Triffin Paradox in 21 Century

Mirza Khidasheli
Doctor of Business Administration, Professor
of Kutaisi University, mirza.khidasheli@unik.edu.ge

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Anotation. *This article presents a fresh perspective on the Triffin Paradox, a concept introduced by economist Robert Triffin in the mid-20th century that continues to have a significant impact on global financial systems and policies. Despite the passage of time and the evolution of the economy, the fundamental principles of the Triffin Paradox remain relevant in today's financial discussions.*

The paper provides a thorough analysis of the ongoing relevance of the Triffin Paradox in the modern global economy. It draws upon historical context, theoretical frameworks, and empirical evidence to shed light on how the paradox continues to manifest itself in the current financial landscape. Specifically, it explores how the dominance of the U.S. dollar as the world's primary reserve currency perpetuates structural imbalances and systemic vulnerabilities, echoing the concerns raised by Triffin.

Moreover, the paper delves into the implications of the Triffin Paradox for various stakeholders, including policymakers and central banks. It examines the challenges posed by the pursuit of domestic monetary policy objectives in an interconnected world, where the stability of the global financial system relies heavily on the stability of the reserve currency issuer. Additionally, the paper explores potential strategies for mitigating the risks associated with the Triffin Paradox and fostering a more sustainable international monetary order.

By integrating insights from economics, finance, and international relations, this paper contributes to a deeper understanding of the Triffin Paradox and its enduring significance in shaping contemporary financial dynamics. It emphasizes the need for policymakers and stakeholders to address the inherent structural tensions in the global monetary system, with the goal of promoting financial stability, economic resilience, and inclusive prosperity worldwide.

Introduction

In today's ever-changing global economy, the Triffin Paradox remains an important concept to consider. Despite the collapse of the Bretton Woods system in the 1970s, the fundamental ideas behind the Triffin Paradox continue to hold true. This paper aims to explore the ongoing significance of the paradox in the context of contemporary global financial dynamics.

Through a thorough examination of literature, historical analysis, and empirical evidence, we will delve into how the Triffin Paradox continues to manifest itself in the modern era. Additionally, we will discuss the implications of this paradox for various key stakeholders such as policymakers, central banks, multinational corporations, and investors. Furthermore, we will outline potential approaches to address the consequences of the Triffin Paradox.

By shedding light on the enduring relevance of the Triffin Paradox, this paper seeks to contribute to a deeper understanding of the complexities within the global monetary system. It emphasizes the importance for policymakers and stakeholders to navigate the delicate balance between national interests and global stability. Ultimately, the goal is to foster a more resilient and fair international monetary order in the 21st century.

