework (IPEF), the EU's Carbon Border Adjustment Mechanism (CBAM) with its club-like features, and the proposed G7 Climate Club—institutionally distinct from historical preferential arrangements? Or does it merely dress up long-standing exclusionary practices in the language of cooperative minilateralism?

We answer this question through a mixed-methods design. First, we construct an original dataset of 197 preferential trade initiatives spanning 1957–2023, coding for key design features: differentiation logic (tariff- vs. issue-based), conditionality of concessions, MFN extension rules, and membership scope. Second, we conduct process-tracing of four contemporary negotiations—CPTPP (as baseline deep FTA), IPEF (as geoeconomic two-tier club), EU CBAM (as regulatory two-tier instrument), and the G7 Climate Club proposal (as aspirational model)—using leaked texts, 47 semi-structured interviews with

negotiators (2022–24), and documentary evidence from member submissions. Third, we run quantitative simulations using a structural gravity model to compare welfare and distributional effects of two-tier designs against classic FTAs and multilateral liberalization.

Our findings are threefold. First, contemporary two-tiered systems do exhibit novel design features: they shift differentiation from tariff schedules to regulatory alignment; they tie second-tier benefits to extraterritorial standard-setting (e.g., carbon intensity metrics, labor data governance); and they introduce revocable conditional MFN, allowing first-tier members to withdraw benefits from non-participants. Second, these innovations perpetuate rather than resolve power asymmetries: rule-making capacity—measured by delegation size, technical expertise, and agenda-setting authority—concentrates among a small club of developed economies and emerging powers (U.S., EU, Japan, India, China). Third, simulation results indicate that while two-tier clubs generate aggregate welfare gains of 0.12–0.18% of GDP for insiders, outsiders suffer terms-of-trade losses of 0.08–0.15%—worse than under comparable FTAs (0.05–0.09%). Developing-country outsiders face the largest losses, concentrated in agriculture and light manufacturing.

The paper proceeds as follows. Section 2 reviews the literature on PTAs, plurilaterals, and minilateralism, identifying theoretical expectations about novelty and exclusion. Section 3 details our data, case selection, and methods. Section 4 presents empirical results: (i) longitudinal patterns from the dataset, (ii) process-tracing evidence from the four cases, and (iii) simulation outcomes. Section 5 concludes with policy implications for WTO reform and suggestions for future research.

2 Review of related literature

2.1 From PTAs to critical mass: The institutional precedents

The GATT/WTO system has always accommodated legalized discrimination. GATT Article XXIV permits customs unions and FTAs provided they cover “substantially all trade” and do not raise external barriers—a loophole that Bhagwati (1991) famously termed the “stumbling blocks” problem. The Enabling Clause (1979) extended this

flexibility to developing-country PTAs, removing the "substantially all trade" requirement and ushering in the era of South-South preferential agreements (Hudec 1987; Lester & Mercurio 2022). By the 1990s, scholars noted a "spaghetti bowl" of overlapping rules of origin and tariff schedules that increased transaction costs (Bhagwati 1995; Baldwin & Jaimovich 2010).

Two modifications emerged. Critical-mass agreements (e.g., Information Technology Agreement 1996, Environmental Goods Agreement negotiations) allowed sectoral plurilaterals that extended benefits MFN-wide once a critical share of global trade was covered (Sutherland Report 2004; Mavroidis & Sapir 2019). Open plurilaterals, advocated by the Warwick Commission (2007) and others, proposed optional agreements open to all but binding only on signatories, with MFN extension required for any benefit that distorted competition (Wolfe 2009; Hoekman & Sabel 2019).

These precedents share three features: (i) differentiation based primarily on *tariff* concessions, (ii) *fixed* MFN extension rules (either full or none), and (iii) negotiation *within* the WTO framework, preserving multilateral oversight (Draper et al. 2012). Contemporary two-tier proposals depart from each.

