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A Review of the Development of Fundamental Theories of International Trade and Trade Policy Instruments

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Abstract. Under the circumstances of global trade patterns adjustment, the rise of trade protectionism and the reconfiguration of supply chains, international trade theories and policy tools have been constantly evolving. Drawing on a literature review and case analysis, this paper reviews the development of classical, neoclassical, and new trade theories, analyzes major trade policy instruments, and examines their practical effects by comparing the U.S.-China trade war with the evolution of global trade rules. The research has found that the international trade theory has gradually expanded from differences in productivity and factor endowments at the national level to factors such as economies of scale, industry characteristics, and corporate behavior, trade policies have expanded beyond traditional tariffs to include non-tariff measures and export controls and the global trade governance has shown a trend of coexistence of a multilateral system and regional trade agreements. Free trade can enhance resource allocation and overall economic efficiency, but its benefits are unevenly distributed with respect to adjustment costs, trade protection may be justified under specific conditions, such as market failure, but prolonged protection can lead to resource misallocation and efficiency losses. Therefore, the effectiveness of trade policies depends on specific economic conditions, policy goals, and the scope of implementation.

Keywords: international trade theories, trade policy, trade policy instruments, free trade, trade protectionism

1. Introduction

With the deepening of globalization, international trade has become an important mechanism for promoting global division of labor, resource allocation and economic development. The multilateral trading system based on the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) has long promoted trade liberalization and global economic integration. However, in recent years, geopolitical conflicts, the rise of protectionism, and the adjustment of global supply chains have made the international trade environment more complex, posing a risk of fragmentation for the global economic and trade system [1]. At the same time, the impact of trade policies has received more attention. Recent trade disputes have shown that traditional policy tools such as tariffs still significantly affect trade flows, domestic prices, and social welfare [2], and their effects may also vary among different industries and economic entities [3]. Reviewing the evolution

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of international trade theory and trade policy instruments can therefore help clarify the current trading system and its policy changes.

Based on this, this article aims to systematically review the development of international trade theory, analyze the main trade policy tools such as tariffs, quotas, and technical trade barriers and their evolution, and examine the economic impact of these policies by using the case of the Sino-US trade dispute. It then compares the conditions, advantages, and limitations of free trade and trade protection.This article mainly adopts the literature review method, combined with comparative analysis and case studies, integrates classic and contemporary research results, and analyzes the development of international trade policies from three levels: theoretical evolution, policy tools and real cases, in order to provide reference for understanding the current trade policy adjustments and the evolution of international trade rules.

2. The evolution trajectory of international trade theory

2.1. Classical theories of international trade

The early stage of international trade theory witnessed a transformation from the mercantilist trade perspective to the mutually beneficial trade perspective of classical economics. Traditional research summarized mercantilism as emphasizing trade surpluses, accumulation of precious metals, and state intervention, and highlighting that trade has certain zero-sum characteristics. However, Pincus pointed out that in 17th-18th century Britain, there were actually complex political and economic debates [4]. Nevertheless, the ideas of state intervention and trade regulation in mercantilism still constituted the theoretical prototype of early trade protectionism.

In *The Wealth of Nations*, Smith framed international trade in terms of the division of labor, specialization, and exchange, arguing that specialization could raise production efficiency and exchange could benefit both parties [5]. This idea was later summarized as the theory of absolute advantage, which states that each country should specialize in producing goods with higher production efficiency. Smith shifted the economic significance of trade from competition for wealth among countries to the common gains resulting from division of labor, but this theory cannot explain why trade still occurs when a country has absolute advantages in all goods.

Ricardo further expanded the basis of trade from absolute production efficiency to relative cost differences, proposing the theory of comparative advantage [6]. The Anglo-Portuguese trade example demonstrated that even if a country has absolute advantages in all goods, specialization and exchange can still benefit both countries as long as relative costs differ, This insight expanded the explanatory scope of classical theory and became a foundation of free trade.

Subsequently, Dornbusch et al. extended the concept of comparative advantage to the case of continuum of goods , enabling it to be applied to the analysis of multi-commodity trade structures. Deardorff further examined the robustness of comparative advantage [7,8]. In general, the classical trade theory mainly explained comparative advantage based on differences in labor input and productivity, but lacked an explanation for the sources of relative cost differences. This led to the development of the neoclassical trade theory that explains comparative advantage based on factor endowments.