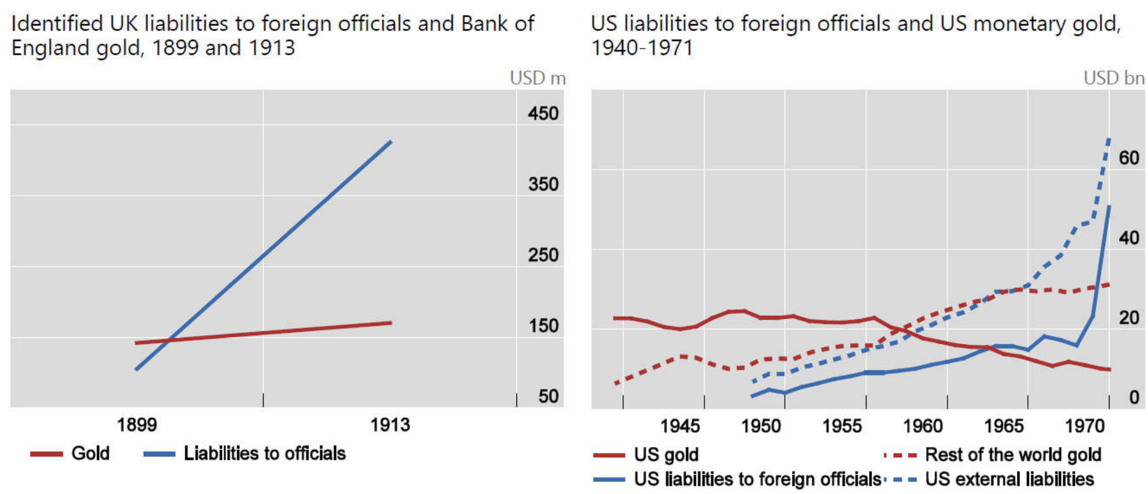
USD dominance beyond legal foundations

The United States has long experienced both benefits and challenges due to the dominance of the US dollar in the global economy, especially in relation to its current account balance. The US dollar's position as the primary reserve currency of the world brings several advantages, such as lower borrowing costs and increased liquidity. However, it also carries inherent risks that can undermine the US current account balance**.** One of the main ways in which the dominance of the US dollar can negatively impact the US current account balance is through its influence on trade flows. Being the primary reserve currency, the US dollar is widely utilized in international trade transactions, with many commodities priced and traded in dollars. While this facilitates global trade and finance, it also means that fluctuations in the value of the US dollar can have significant consequences for the competitiveness of US trade.

Triffin described his "double dilemma" to the Joint Economic Committee. If the United States eliminated its "overall balance of payments deficits" – its accumulation of short-term liabilities to the rest of the world – it would deprive the world economy of international liquidity needed for the expansion of global trade. If the United States did continue to provide international liquidity, then eventually US policy would be unable to lower interest rates without a run on the gold stock. Either way, deflation, and depression threatened (Bordo & McCauley, 2018).

The same picture Triffin saw in the case of the UK before WWI. Prior to World War I, the United Kingdom utilized the pound sterling as the main reserve currency globally, akin to the role assumed by the US dollar post-Bretton Woods. This status was underpinned by the UK's extensive colonial holdings, robust industrial foundation, and supremacy in international commerce. Nevertheless, this hegemony started to diminish over time due to the mounting expenses associated with upholding the empire, in conjunction with economic adversities and the profound repercussions of World War I. (see pic.1.)

Pic.1. UK pre-WWI and US post-WWII Liabilities to officials and holdings of gold



Source: Bordo & McCauley, 2018.

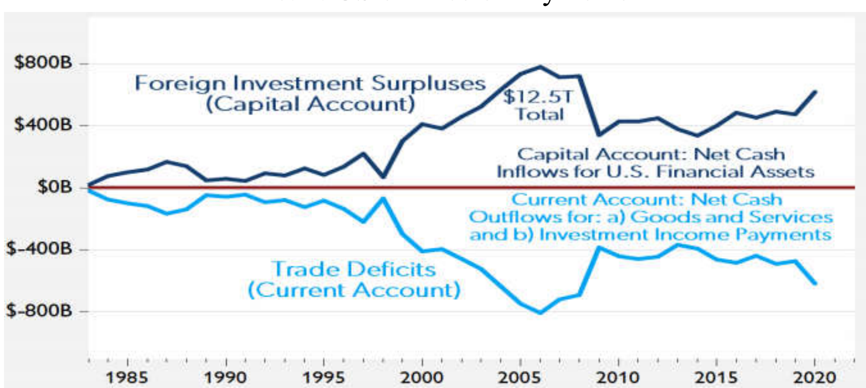
In the Bretton Woods system of the 1950s, the US was the center region with essentially uncontrolled capital and goods markets. Europe and Japan, whose capital had been destroyed by the war, constituted the emerging periphery. The periphery countries chose a development strategy of undervalued currencies, controls on capital flows and trade, reserve accumulation, and the use of the center region as a financial intermediary that lent credibility to their own financial systems. In turn, the US lent long term to the periphery, generally through FDI (Dooley, Folkerts-Landa, Garber, 2003)

Following the United States' withdrawal from the Bretton Woods Agreement in 1971, the US dollar not only maintained its supremacy but also strengthened its position as the primary reserve currency globally. There were several factors that contributed to this remarkable continuity of the US dollar's dominance in the international financial landscape:

- Absence of Feasible Alternatives: Despite the breakdown of the Bretton Woods system, no other currency emerged as a viable substitute for the US dollar. Although several currencies were available, none possessed the same level of depth, liquidity, and universal acceptance as the US dollar. Market participants, including central banks and multinational corporations, continued to rely on the US dollar for their reserve holdings and international transactions due to its unparalleled stability and liquidity.
- Impact of Network Effects and Path Dependence: The entrenched usage of the US dollar in global finance resulted in the creation of network effects and path dependence, further solidifying its dominance. Central banks and financial institutions worldwide held substantial reserves in US dollars, while trade and financial transactions were predominantly conducted in US dollars. This widespread adoption established a self-reinforcing cycle, making it increasingly challenging for other currencies to challenge the hegemony of the US dollar.