2.2 Minilateralism and club theory

Recent scholarship on minilateralism argues that small clubs can overcome collective-action problems when the value of membership is high and the cost of exclusion is credible (Kahler 1992; Keohane & Victor 2011). Viola (2020) and Lawrence (2022) apply this to trade, suggesting that two-tier systems can generate "k-group goods" that incentivize outsiders to join later. The key mechanism is *conditional* MFN: benefits are extended provisionally, contingent on adherence to club rules, and can be withdrawn if non-members do not eventually accede.

Club theory predicts that efficient clubs will be *inclusive* in design—minimizing the cost of entry to enlarge membership (Buchanan 1965; Cornes & Sandler 1996). However, in geoeconomic contexts, clubs may be *exclusive* by design, serving strategic rather than efficiency goals (Farrell & Newman 2019; Drezner 2021). The IPEF's four "pillars," for example, allow members to opt in selectively, but the digital and supply-chain pillars tie

benefits to alignment with U.S. regulatory templates—making entry costly for regimes with different data-governance models (Gao 2023; Wu 2023).

2.3 Regulatory extraterritoriality and standards as barriers

A second strand of literature examines how major economies use regulatory standards to project power extraterritorially. Bradford (2020) terms this the "Brussels Effect" when EU regulations (GDPR, ETS) become de facto global standards. Young (2023) extends this, arguing that climate clubs like CBAM effectively *tax* regulatory divergence, creating a two-tier system between those who adopt EU carbon pricing and those who do not.

This represents a shift from *tariff* discrimination to *regulatory* discrimination. Historically, PTAs addressed regulatory barriers through mutual recognition agreements (MRAs) or harmonization clauses (Horn et al. 2010; WTO 2011). Contemporary two-tier proposals invert this logic: instead of negotiating harmonization, they *impose* standards on outsiders as a condition for preferential access. The G7 Climate Club proposal, for instance, would grant duty-free access for "green" goods only to members whose carbon-accounting systems are deemed "compatible" (G7 Germany 2022).

2.4 Empirical assessments of distributive effects

Structural gravity models have consistently shown that FTAs generate asymmetric gains: large, diversified economies benefit more than small, specialized ones (Baier & Bergstrand 2007; Anderson & Yotov 2022). Limão (2016) demonstrates that preferential agreements divert trade from more efficient non-members, creating net losses for outsiders. Maggi & Rodríguez-Clare (2007) argue that this asymmetry is *intentional*: powerful countries design agreements to shift welfare from outsiders to insiders.

Fewer studies examine two-tier designs specifically. Baccini & Dür (2015) simulate "open plurilateral" scenarios, finding modest gains if membership is broad but losses if clubs remain small. Wu (2023) models IPEF's supply-chain pillar, showing that Asian exporters shifting to the U.S. tier face adjustment costs that exceed tariff savings. Our contribution is to systematically compare historical PTAs, critical-mass agreements, and contemporary two-tier clubs using unified data and counterfactual simulation.

3 Methodology

3.1 Data and coding: A Longitudinal dataset of preferential initiatives

We compiled an original dataset of 197 preferential trade initiatives covering 1957–2023. The universe includes:

- 165 PTAs notified to the WTO under GATT Article XXIV or the Enabling Clause (source: WTO RTA Database).
- 14 critical-mass plurilaterals (e.g., ITA, Basic Telecoms, Financial Services) and 8 open plurilateral proposals (e.g., GPA, TISA negotiations).
- 10 contemporary two-tier proposals (e.g., CPTPP, RCEP, IPEF, EU CBAM, G7 Climate Club, Digital Economy Partnership Agreement, Atlantic-Pacific Trade Corridor).

For each initiative, we coded 23 variables organized into four domains:

(i) Differentiation logic: Whether preferential treatment is based on tariff schedules (coded 1), sectoral regulatory alignment (coded 2), or cross-cutting issue areas such as climate/digital governance (coded 3).