2.2. Development of neoclassical trade theory and current challenges

Because classical trade theory did not explain why costs differed across countries, the Heckscher-Ohlin (H-O) theory expanded the analysis to factor endowments, arguing that the relative abundance

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of factors such as capital and labor leads to different factor prices and production costs and that a country tends to export goods intensive in its relatively abundant factors [9]. Thus, the neoclassical trade theory further explained the source of comparative advantage.

Based on this, Samuelson proposed the theory of factor price equalization, stating that under certain conditions, commodity trade can replace part of the cross-border flow of factors and promote the equalization of factor prices in different countries [10]. However, Leontief used the U.S. input-output data to test the H-O theory and found that the capital intensity of US exports was actually lower than that of import substitutes, which contradicted the theoretical prediction of abundant capital in the U.S., thus forming the Leontief paradox [11]. This discovery indicates that there is a deviation between the traditional H-O model and the actual trade structure.

Subsequent studies addressed this issue by reinterpreting the testing methods and relaxing the model assumptions. Leamer pointed out that merely comparing the capital-labor ratio does not fully determine a country's factor abundance. The U.S. trade structure may still be consistent with the feature of capital abundance [12]. Trefler incorporated the productivity differences between countries into the H-O-V model and found that technological differences could better explain actual factor trade and factor price differences [13]. The explanation of comparative advantage thus gradually expanded from traditional endowments such as capital and labor to technology, laying the foundation for new trade theory.

2.3. Modern extensions of the new trade theory and the new new trade theory

The neoclassical trade theory mainly explains trade based on differences in factor endowments, but it is difficult to fully account for intra-industry trade between countries with similar factor endowments. Krugman introduced increasing returns to scale and monopolistic competition into international trade analysis, pointing out that economies of scale can reduce average costs by expanding the market and specializing in production, enabling countries without obvious traditional comparative advantages to also benefit from trade [14]. At the same time, product differentiation leads consumers to demand different varieties. In a monopolistic competition market, countries can produce different varieties and conduct two-way trade, thereby providing a theoretical explanation for intra-industry trade [15].

Based on this, Melitz further incorporated firm heterogeneity into trade analysis, pointing out that there are productivity differences among firms within the same industry. After trade liberalization, firms with high productivity have a greater ability to bear the fixed costs of entering the international market and participate in exports, while firms with lower productivity may withdraw. Resources are thus reallocated to high-productivity firms, and this promotes an overall increase in industry productivity [16]. This research shifts the analytical focus of trade theory from countries and industries to firms.

Overall, international trade theory does not simply replace the traditional theory of comparative advantage with a new theory. Instead, it continuously expands the scope of its explanations based on the existing theory. The research perspective has gradually shifted from differences in productivity and factor endowments among countries to industry characteristics, market structure, and even more micro-level trade behaviors, enabling the trade phenomena that were difficult to explain by the traditional theory to be further clarified [17]. International trade theory thus continues to expand its explanatory factors and deepen its levels of analysis.

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3. International trade policy instruments, cases, and the evolution of global trade rules

3.1. Classification, mechanisms, and effects of major trade policy instruments

3.1.1. Major trade policy instruments and effects

International trade policy instruments can be classified based on the methods of trade intervention into types such as tariffs, quantity restrictions, technical measures, and fiscal measures. The non-tariff measures classification system of UNCTAD further systematically categorizes the policy measures that affect international commodity trade beyond tariffs, including technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS), all of which are important technical measures [18]. The operation methods and economic impacts of the main trade policy tools are shown in Table 1 below.

