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Does the Triffin Dilemma Really Exist on the Dollar as A Reserve Currency?

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Abstract: According the Triffin dilemma, with the excessive deficits and debts of the US, the confidence in the value of the dollar as reserve currency will be eroded. However, the fact doesn't exist in the dollar. The paper tries to borrow other theories to explain the reasons behind the scenario. The paper firstly points out the faiths of the dollar can be considered as intangible assets of the US. It is influenced by the position of the US in the world. The faith of the dollar will be wobbled only when the positon of the US in the world is being challenged, not by the excessive deficits and debts of the US.
Keywords: Tiffin Dilemma; Dollar

1. Introduction

The Triffin dilemma was identified by Robert Triffin in the 1960s. He pointed out that there is a conflict of economic interest that arises between short-term domestic and long-term international objectives for countries whose currencies serve as global reserve currencies. For the country whose currency being the global reserve currency, with the large demand of foreign countries, they must be willing to supply the world with an extra supply of its currency to provide the liquidity for global economic growth, which leading to a continuous domestic trade deficit. However, excessive deficits would erode confidence in the value of reserve currency.

The Triffin dilemma is well discussed by scholars. Scholars formulate new versions of the Triffin dilemma, most of the discussion and research are done on US. They also focus on the ways to solve the Triffin dilemma. Zhou (2009), governor of the People Bank of China, suggested to replace the dollar as reserve currency with the SDRs issued by the IMF. Campanella (2010) suggested the creation of an international monetary system of block regional currencies. The US and Europe should adopt the same currency though a system of fixed exchange rates. Eichengreen (2011) discussed potential of multipolar system of currencies mainly by the dollar, the euro and the Chinese renminbi. Seghezza (2018) discussed the ways for swap line arrangements to help solve the Triffin dilemma.

However, does the Triffin dilemma really exist on the dollar as a reserve currency? The balance sheet of the Federal Reserve reached around 8.68 trillion US dollars at the beginning of November 2022. The Federal Reserve expanded its balance sheet by more than 8 trillion dollars between 2007 and 2022. Liquidity is provided not only in the US but also all over the world. The dollar didn't depreciate a lot during the crisis as safe asset. After the crisis, when the Federal Reserve shrink the balance sheet from 8.97 trillion in April 2022 to 8.68 trillion in November 2022, the dollar appreciate a lot against other currencies. As long as the dollar keeps its position of dominance, the Triffin dilemma won't happen. Excessive deficits won't erode confidence in the value of reserve currency. The other countries have no choice. The dollar may lose the dominant position as reserve currency one day. It will not due to the Triffin dilemma, but other things which change the leading position of US.

This paper will talk about the Triffin dilemma, the current situation for dollar as a dominate reserve currency, borrow other theories to discuss why the Triffin dilemma doesn't work on the dollar and briefly discussion.

2. The Triffin Dilemma

The Triffin Dilemma was described in his book Gold and the dollar crisis (1960). The book warned the nascent gold-dollar system was unsustainable. If the US eliminated its balance of payments deficits, it would deprive the world economy of liquidity needed for the expansion of global trade. If the US did continue to provide international liquidity, then eventually US policy would be unable to lower interest rates without a run on the gold stock. It indeed predicted the break of gold-dollar link in 1971.

After the success of the Triffin Dilemma on the gold-dollar link, it has been carried on and well discussed by scholars. The Triffin Dilemma has been formulated into new versions. The most well-known one is similar to the original version. There is a conflict of economic interest that arises between short-term domestic and long-term international objectives for countries whose currencies serve as global reserve currencies. For the country whose currency being the global reserve currency, if they eliminate their balance of payments deficits, it will deprive international liquidity needed for the global economic growth. If they continue to provide the liquidity for global economic growth, then the country will have a continuous domestic trade deficit. However, excessive deficits would erode confidence in the value of reserve currency. The system is still unsustainable.

