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GOLD AND THE DOLLAR CRISIS: YESTERDAY AND TOMORROW

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INTERNATIONAL FINANCE SECTION
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Princeton, New Jersey

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This Essay *was presented as the first John J. McCloy Lecture at the Council on Foreign Relations. On that occasion, Robert V. Roosa, Under Secretary of the Treasury for Monetary Affairs in the Kennedy and Johnson Administrations and a distinguished contributor to thought and action in international monetary relations, introduced the author. He has graciously agreed to do so again here, in the Foreword to this* Essay.

The Section sponsors the Essays in this series but takes no further responsibility for the opinions expressed in them. The writers are free to develop their topics as they wish.

PETER B. KENEN, *Director*
International Finance Section

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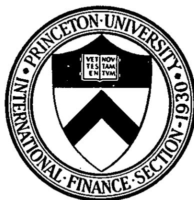

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FOREWORD

On November 14, 1978, Professor Robert Triffin inaugurated the newly established John J. McCloy Lectures at the Council on Foreign Relations. This Essay reproduces his lecture and fortunately includes several detailed sections that had to be trimmed in the oral presentation.

The McCloy series has been endowed to promote and perpetuate the spirit of action-oriented inquiry that Mr. McCloy has been bringing to the problems of world affairs for more than six decades. It was uniquely appropriate that Professor Triffin should have been the person selected to inaugurate the series, as he rounds out four decades of pioneering work in diagnosing and prescribing for a faltering international monetary system. He was asked to present both a personal history of his views and an appraisal of the prospects ahead.

Robert Triffin began his searching studies of monetary affairs (and also began his teaching) while a graduate student at Louvain, in Belgium, just as the Tripartite Agreement was collapsing. But, along with many others, he turned first to more general questions of theory as he faced the doctoral hurdle at Harvard in the late 1930s. His *Monopolistic Competition and General Equilibrium Theory* won the Wells Prize in 1940 as the most distinguished thesis of that year, and it was during his brilliant oral exposition of that *tour de force* before the Instructors Seminar at Harvard that I first met and began to learn from him.

His interest in the ways in which monetary systems support, guide, or possibly stifle economic progress soon became overpowering, however, and he turned in 1942 to the questions that have been the dominant theme of his professional career. Through the remaining war years, as head of the Latin American Unit at the Federal Reserve Board, he successively advised and reorganized central banks to serve the needs of countries throughout the hemisphere. In 1946, with the establishment of the International Monetary Fund, he was made the first director of the exchange-control division. Thereafter, he concentrated his work on monetary relations among nations, serving first the Fund and later the U.S. government as adviser on intra-European payments arrangements (and in practice as a principal designer of the European Payments Union).

In 1951, he began his professorship at Yale, where, while producing a succession of landmark studies up to the present moment, he has also served for a decade as Master of Berkeley College and has remained a consultant to various bodies engaged in organizing the European Economic Community and to the Community itself. It is a happy develop-

ment that, as he nears the formal retirement age, he is again teaching at Louvain, as well as at Yale, continuing his truly international career.

Robert Triffin's Essay reviews the evolution of his thoughts and the classic volumes he has written. But no introduction could conclude without emphasizing the pathbreaking contribution of his *Gold and the Dollar Crisis: The Future of Convertibility*, published in 1960. Indeed, in my first conversation with President-elect Kennedy after the announcement of my appointment as his Under Secretary for Monetary Affairs in December 1960, he pointed to the relevance of "Bob Triffin's thinking" for the effort we were then initiating to buttress the dollar's defenses through the transition period we saw ahead for the international monetary system.

The rest of the story is better told by Professor Triffin himself.

ROBERT V. ROOSA

Introduction

To introduce this Essay, a few words of apology are necessary. There is a French saying, for which I fail to find an exact English equivalent, that "Le moi est haïssable," literally translatable as "The I is hateful." The organizers of the meeting at which I delivered the lecture from which this Essay is derived asked me to be "hateful" by reviewing the changes in, or the obstinacy of, my views regarding the major issues that confronted our international monetary system yesterday, and will still—alas!—confront it tomorrow. To quote the French again, have I, like Louis XVIII, "learnt nothing and forgotten nothing"? Or has our own brief experiment with freedom—of exchange rates, of course—taught me to forget the lures of the "ancien régime" of international monetary order and relative stability of exchange rates?

I shall group my remarks around the two fundamental approaches to international monetary reform to which I have devoted most of my career over more than thirty years, both in academia and as a consultant to the U.S. government and various international organizations: (1) *worldwide* monetary reform and (2) *regional* monetary cooperation, or integration.