Table 1. Summary of main trade policy instruments

Policy Instruments	Mode of Operation	Main Function	Main economic impact
Tariff	Imposing taxes on imported goods and raising their domestic market prices	Restricting imports and protecting domestic producers	Consumer welfare declines, domestic producers benefit, government tax revenue is generated and there is a distortion in resource allocation.
Import Quotas	Set an upper limit on the import quantity of specific goods	Directly restricting imports and protecting domestic industries	Increase in domestic prices, quota rents emergent, may lead to rent-seeking behavior
TBT	By means of technical standards, product requirements, labels and conformity assessment procedures, the market access is regulated.	Ensure product quality and safety, etc.	Increase the compliance costs for firms and may affect the entry of foreign products into the market
SPS	Establish hygiene and quarantine requirements for food safety and the health of animals and plants	Prevent risks related to food safety, animal diseases and plant pests and diseases	may increase trade costs, reduce health risks and information asymmetry.
Export Subsidies	Provide financial support to exporting firms, reducing their export costs.	Enhance export competitiveness and expand exports	Increase the government's financial burden and may cause distortion in resource allocation

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Among them, Bhagwati pointed out that under specific conditions such as perfect competition, tariffs and quotas can achieve similar import restriction effects, but the rent distribution resulting from quotas makes their actual economic impacts different [19]. By contrast, TBT and SPS measures are not intended solely to restrict trade. But rather, they affect firms' market-entry costs through technical standards, inspection and certification, and health and safety requirements. The WTO noted that such measures may achieve public policy goals such as consumer health, safety, and the environment, or may restrict trade due to increased compliance costs [20]. Export subsidies increase a company's international competitiveness by reducing its export costs, but they also increase government expenditures and may cause resource allocation distortions.

3.1.2. Comparison of policy effects of tariff and non-tariff measures

As the tariff levels under the GATT/WTO framework gradually decreased and were subject to rules, the attention paid to trade policy regarding other trade intervention tools has been increasing, at the same time, the expansion of the global production chain and the emphasis on issues such as food safety, public health, and environmental protection have also driven non-tariff measures to become important policy tools [20]. Both tariffs and non-tariff measures can affect international commodity trade, but their mechanisms of action and policy effects differ. Tariffs mainly exert their influence by raising import prices, and their policy levels can usually be directly measured by tax rates, with trade impacts being relatively transparent, non-tariff measures may affect trade through various channels such as quantity restrictions, technical requirements, administrative procedures, and firm compliance costs, and the actual degree of restrictions is also more difficult to measure with a single indicator [21]. In addition, although some TBT and SPS measures raise trade costs, they also serve regulatory goals such as product safety, public health, and environmental protection, they therefore cannot simply be equated with trade barriers designed to protect domestic industries [19, 20]. Overall, non-tariff measures reflect a shift in trade policy from traditional border protection toward balancing trade and diverse public policy goals.

3.2. U.S.-China trade war case: analysis of policy tool implementation and economic impact

3.2.1. The development of the U.S.-China trade war and its key policy instruments

In 2018, the United States imposed tariffs on Chinese goods based on the findings of its Section 301 investigation, prompting China to respond with countermeasures, thereby escalating the U.S.-China trade conflict. From 2018 to 2019, both sides raised tariffs in multiple rounds, continuously expanding the scope of trade restrictions. In 2020, the two countries signed the Phase One trade agreement, which led to some adjustments in tariffs, but most tariff measures remained in place [22]. Since then, the U.S.-China trade friction has further expanded beyond traditional tariff measures to include technological restrictions and export controls, gradually extending policy coverage into technology and supply chain areas [23]. The main trade policy tools used during the U.S.-China trade war are shown in Table 2 below.

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Table 2. The main trade policy instruments in the U.S.-China trade war and their applications

policy instruments	Application in the trade war	Main policy objective
Tariff	The United States imposed tariffs on a large number of Chinese goods, and China responded with counter-tariffs.	Protecting domestic industries and exerting pressure in trade negotiations
Technology restrictions	Restricting Chinese firms from accessing certain advanced technologies and key equipment	Maintaining technological superiority and national security
Export controls	Imposing restrictions on the export of advanced computing chips, semiconductor manufacturing equipment, etc. to China	Restrict the flow of sensitive technologies and strategic products
Other non-tariff measures	Administrative restrictions such as the list of entities	Restrict the activities of specific firms and related industries