Triffin's assessment of the risks to the US current account balance remains valid nonetheless, he did not foresee the enduring supremacy of the USD following the end of the Bretton Woods.

Pic. 2. US balance of Payments



Source: Perry, 2021

However, Triffin's analysis primarily focused on the gold standard framework, where currencies were linked to gold and subject to fixed exchange rates. Triffin's criticism revolved around the predicament faced by the United States as the issuer of the global reserve currency under the Bretton Woods system. This situation entailed the challenge of maintaining the convertibility of the US dollar into gold at a fixed rate, which constrained domestic monetary policy and necessitated substantial current account deficits. (See pic 2)

Nevertheless, Triffin may not have foreseen the possibility of the US dollar retaining its position as the predominant reserve currency without a gold peg. The breakdown of the Bretton Woods system in 1971, when President Richard Nixon suspended the convertibility of the US dollar into gold, marked a departure from the gold standard and introduced a regime of fluctuating exchange rates.

In the absence of a gold peg, the US dollar continued to serve as the primary reserve currency globally, supported by its inherent strengths such as deep and liquid financial markets, stable political institutions, and robust economic fundamentals. Furthermore, the lack of viable alternatives and the entrenched use of the US dollar in international trade and finance further solidified its dominance. See pic. 3.

Pic.3. Dollar dominance - reserves, trade, and transactions (2024)

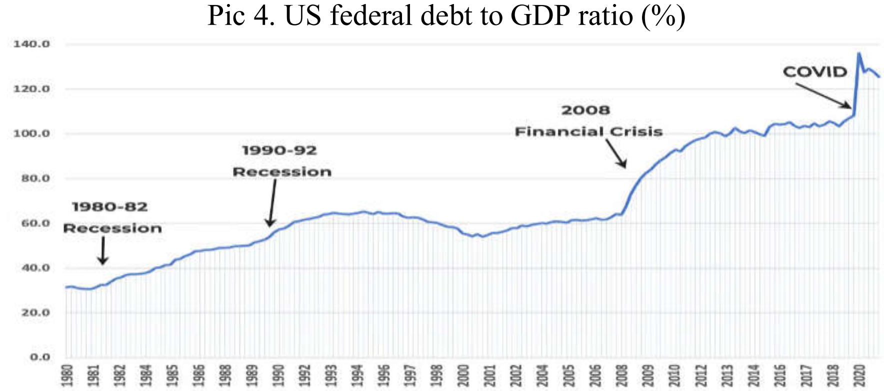
Source: atlanticcouncil.org

The intellectual heritage of Robert Triffin begins with the relevance of his "dilemma" to our days. We still have a situation in which one national currency – the US dollar – serves as the main international currency. It remains at the heart of the international monetary and financial system (or IMS). And we still have a fundamental tension between the currency demands of rapidly growing economies, the domestic policy incentives of reserve issuing/holding countries, and global economic and financial stability: in Triffin's words, the system remains "highly dependent on individual countries' decisions" (Smaghi, 2011).

The United States faces an internal predicament. Numerous nations across the globe maintain US dollars as a component of their foreign exchange reserves, and the dollar is widely utilized in international trade and financial transactions. In order to meet the global demand for dollars, the United States must ensure an adequate supply of dollars to the rest of the world. This often entails consistently running current account deficits, as the US must export dollars to balance its trade, investment, and financing requirements.

To finance these ongoing current account deficits, the US government frequently resorts to borrowing through the issuance of debt securities, such as Treasury bonds. Foreign entities, including central banks, play a significant role as holders of US Treasury securities. As suggested by the Triffin Paradox, the United States must maintain current account deficits to provide the world with the necessary supply of dollars, which consequently necessitates the continuous issuance of debt. (See pic. 4)

Pic 4. US federal debt to GDP ratio (%)



Sources: OMB; St. Louis Fed

Triffin paradox revisit

History shows that the international monetary system is prone to periodic crises. The 1930s brought the collapse of the reserve currency system built around the gold standard. The 1970s saw the breakdown of its successor, the Bretton Woods system. And forty years later, today's international monetary system is beset by economic tensions that look quite familiar. Indeed, given the scale of reserve accumulation, cross-border financial integration, and banking leverage, the crisis facing today's system may be the most serious of all. If economic history teaches us to expect trouble, economic theory helps us understand its sources. Two principles from theory are important here. One concerns the determinants of the demand for reserves, and the other the supply of reserves (Taylor, 2013).

