European and External Relations Committee

Types of trade agreement

Briefing paper by Professor Michael Keating

Free Trade Area

A free trade area is a group of countries that have agreed to abolish tariffs on trade. Non-tariff barriers may remain in the form of product standards. Many free trade agreements exclude agriculture. Abolition of tariffs is not usually relevant to trade in services because they are not normally subject to tariffs in the first place. Instead, there are non-tariff barriers including the right to offer services in other countries and professional qualifications. Most free trade agreements do not address these barriers and thus do not include free trade in services, although recently there have been moves to include services, for example in the CETA agreement with Canada.

Single Market

The European Union represents a unique example of a single market agreement although some other areas have adopted some of its features. The single market involves the removal of barriers to the free movement of goods, services, capital and workers. This includes harmonization of product standards, or mutual recognition so that products meeting home standards are deemed to have met the standard everywhere in the EU. The EU single market is not yet complete, but there is a commitment (strongly supported by successive UK governments) to completing it, especially in services. The four freedoms of the single market are deemed to be inseparable in order to ensure a level playing field. Freedom of movement of workers is also important in facilitating free movement in services. There are also rules about state aid, competition, public procurement and other fields.

There has been some debate distinguishing ‘access’ to the single market from ‘membership’. This has become quite misleading. Any country can access the EU market in the sense of exporting goods there, subject to tariffs and other obstacles to trade. Only the member states of the EU are ‘members’ in the sense of owning the institutions and participating in making the rules.

There is only one exception, which allows non-EU members to enjoy the same terms as EU member states in the single market. This is the European Economic Area (EEA), which includes the three countries of the European Free Trade Area (EFTA) – Norway, Iceland and Lichtenstein. The condition for this is that they accept the four freedoms and also the various single market regulations, but without a vote in the making of those regulations. There is no provision for opting out of parts of the single market, with the exception of agriculture and fisheries, which are not covered. A bilateral agreement (in the form of some 120 treaties) between the EU and Switzerland includes some of the single market terms but does not cover financial services. It also obliges Switzerland to accept the free movement of works, a matter on which it is currently in dispute with the EU.

Customs Union

In a customs union, not only are tariffs between the member states abolished, but there is a common external tariff. The EU is a customs union. This means that goods imported into any state of the union can then circulate freely without further controls. That includes raw materials and components that are imported from third countries and used in the assembly of finished products which are then exported to other member countries. Member states of a customs union cannot negotiate their own trade deals with third countries, since there can only be one tariff regime.

EFTA is not a customs union nor, by extension, is the EEA. This means products assembled in the three EEA countries from raw materials and components coming from outside the EEA, which are then exported on to other EEA states (including the EU), are subject to rules of origin. Rules of origin determine how much of the product was made within the EEA and how much imported, to decide what tariffs are due. Applying these rules is costly to business and governments, and requires the scrutiny of trade.

Countries in a free trade area that is not a customs union can negotiate their own trade deals with third countries since they control their own external tariffs. EFTA negotiates trade deals, as do its individual members. This, however, creates further complexity as all the various regulations and rules or origin have to be reconciled. This has proved particularly problematic in industries, like the automotive sector, with global production chains. Rules of origin can themselves be relatively liberal or highly restrictive.

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