3.2.2. The economic impact of trade policy instruments

Tariffs mainly affect bilateral trade by increasing the cost of imports. Fajgelbaum et al. found that after the United States imposed tariffs in 2018, the import prices of goods affected by the tariffs did not decrease accordingly, indicating that the tariffs were largely passed on to domestic prices in the United States. As a result, American consumers and firms purchasing imported goods suffered losses of approximately 51 billion US dollars, accounting for 0.27% of GDP. After including tariff revenues and domestic producer benefits, the overall actual income of the United States still decreased by approximately 7.2 billion US dollars, accounting for 0.04% of GDP [3]. Amiti et al. also found that tariffs were almost entirely passed on to the import prices in the United States and estimated that by the end of 2018, the actual income loss in the United States was approximately 1.4 billion US dollars per month [2]. These results indicate that although tariffs can protect some domestic producers, their costs are largely borne by domestic importers and consumers and may reduce overall welfare.

In contrast, technology blockades and export controls affect not only commodity trade but also firms' access to key technologies and intermediate inputs, with further effects on supply chains and industrial structures. Shen et al. found that US export controls imposed constraints on the technology acquisition of China's high-tech firms, and at the same time prompted some firms to increase their R&D investment [24]. From the perspective of global trade, the decline in bilateral trade between China and the United States did not fully translate into a contraction in global trade, instead, it was accompanied by significant trade shifts. Fajgelbaum et al. discovered that among the products affected by the tariffs of China and the United States, the average exports of third countries increased by approximately 6.7%, with countries such as Vietnam, Thailand, South Korea, and Mexico becoming notable beneficiaries of increased exports [25].

3.2.3. Comparison of different research conclusions and perspectives

Current research indicates that the U.S.-China trade war has incurred significant economic costs, and its impact has gradually extended beyond bilateral trade and domestic price changes. The relevant

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studies initially revealed the direct costs of trade protection through the analysis of tariff transmission and welfare effects, showing that the tariff costs are largely borne by the firms and consumers in the importing country [2, 3]. Further research has expanded the analysis scope to the global level, discovering that the decline in U.S.-China trade is accompanied by trade diversion and reconfiguration of supply chains, and some third countries have thus gained new export opportunities [23, 25]. At the same time, by restricting access to key technologies and intermediate inputs, export controls further affect firm innovation and industrial adjustment [24]. Thus, the relevant studies have expanded from bilateral trade and price changes to global trade diversion, supply chain adjustments, and firm behaviors, indicating that the impact of the U.S.-China trade war has structural and distributive characteristics. Overall, the U.S.-China trade war not only demonstrates the domestic efficiency and welfare costs that trade protection may generate, but also shows that it can produce broader international spillover effects through trade diversion, industrial chain integration, and firm behavior adjustments.

3.3. The iterative process and trends of multilateral and regional international trade rules

The institutionalization of international trade rules began with GATT. After the GATT was signed in 1947, early negotiations focused mainly on tariff concessions. The Tokyo Round further paid attention to non-tariff measures, while the Uruguay Round incorporated issues such as service trade and intellectual property rights into the negotiations and promoted the establishment of WTO in 1995 [26]. This evolution gradually expanded trade rules from traditional tariff concessions to broader institutional coordination [27]. The WTO constrains members' trade policies through principles such as reciprocity and non-discrimination, providing an institutional foundation for multilateral trade cooperation [28].

Since the 21st century, the multilateral system of the WTO has continued to function effectively, and regional trade agreements have also further developed. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) signed in 2018 and the Regional Comprehensive Economic Partnership (RCEP) signed in 2020 both go beyond traditional tariff preferences and cover areas such as services, investment, and intellectual property rights [29]. Among them, CPTPP emphasizes deeper rule coordination, while RCEP pays more attention to the integration of regional trade and supply chains [30]. Overall, international trade rules have gradually expanded from tariff liberalization to broader areas such as services and investment, and trade governance now features the coexistence of multilateral mechanisms and regional agreements. Although regional agreements promote trade liberalization, they may also raise coordination costs among different rule systems [29, 30]. Therefore, international trade rules do not evolve along a single direction of liberalization, instead, they constantly adjust between rule deepening, scope expansion, and coordination between multilateral and regional mechanisms.