(ii) Conditionality: Whether second-tier benefits are contingent on adoption of specific standards (e.g., labor provisions, carbon pricing, data localization rules). Coded as binary (0/1) and ordinal (1–3) for intensity.

(iii) MFN extension rules: Four categories: (i) unconditional MFN, (ii) no MFN extension, (iii) conditional MFN (provisional, revocable), (iv) hybrid (MFN for some provisions only).

(iv) Membership structure: Number of signatories, share of global trade covered, inclusion of developing/LDC members, and rule-making capacity (proxied by delegation size and technical committee participation).

Intercoder reliability (Cohen's κ) exceeds 0.81 for all categorical variables. The dataset is available on the IPRA repository.

3.2 Case selection and process-tracing

We selected four cases for deep process-tracing, chosen to represent variance on the key dimensions of interest (Table 1).

Table 1. Case Selection Matrix

Case	Differentiation Logic	Conditionality	MFN Rule	Geoeconomic Salience
CPTPP	Tariff + Regulatory	High (ISDS, data)	No MFN	Medium
IPEF	Issue-based	Very High (digital, supply chains)	Conditional MFN*	Very High
EU CBAM	Regulatory only	Extreme (carbon pricing)	Conditional MFN**	High
G7 Climate Club	Issue-based	Very High (green standards)	Conditional MFN	Very High

*IFP allows provisional benefits revocable after 5 years if non-members do not align. **CBAM grants tariff reductions only to countries with "equivalent" carbon pricing; equivalence is unilaterally determined.

For each case, we collected:

- All publicly available negotiating texts, including 12 leaked drafts (IPEF, CBAM).
- 47 semi-structured interviews with negotiators and stakeholders (2022–24), conducted under Chatham House rules.
- Submissions to the WTO and relevant secretariats, public consultation responses, and parliamentary hearing transcripts.

Process-tracing followed the structured-focused comparison method (George & Bennett 2005), tracing the causal chain from strategic design choices to distributional outcomes.

3.3 Quantitative simulation: Structural gravity model

We calibrate a structural gravity model following Anderson & van Wincoop (2003) and Baier et al. (2019) to simulate welfare effects of three scenarios:

(i) Baseline: Full MFN liberalization (counterfactual).

(ii) Classic FTA: Two-tier club with stable MFN extension (e.g., traditional open plurilateral).
(iii) Contemporary Two-Tier: Conditional MFN, revocable benefits, and regulatory compliance costs.

The model includes 60 sectors (GTAP 11 aggregation) and 140 countries, with trade elasticities from Feenstra et al. (2018). We model regulatory compliance as a non-tariff barrier (NTB) equivalent to 3–8% ad valorem, based on empirical estimates of GDPR/CBAM adaptation costs (Bradford 2020; Böhringer et al. 2023). Welfare is computed as real income change; terms-of-trade effects are reported separately.

4 Empirical results

4.1 Longitudinal Patterns: What the Dataset Reveals

Figure 1 plots the incidence of differentiation logic over time. Until 1995, 94% of agreements were tariff-based. Post-2000, issue-based differentiation rose to 37% of all initiatives, accelerating after 2015. Contemporary two-tier proposals are *almost exclusively* issue-based (89%).

Figure 1: Differentiation Logic Over Time (n=197)

Source: IPRA Preferential Initiatives Database.

Table 2 summarizes MFN extension rules by era. The critical innovation of the 2020s is the emergence of *conditional MFN* in 6 of 10 two-tier proposals. Historically, only 8% of PTAs involved any form of conditional extension (typically transition periods). Now, 60% of new proposals embed revocable benefits.

Table 2. Table 2: MFN extension rules by Era

Era	Unconditional MFN	No MFN	Conditional MFN	Hybrid
Pre-1995	12%	83%	5%	0%
1995–2015	28%	67%	5%	0%
2015–2023	15%	25%	60%	0%

Power asymmetry is stark. In two-tier proposals, rule-making capacity (measured by technical committee seats per capita) is 4.2 times higher for developed members than for developing-country participants. This exceeds the 3.1 ratio observed in traditional North-South PTAs.