The prevalence of the US dollar can lead to structural disparities within the US economy, particularly concerning consumption and savings. Being the issuer of the world's primary reserve currency, the United States has been able to sustain continuous current account deficits, supported by foreign capital inflows. While these inflows have facilitated US consumption and investment, they have also led to the accrual of external debt and a reliance on foreign funding.

Moreover, the dominance of the US dollar may discourage the United States from addressing fundamental economic disparities and structural deficiencies. The reserve currency status of the US dollar has historically enabled the United States to finance its deficits at reduced expenses and delay essential adjustments to its trade and fiscal policies. This situation can perpetuate a cycle of dependence on foreign capital and worsen imbalances in the US current account balance in the long run.

The history of the international monetary system can be interpreted as the endless search for safe assets, safe from the erosion of value and the debasement of the currency that can derive from the misguided actions of monarchs, elected governments, parliaments and central banks. Gold was initially considered the safest asset as it was nobody's liability, but then the relative shortage of gold led to the creation of the gold-dollar standard, where the safety of dollar-denominated assets was indirectly guaranteed by the link of the dollar to gold. When that link was severed, the world de facto delegated to financial markets the task of determining which assets are to be considered safe and which not (Saccomanni, 2011)

The significance of a global payment unit, separate from any domestic currency, lies in its capacity to facilitate seamless and effective transactions within the worldwide economy. This particular currency acts as an impartial medium of exchange, unaffected by the economic policies or fluctuations of any individual nation. By providing a shared unit of measurement for international trade and finance, it diminishes transaction expenses, mitigates risks associated with exchange rates, and promotes enhanced transparency and trust in cross-border transactions. Furthermore, an international payment unit can contribute to addressing imbalances in global trade and finance by encouraging more equitable and sustainable economic relationships between nations. It prompts countries to prioritize structural reforms and domestic policies to rectify their trade imbalances, rather than relying solely on currency devaluations or protectionist measures. All in all, an international payment unit plays a pivotal role in fostering stability, efficiency, and cooperation within the interconnected world economy.

The advent of digital currencies in the modern era has laid the groundwork for establishing a robust monetary system that goes beyond the limitations imposed by tangible assets such as gold or the supremacy of any single national currency. The emergence of cryptocurrencies and digital assets has led to a decentralization of monetary transactions, making them borderless and accessible to individuals with internet connectivity. Powered by blockchain technology, which underpins these digital currencies, transactions are characterized by transparency, security, and immutability, thus mitigating the risks associated with centralized authority or manipulation. By eliminating the dependence on physical commodities like gold or the dominance of a specific national currency, digital currencies provide a neutral and inclusive means of conducting global trade. This democratization of money promotes financial inclusivity, encourages innovation in financial services, and lowers barriers to international trade and investment. As the digital landscape continues to progress, it has the potential to shape a resilient monetary system that is adaptable, efficient, and fair, laying the groundwork for sustainable economic development and prosperity worldwide.

The Special Drawing Rights (SDR) is another concept that warrants consideration in discussions surrounding universal monetary units. Unlike conventional currencies issued by individual countries, the SDR is a synthetic reserve asset established by the International Monetary Fund (IMF) to supplement the official reserves of its member nations. What distinguishes the SDR is its unique composition, comprising a weighted basket of major currencies. This innovative blend ensures that the value of the SDR is derived from a diversified mix of currencies, rather than being linked to the economic performance of any single country. This diversity not only bolsters stability but also promotes equity by incorporating the interests and contributions of multiple nations. Moreover, the governance of the SDR, overseen by the IMF and its member states, guarantees transparency and accountability in its management, thereby fostering confidence in its role as an international currency. Consequently, the SDR stands as a symbol of ingenuity and fairness in the realm of global finance, providing a more inclusive and resilient alternative to traditional currency systems.