4. Comparative analysis of free trade and trade protection policies

4.1. The applicable conditions, advantages and limitations of the free trade policy

Free trade is generally regarded as the benchmark of international trade policies. However, its application is conditional: in the absence of severe market distortions, reducing trade restrictions such as tariffs and quotas can facilitate the reallocation of resources and enhance overall economic welfare. Bhagwati pointed out that when there are no trade monopolistic forces or domestic distortions, free trade can become a superior policy choice compared to no trade, if there are

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domestic distortions, its optimality needs to be re-evaluated [31]. Therefore, the applicable conditions of free trade policies are based on the premise that the market mechanism can effectively guide resource allocation.

The main advantages of free trade lie in resource allocation and productivity improvement. Holmes, Hsu and Lee pointed out that trade can enhance resource allocation and generate additional welfare benefits [32]. At the same time, trade liberalization can increase firm productivity through competitive pressure and input acquisition. Khandelwal and Topalova's research on India's trade reforms found that the reduction of product and input tariffs both contribute to improving firm productivity [33]. The benefits of free trade therefore come not only from the static efficiency of specialized division of labor but also from dynamic gains such as productivity growth.

However, the overall improvement in efficiency does not mean that all industries and workers benefit equally. Import competition may lead to the contraction of some industries and result in adjustment costs for the reallocation of capital and labor. McLaren points out that there are high costs associated with workers' transitions between industries and occupations, making the labor adjustment under trade shocks difficult to complete immediately [34], Ghose argues that the impact of trade liberalization on employment depends on the industrial structure, trade structure, and economic development conditions [35]. Therefore, the limitation of free trade lies in the possible uneven distribution of its benefits and adjustment costs among different industries and workers.

4.2. Theoretical basis, applicable scenarios and drawbacks of trade protection policies

Trade protection is not merely about restricting imports. Its theoretical basis mainly stems from specific conditions such as market failure, incomplete competition, and the market power of major countries. Neary points out that in situations deviating from perfect competition, government intervention may improve the welfare of the country through optimal tariffs or industrial policies, but its effect depends on specific market conditions [36]. Trade protection is therefore justified only under certain conditions.

The infant industry theory is a typical viewpoint within the field of industrial protection theory. Baldwin argued that protecting emerging industries is reasonable only when market failures such as learning effects exist, and that temporary protection can promote long-term capacity growth [37]. With the development of new trade theory, strategic trade policies have further incorporated imperfect competition and international market competition into their analysis. Brander and Spencer pointed out that under certain conditions, policies such as export subsidies can influence firm strategic interactions and improve the country's market position, but their effects depend on market structure, firm behavior, and the policy responses of competitors [38, 39]. Therefore, trade protection requires the selection of appropriate policy tools based on specific market failures.

However, the theoretical potential benefits do not mean that protection can continuously improve economic welfare. Brock and Turnovsky pointed out that tariff policies may bring short-term benefits but also may lead to long-term growth and welfare costs [40], Kilumelume et al. further discovered that higher tariffs may cause resource misallocation at the firm level and reduce productivity [41]. Therefore, long-term and widespread trade protection may undermine the efficiency of resource allocation. Overall, the effectiveness of trade protection depends on specific economic conditions, policy goals, and the scope of implementation.

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5. Conclusion

This paper reviews the development of international trade theory, trade policy instruments, and global trade rules. The research shows that international trade theory has gradually expanded from the earlier explanations of productivity and factor endowment differences to factors such as economies of scale and firm heterogeneity, trade policies have expanded from traditional tariffs to non-tariff measures and export controls, and global trade rules now feature parallel multilateral systems and regional trade agreements. In general, free trade can enhance overall economic efficiency through specialization in production, resource allocation, and competition mechanisms, but the distribution of trade benefits and adjustment costs varies unevenly among different industries and workers. Trade protection may be reasonable under specific conditions of market failure, but long-term and excessive protection may also cause resource misallocation and efficiency losses. Therefore, the effectiveness of trade policies depends on specific economic conditions, policy goals, and implementation scope. This paper is limited mainly by its lack of unified quantitative empirical analysis and by its limited discussion of the long-term dynamic effects of policy and emerging issues such as digital and green trade. Future research can further combine industry and firm data to examine the impact of trade policies on industrial upgrading, technological innovation, and the reconfiguration of global value chains, and explore the evolution of rules in emerging trade fields.

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