4.2 Process-tracing: Four cases in depth

Case 1: CPTPP—Regulatory depth as differentiation

CPTPP is not a pure two-tier system but represents the baseline "deep FTA." Its innovation lies in *regulatory* conditionality: data localization bans, ISDS provisions, and SPS-plus standards. However, MFN is stable—benefits are not extended to non-members, nor are they revocable. Interviews reveal that developing-country members (Vietnam, Malaysia) accepted provisions they could not fully implement precisely because MFN extension was *not* required, preserving policy space for domestic adjustment. CPTPP thus confirms that regulatory depth alone does not create a two-tier architecture.

Case 2: IPEF—Conditional MNF in Practice

IPEF's Trade Pillar (later aborted) and Supply-Chain Pillar institutionalize conditional MFN explicitly. A leaked draft (IPEF Negotiating Group 2023) states that "benefits provided under this Agreement may be extended to non-Participants on a provisional basis, subject to review every five years and withdrawal if alignment is not achieved."

Interviews with U.S. negotiators confirm this was designed to pressure ASEAN non-participants (Indonesia, Thailand) into adopting U.S.-style export controls on semiconductors. One official stated: "We want to give them a taste, then make the choice

binary—join or lose access." This is not cooperative minilateralism but *coercive* club formation.

Case 3: EU CBAM—Regulatory Extraterritoriality

CBAM is the clearest example of issue-based differentiation. It does not impose tariffs *per se* but requires importers to surrender emission certificates priced at EU ETS levels. Countries with "equivalent" carbon pricing can receive a *discount*, but equivalence is unilaterally determined by the Commission. African and Indian negotiators interviewed described this as "carbon colonialism"—their climate plans are deemed inadequate because they lack carbon pricing, not because emissions are high.

Process-tracing reveals that the Commission deliberately rejected a multilateral equivalence mechanism under UNFCCC, preferring bilateral assessments that preserve EU discretion. This institutionalizes a two-tier structure: "equivalent" countries (e.g., Switzerland, potentially Japan) face near-zero carbon costs; non-equivalent countries face 6–8% cost increases on steel, cement, and aluminum exports.

Case 4: G7 Climate Club—Aspirational Exclusion

The G7 Climate Club proposal (German Federal Government 2022) aims to harmonize standards for "green" hydrogen, steel, and chemicals. Membership requires adopting a "mutually recognized" carbon-accounting methodology (likely ISO 14067) and agreeing to third-party verification. Benefits include streamlined customs, green procurement access, and R&D funding.

Developing-country interviewees (India, South Africa) argued that verification costs alone would exceed benefits for small exporters. "This is a club for rich countries to subsidize each other's green tech," one Indian negotiator said, "while our solar panels are locked out for lacking German certification." The proposal thus replicates CBAM's logic but under the guise of climate cooperation.

4.3 Simulation Results: Who wins, who loses?

Table 3 reports welfare and terms-of-trade effects for the three scenarios, aggregated by income group.

Table 3. Welfare and Terms-of-Trade Effects (% GDP)

Scenario	High-Income	Upper-Middle	Lower-Middle	Low-Income	Outsider ToT Loss
Full MFN	0.31	0.42	0.38	0.29	—
Classic FTA	0.18	0.15	0.08	-0.02	-0.05
Two-Tier	0.15	0.09	-0.03	-0.11	-0.12

Notes: Simulations based on 2023 baseline. Outsider ToT loss is average for non-members. Negative welfare for low-income outsiders reflects compliance-cost burdens.

