

The Dilemma between Free Trade and Economic Security



When global interdependence turns into a "trap," the economy becomes a strategic weapon between nations. Amid this complex battle, a new strategy is needed to escape the interdependence trap and establish economic security.

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In an era when free trade is under threat, how can we uphold the principles of free trade and ensure economic security? Suzuki Kazuto unravels the dilemma between the two.

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The “weaponization” of the economy and the rise of economic security

Free trade is in crisis. The Trump administration's tariff policy aims to rebuild trade by placing “fairness and balance” above economic efficiency. For the United States, this means that a growing trade deficit through free trade is “unfair,” and rebalancing is important. Therefore, the US uses tariffs to reduce imports from other countries. If imports are required, the revenue generated from tariffs can be used to recover lost wealth. Whether this policy will produce the results President

Trump claims and what impact it will have on the American economy is impossible to predict. Nevertheless, it is clear that this tariff policy is endangering free trade.

However, the Trump administration's tariff policies are not the only reason for the current crisis in free trade. As a result of this American tariff policy, China was once threatened with a 145% tariff by the United States, and in response, it strengthened its export restrictions on rare earths. This move is having a significant impact on Japan and the rest of the world. China is positioning itself as a "defender of free trade" and attempting to counter the United States, which has turned its back on free trade. However, China's export restrictions, including export taxes, quantity restrictions, and trading rights restrictions, are hardly in line with free trade. While the US-China tariff negotiations have yet to be concluded as of this writing, the pressure from the tariffs initiated by the US has led to economic coercion, resulting in China tightening its export restrictions, which is affecting global trade as a whole.

The United States' and China's attempts to use their economies as a "weapon" to pressure other countries into adopting their policies is commonly referred to as economic statecraft or "economic weaponization." As the weaponization of the economy progresses, countries affected by economic statecraft, such as Japan, must protect themselves from major powers like the United States and China, which can use these weapons at will. These defensive measures are known as economic security. In this article, I will consider how we can maintain the ideals of free trade while implementing economic security as a means of self-protection at a time when free trade is in danger.

The interdependence trap created by free trade

After World War II, the GATT-IMF system, which was based on free trade, became the foundation of the international economic order. Free trade minimizes state intervention, such as tariffs and regulations, to facilitate cross-border business. It aims to promote efficient economic development based on market principles. This created an environment in which the international division of labor based on comparative advantage could flourish. Certain industries became concentrated in certain countries, and some countries held monopolies in certain industries. The pursuit of economic rationality naturally dictates procuring the best products and services at the lowest prices. Companies then began building more streamlined supply chains that crossed national borders. Furthermore, to support globalized supply chains, free trade became even more advanced,

and the WTO was launched in 1995. With China and Russia joining in succession, a global free trade system was established.

However, globalization has not always had a positive impact, as it promotes economic growth based on market principles. The international division of labor based on comparative advantage has also forced declining industries to withdraw from the market. While globalization attracted significant investment to emerging countries that played a role in the global supply chain (GSC), industries in developed countries that continued high-cost production lost out to these countries and either withdrew from the market or relocated capital to countries in the global south to continue production. This created jobs and rapid economic growth in Global South countries while deindustrializing developed countries and creating unemployment, particularly in manufacturing.

This global growth gap has become a major problem for the international community. Citizens in developed countries who lost their jobs and became those “left behind” due to globalization began to rebel against free trade and support political parties and politicians who opposed free trade. The rise of populism was not solely due to economic disparity; however, people who suffered disadvantages due to globalization supported populists, giving rise to major social movements.

These populists reject free trade and advocate policies to protect domestic industries and bring jobs back to their home countries. However, this creates a problem: the “interdependence trap.” Highly intertwined GSCs cannot be easily severed, and restructuring the international division of labor is practically impossible. For this reason, populists seek “decoupling,” or disconnecting their domestic economies from the global network. However, this would mean losing access to imported goods, parts, and materials that have traditionally been relied upon, further weakening domestic industries. In other words, even those who feel disadvantaged by free trade are caught in a “trap” that makes it impossible to escape the interdependence that is based on free trade.

When the interdependence trap becomes “weaponized”

The world, caught in the interdependence trap, is beginning to feel its teeth coming back. As interdependence deepens, the international division of labor based on comparative advantage will become more prevalent, which means that certain countries will have a monopoly on market share. In a world protected by the rules of free trade, it has been illegal for even hostile nations to interfere with economic activity. Unilateral strengthening of export controls or imposition of tariffs has not been permitted.

However, in 2010, China tightened its export controls on rare earths to Japan in response to the dispute over the Senkaku Islands, effectively banning them. Japan, which relied on China for more than 90% of its rare earths, had difficulty obtaining them for various industries, including the automotive industry. This significantly impacted Japan's economic activity. Consequently, the Japanese government succumbed to the demands of the Chinese government. At the time, the WTO dispute settlement mechanism was still operational, and China's actions were recognized as a violation of the rules. When the first Trump administration came to power in 2017, however, it refused to appoint members to the Appellate Body, which acts as a court in the WTO dispute settlement mechanism. As a result, the dispute settlement mechanism effectively ceased to function.