Transitioning the Special Drawing Rights (SDR) into an international digital currency has the potential to transform the global financial landscape significantly. This shift could lead to a more equitable and resilient system by enhancing the accessibility and efficiency of SDR in international transactions. The digitalization of SDR could streamline cross-border payments, reduce transaction costs, and democratize access to a stable international currency. This move would level the playing field for smaller economies and decrease their reliance on dominant currencies such as the USD.

Furthermore, establishing the SDR as the universal unit of international payment in digital form could help mitigate the risks associated with currency fluctuations and geopolitical tensions linked to dependence on a single dominant currency. As a basket of major currencies managed by the International Monetary Fund (IMF), the SDR inherently embodies diversification and stability. Leveraging blockchain or other advanced technologies could further enhance the transparency and security of SDR transactions, fostering trust and confidence among participants in the global financial system.

The transition to an SDR-based international digital currency would necessitate collaborative efforts from the international community, involving central banks, financial institutions, and regulatory bodies. Standardizing protocols for SDR transactions and ensuring interoperability with existing payment systems would be critical steps in this process. Additionally, raising awareness about the advantages of SDR digitalization could help garner support and adoption from both developed and developing economies.

The adoption of a digital currency based on the Special Drawing Rights (SDR) has the potential to reshape the current dominance of the USD, offering a fairer and more resilient alternative that aligns with the changing dynamics of the global economy. By serving as a neutral and inclusive medium of exchange, the SDR can promote enhanced economic stability and cooperation among nations, mitigating the risks associated with a system heavily dependent on a single currency. Embracing the possibilities presented by the digitalization of SDR represents a significant and transformative stride towards establishing a more equitable and sustainable international monetary system.

Conclusion

To conclude, transforming the Special Drawing Rights (SDR) into a digital currency for global payments has the potential to revolutionize the worldwide monetary system in a fairer and more robust way. By utilizing the SDR's unique makeup as a combination of major currencies, digitalizing it can help reduce the dominance of any single currency, like the USD, thereby addressing the imbalances and vulnerabilities identified by Robert Triffin's paradox. This transition promotes equity by offering a neutral and inclusive medium of exchange that represents the interests of multiple countries, encouraging greater stability and collaboration in the global financial framework. Moreover, digitizing the SDR opens up possibilities to improve transparency, efficiency, and accessibility in cross-border transactions, ultimately lowering costs and trade barriers. Through collaborative efforts from the international community and leveraging technological progress, the SDR has the potential to become a cornerstone of a more resilient and sustainable international monetary system, free from the controversies and constraints of previous systems. As the world economy progresses, embracing the potential of the SDR as a digital currency signifies a transformative move toward a more balanced and inclusive financial future.

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ტრიფინის პარადოქსი ოცდამეერთე საუკუნეში

მირზა ხიდაშელი
ბიზნესის ადმინისტრირების დოქტორი, ქუთაისის
უნივერსიტეტის პროფესორი, mirza.khidasheli@unik.edu.ge

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ანოტაცია. *ნაშრომი წარმოადგენს რობერტ ტრიფინის მიერ მეოცე საუკუნის შუა ხანებში აღწერილი „პარადოქსის" ხელახალ გააზრებას, რომელიც, მიუხედავად მისი ნახევარსაუკუნოვანი ხანდაზმულობისა, კვლავაც ინარჩუნებს აქტუალობას, რადგან მისი კონცეფციის ლოგიკა კვლავ მოქმედებაშია და რელევანტურია.*

ნაშრომი, ემპირიული მაგალითების პარალელურად აღწერს ისტორიულ კონტექსტს და თეორიული ჩარჩოს, რომელშიც „ტრიფინის პარადოქსი" კვლავ აგრძელებს საკუთარი მნიშვნელობის მანიფესტაციას. იგი აჩვენებს, რომ ერთი კონკრეტული ვალუტის დომინანტური როლი იწვევს სტრუქტურულ დისბალანსსა და სისტემურ ჩავარდნებს, რომლის შესახებაც ნახევარი საუკუნის წინ მიუთითებდა რ.ტრიფინი.

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ვფიქრობთ, ეკონომიკის, ფინანსებისა და საერთაშორისო ურთიერთობების იდეების ინტეგრირებით, ნაშრომი ხელს უწყობს ტრიფინის პარადოქსისა და მისი მუდმივი მნიშვნელობის უფრო ღრმა გაგებას საერთაშორისო მონეტარული წესრიგის ფორმირებაში.

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