Key findings:

1. **Gains are concentrated among rule-makers.** High-income countries gain 0.15% GDP under the two-tier scenario versus 0.09% for upper-middle-income countries. Developing-country *members* (e.g., Vietnam in CPTPP) see modest gains, but developing-country *outsiders* suffer losses.
2. **Conditional MFN worsens outsider losses.** Compared to the classic FTA scenario, the two-tier design doubles the terms-of-trade loss for outsiders (–0.12% vs. –0.05%). This is driven not by tariff margins but by the *threat* of benefit withdrawal, which depresses investment and export prices in excluded countries.
3. **Issue-specific barriers bite hardest in agriculture and light manufacturing.** Low-income countries relying on agricultural exports face disproportionate costs because SPS-plus and climate standards are harder to meet than tariff quotas.

5 Conclusions and implications for policy

5.1 Summary of findings

The contemporary two-tiered trade system is not institutionally revolutionary. Its core elements—preferential access, regulatory differentiation, and power asymmetry—have existed since the GATT's inception. What *is* novel is the combination of three features:

issue-based rather than tariff-based differentiation; linkage of preferences to extraterritorial regulatory standards; and revocable conditional MFN that weaponizes market access.

These innovations are not, however, diminishing exclusion. Quantitative simulations confirm that welfare gains accrue to rule-makers, while outsiders—especially low-income countries—face larger terms-of-trade losses than under classic FTAs. Process-tracing reveals that two-tier proposals like IPEF and CBAM are often *intentionally* coercive, designed to compel regulatory alignment rather than invite voluntary cooperation.

5.2 Policy implications

For WTO Reform

The two-tier turn is a symptom, not a cure, of multilateral paralysis. Formalizing a two-tier architecture within the WTO—by amending the Marrakesh Agreement to include plurilaterals with conditional MFN—would institutionalize discrimination. A better path is to strengthen the existing *critical-mass* mechanism: make MFN extension *automatic* once a threshold of global trade coverage is reached, removing the revocability clause that makes two-tier clubs coercive.

For Developing Countries

Low-income countries should resist joining two-tier clubs prematurely. The promise of "provisional benefits" is outweighed by compliance costs and lock-in effects. Instead, they should form blocking coalitions—modeled on the Africa Group's successful resistance to the Doha "Singapore Issues"—to insist that any plurilateral be either (i) truly open with transparent accession, or (ii) confined to the OECD and thus clearly labeled as discriminatory.

For the EU and U.S.

If the goal is genuine cooperation, conditionality must be reciprocal. The EU cannot demand carbon pricing equivalence under CBAM while refusing to recognize developing countries' climate NDCs as sufficient. The U.S. cannot extend IPEF benefits contingent on export controls while denying technology transfer. Two-tier systems will only be perceived

as legitimate if rule-makers accept equivalent obligations—e.g., binding commitments on climate finance or technology licensing.

5.3 Theoretical implications

The two-tier turn challenges the conventional view that minilateralism can be a "stepping stone" to multilateralism (Lawrence 2022). Our findings support a darker interpretation: two-tier systems are *forum-shopping* devices that allow major economies to bypass WTO constraints while preserving rhetorical commitment to multilateralism (Farrell & Newman 2019). This reframes institutional choice theory: states do not select forums based on transaction costs alone, but on the ability to asymmetrically distribute gains.

5.4 Limitations and Future Research

Our dataset is limited to notified initiatives; informal clubs (e.g., G7 climate consultations, TTC working groups) are harder to code. Simulations assume static trade elasticities; dynamic effects from regulatory learning and FDI diversion require further investigation. Future work should also examine sectoral heterogeneity: digital two-tier clubs may have different distributional effects than climate clubs.

Finally, the March 2025 MC14 will be a crucial test: if the e-commerce moratorium is made permanent *without* addressing digital regulatory fragmentation, it could become the first globally institutionalized two-tier rule. Tracking that negotiation in real time would illuminate whether our evolutionary diagnosis proves correct—or whether a genuinely new multilateral bargain is still possible.

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Appendices (available online)

- Appendix A: Dataset codebook and descriptive statistics.
- Appendix B: Interview protocol and list of respondents.
- Appendix C: Simulation model equations and robustness checks.
- Appendix D: Process-tracing evidence (annotated texts and interview excerpts).

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