Triffin's prognosis led to efforts by the IMF, G10 and OECD (Working Party 3) to reform the international monetary system by developing a substitute for the US dollar as international reserve asset (Bordo and McCauley 2017). Zhou (2019) also suggested to replace the dollar as reserve currency with the SDRs issued by the IMF. However, the dollar still dominates the global monetary system, it is still the primary reserve currency for central banks. US has exorbitant privilege. They do not have to adjust balance payments deficit whereas other countries do (Eichengreen 2011; McCauley 2015). Does the Triffin dilemma really exist on the dollar as a reserve currency? It looks like excessive deficits of US do not erode confidence in the value of the dollar as reserve currency.

3. Primary Reserve Currency – the dollar

The dollar is the current world dominate reserve currency. According to IMF, central banks hold about 60% of their foreign exchange reserve in dollars. Not only the primary reserve currency, the dollar is also the dominate currency in the world. About half of international trade is invoiced in dollars, and about half of global debt securities are denominated in dollars. In foreign exchange markets, dollars are involved in nearly 90% of all transactions.

With the dominant position in global monetary system, many central banks, financial institutions, and even individuals would like to hold the dollar. With the strong demand for the dollar, it allows the US to borrow more cheaply than it would. In return, it benefits US economy which is well known as "exorbitant privilege" of the dollar.

With the dominant position in global monetary system, the dollar is the preferred currency by investors as a safe asset, especially during the crisis. On one way, the Federal Reserve needs to boost economy through QE during crisis. On the other way, the global investors seek the dollar as a safe asset during the crisis, expecting the dollar to retain its value. With the strong demand, the dollar can maintain its value even with large supply. The inflation effect due to large monetary supply is absorbed by the whole wide world, not only the burden of US.

By being the primary reserve currency, the dominant global currency, and the preferred safe asset, the dollar can provide global liquidity and maintain the value. Excessive deficits and debts of US do not erode confidence in the value of the dollar as reserve currency.

4. Why the Triffin Dilemma doesn't work on the dollar?

For the reason why excessive deficits and debts of US won't erode confidence in the value of the dollar as reserve currency, we can borrow some other theories which may explain it from different perspectives.

The Modern Monetary Theory (MMT) says that monetarily sovereign countries are not constrained by revenues when it comes to government spending. For the fiat currency system, the governments do not rely on taxes or borrowing for spending, they can print as much money as they need as they are the monopoly issuers of the currency. The key point is that the governments do not need anything to backup their printed currency like the gold standard era. That's the reason why the US can sustain much greater deficits without causing for concerns.

Di (2019) gets the similar conclusion from different perspective in his book 'the power of money: relations among politics, the market and the people'. He points out that the domestic currency debt is not really debt for that country.It's actually a tax for others who hold it, such as other central banks and institutions. He believes countries should try to issue as much domestic currency debt as they need instead of foreign currency debt. As domestic currency debts are not really debts for those countries, they can print as much as they need in fiat money system. Instead those are assets for the countries. He explains from another perspective why US doesn't need to worry about their excessive debts as those are all in the dollar.

5. Discussion and Conclusion

We know that MMT is still controversial. We can find positive examples like the US and Japan to support this theory. We can also find negative examples like Sri Lanka to argue against it. Also, for Di's theory, we know that not every country can issue as much as domestic currency debt as they want. Lots of emerging countries have to issue foreign currency debt to finance themselves in the global financial market, and most of them issue the dollar bonds.

Bolton and Huang (2018) take a corporate finance approach to get the conclusion that a nation's fiat money is similar as common stock for a corporate. Both serve as a store of value. To step further, I think the dominant position of a country's currency in the global financial system can be consider as intangible assets of that country. For the dollar, it is the primary reserve currency and the most involved currency in international trading and foreign exchange market. As long as the US can keep the dominate position of the dollar among global currencies, it the monopoly in the market. People have beliefs in the dollar. With the faiths of the dollar as it is the monopoly currency in the global financial system, it can be considered as high value of intangible assets. Thus, excessive deficits and debts of US do not erode confidence in the value of the dollar as reserve currency. The Triffin dilemma doesn't work on the dollar.

The situation only wobbles when the dominate position of the dollar is being challenging. It will erode confidence in the value of the dollar as reserve currency. The confidence in the value of the dollar is influenced by the faiths in the dollar which corresponding with the position of the US in the world, not the excessive deficits and debts of US. That's the reason why Triffin dilemma doesn't work on the dollar as the primary reserve currency.

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