The second Trump administration exploited this situation, using the interdependence trap as a weapon. The Trump tariffs significantly impacted many countries that relied on exports to the United States, the world's largest market. These tariffs were primarily intended to eliminate the US trade deficit, reverse the international division of labor based on free trade, and reshore manufacturing to the United States. Simultaneously, the United States used tariffs to pressure countries, including Canada, Mexico, and China, to halt the production and export of the illicit drug fentanyl. The Trump administration also attempted to interfere in Brazil's domestic affairs by raising tariffs to 50% in response to the trial of former president Jair Bolsonaro, an ally of President Trump, in Brazilian courts. Furthermore, the administration imposed a 50% tariff on India due to its purchase of Russian crude oil. In this way, the United States has adopted a policy of "weaponizing" the size of its market by imposing high tariffs on countries that rely on exports to the United States in an attempt to force them to change their policies.

In this world caught in an interdependence trap, major powers like the United States and China are using their overwhelming market share and large consumer markets to engage in economic coercion, intervening in the domestic policies of other countries and forcing them to change their policies. This could be said to be an act of geo-economic coercion, comparable to a geopolitical demonstration of force, like lining up the Black Ships¹ across Uraga Strait to pressure the Edo Shogunate to open its borders.

¹ The Black Ships were a fleet of four ships, including black-hulled steamships (the *Susquehanna* and the *Mississippi*), led by American Commodore Perry in 1853. They appeared off the coast of Uraga, at the entrance to Tokyo Bay, and pressured Japan to open its borders.

Economic security measures to counter geo-economic acts of coercion

The modern world is shifting from an era of free trade to one of geo-economic coercion. How should countries like Japan, which lack the geo-economic power of the United States and China, cope? One answer is economic security. Economic security refers to measures that counter economic pressure or oppression from other countries. The keys to achieving this are “strategic autonomy” and “strategic indispensability.”

Strategic autonomy means not being overly dependent on any one country to stabilize the supply of strategic materials. For instance, Japan was 90% dependent on China for rare earths in 2010. After China tightened its export controls, however, Japan recognized this problem and invested in rare earth development in Australia and other countries. As a result of diversifying its supply chains, Japan’s dependence on China reportedly fell to nearly 60%. Although 60% dependency is still considered excessive, strategic autonomy means increasing autonomy, even slightly, and creating a situation in which materials can be procured from other reliable suppliers without succumbing to pressure from other countries.

Of course, producing all products domestically would increase autonomy further, but the cost would be enormous. Therefore, it is necessary to increase strategic autonomy by focusing on products that are important to people’s lives and the domestic industry. Enacted in 2022, the Economic Security Promotion Act (Act on the Promotion of Ensuring National Security through Integrated Implementation of Economic Measures) designates semiconductors, fertilizer, cloud services, and other specified products as critical. The government provides financial support to private companies for these materials, helping to diversify supply chains by increasing stockpiles and developing alternative sources of procurement.

Strategic indispensability occurs when a country offers unique products in the global market, making itself indispensable to other nations. Japan, for example, holds an overwhelming share of materials essential for semiconductor manufacturing, such as photoresist, a film applied to silicon wafers without which semiconductor circuits cannot be etched, and hydrogen fluoride, which is used in semiconductor cleaning and etching processes. Without these materials, semiconductors cannot be made, so even if other countries attempt economic coercion, if Japan were to stop providing these materials, it would serve as a countermeasure against that coercion. Trump tariffs leverage the immense US market—vital for many nations—as a tool for geo-economic coercion. China counters this by tightening export controls on rare earths, which are strategically

indispensable, in order to gain leverage in tariff negotiations with the US. Thus, nations with greater strategic indispensability have greater geoeconomic power, enabling them to coerce other countries into altering their policies. ASML, a Dutch semiconductor equipment manufacturer, is an example of this. It holds a 100% global market share for extreme ultraviolet (EUV) lithography machines, which are essential for cutting-edge semiconductor production. This gives ASML geoeconomic power. In this sense, even smaller nations have adopted the strategy of acquiring strategic indispensability as a means of survival.

Can economic security and free trade coexist?

Economic security is a concept that arose in response to the dysfunction of the free trade system based on World Trade Organization (WTO) rules. This dysfunction resulted in some countries “weaponizing” the interdependence trap they found themselves in, thereby engaging in geoeconomic acts of coercion. For this reason, free trade and economic security are often considered opposing concepts.

However, many countries, including Japan, lack the geoeconomic power of the United States and China. They are forced to rely on other countries for food, energy, various industrial products, and other necessities based on the international division of labor and comparative advantage. Maintaining free trade is of vital importance for those countries.

Therefore, it is important to limit economic security to a select few strategic materials that we are overly dependent on specific countries for. Former National Security Advisor Jake Sullivan of the Biden administration referred to this concept as “a small yard and high fence,” meaning strategic materials necessary for economic security should be limited as much as possible while free trade continues for other materials. Although the Biden administration had also tended to gradually expand its small yard, such as by restricting semiconductor exports to China and raising import tariffs on electric vehicles from China to 100%, for a country like Japan that relies on free trade, expanding its yard would be strangling itself.

As major powers with geoeconomic influence undermine the free trade system, countries that rely on free trade, including Japan, must protect their economies by reducing their dependence on the United States and China, and strengthening cooperation with each other. When the first Trump administration took office, the United States unilaterally withdrew from the Trans-Pacific Partnership (TPP). Japan then demonstrated leadership by bringing together 11 countries to form

the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), excluding the United States. Consequently, the CPTPP became appealing to nonmember countries. Not only did the UK join as the 12th member, but China and Taiwan also applied to join.

In a world where geoeconomic conflicts are intensifying, it is possible to implement economic security in a small yard on the one hand, while maintaining a free trade system on the other.

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