World Monetary Reform

Initial Diagnosis and Prescription: 1957 and 1959

In 1957 I had already expressed my doubts about the forthcoming restoration of convertibility "if it remained based only—as in the nineteenth century—on the spontaneous adoption and unflinching pursuit of [appropriate] policies by independent, uncoordinated, national decisions on the part of sovereign countries" (Triffin, 1957, p. ix). I had argued for some years, in opposition to many of my closest economic friends, that the dollar shortage had ended and would not be an obstacle to the return to convertibility:

> The enormous improvement of foreign countries' reserves which has taken place in recent years has been primarily the result of a vast redistribution of net reserves from the United States to the rest of the world. . . . It is evident that such a movement could not continue indefinitely without eventually undermining confidence in the dollar itself (1957, pp. 296-297).

This forecast has not yet been proved incorrect, to say the least.

My doubts about the future maintenance of convertibility were more broadly based:

> The enormous expansion of the objectives and techniques of state intervention in economic life seems to me incompatible with the restoration and maintenance of convertibility on the basis of the uncoordinated national decisions and policies of several scores of independent sovereign states. The institutional framework of international convertibility needs to be greatly strengthened if it is to survive the inevitable shocks occasionally to be expected from unfavorable developments and policies in some of the major trading countries. A collective organization and effective internationalization of the present gold exchange standard are particularly essential in this respect, if we are to eschew the well-known pitfalls unanimously denounced by economists and sadly demonstrated by events in the early 1930's (1957, p. 303).

The analysis and suggestions presented in 1957 in *Europe and the Money Muddle* were expanded in 1959 in several articles, and particularly in those published by the *Banca Nazionale del Lavoro Quarterly Review* (1959a and 1959b) and reproduced, together with my October 1959 Statement to the Joint Economic Committee of Congress, in *Gold and the Dollar Crisis: The Future of Convertibility* (1960).

I cannot resist quoting to you the dedication of this book:

> To my children:
>
> NICKY
> KERRY
> ERIC
>
> who undoubtedly will, some years from now, feel inordinately proud or amused, when discovering this intrepid attempt of their father to prophesy history and to deflect its course.

I think they have been mostly amused, and I hope my readers will be too. As for my publishers, they were worried about the title of the book. Since it would take about nine months to bring out in print, they feared that the "crisis" might be over by then. I reassured them that this was most unlikely indeed.

My *diagnosis* soon became known as "the Triffin Dilemma," the summary title given to it by Oscar Altman (1961). I forecast that if the United States corrected its persistent balance-of-payments deficits, the growth of world reserves could not be fed adequately by gold production at $35 an ounce, but that if the United States continued to run deficits, its foreign liabilities would inevitably come to exceed by far its ability to convert dollars into gold upon demand and would bring about a "gold and dollar crisis."

My 1959 *prescription* was, in brief, gradually to replace gold and foreign-currency accretions by gold-guaranteed deposit accounts at the

International Monetary Fund as the major source of increase in world reserves. First of all, this would enable the IMF to control the expansion of world reserves, adjusting them to the noninflationary requirements of the feasible growth of world trade and production rather than to the unpredictable vagaries of the U.S. balance of payments and the private gold market. To guard against inflationary abuses of the Fund's lending capacity, I suggested that a qualified vote of two-thirds, three-fourths, and ultimately four-fifths of the total weighted voting power, or even unanimity, be required to authorize IMF lending susceptible of increasing world reserves by more than 3, 4, or 5 per cent a year.

Secondly, I suggested that this expansion of IMF lending capacity be used (1) primarily to finance the IMF's traditional stabilization assistance to deficit countries, subject, of course, to the adoption of agreed readjustment policies, (2) to offset speculative switches from some currencies into others or into gold, and (3) to accelerate the financing of development in the third world through the purchase of obligations of the World Bank, its affiliates, and the various regional development banks that were emerging at the time.

The Next Twenty Years: 1959-79

Diagnosis. The events of the next twenty years could hardly have induced me to alter my diagnosis. They obviously resolved the 1959 "Triffin Dilemma," however, in favor of the second rather than the first horn of that dilemma. The United States did not correct its deficits, and its piling up of indebtedness to foreign central banks and commercial banks finally generated the gold and dollar crisis that culminated—but did not end—in 1971 with the suspension of dollar convertibility and the collapse of the Bretton Woods system.

May I claim, immodestly, to have been more clairvoyant in this respect than U.S. and international monetary leaders? They reacted to my 1959 Congressional presentation by asserting that IMF resources would enable it "to provide the degree of liquidity needed . . . in the *foreseeable* future" and "to play its part in overcoming monetary disequilibriums . . . *under any foreseeable conditions*" (italics mine).[1]

Let me also admit, however, that I *did* change my mind about the main danger confronting the future of the international monetary system.

[1] Secretary of the Treasury Robert Anderson's and IMF Managing Director Per Jacobsson's answers to Chairman Paul Douglas's request for comments on my statement to the Joint Economic Committee. For further details, see Triffin (1966, pp. 230-231).

While my initial diagnosis was seen by central bankers[2] as placing an excessive stress on the first horn of the Triffin Dilemma, the danger of world deflation, my later writings placed increasing stress on the second, the inflationary potential of continuing U.S. deficits and the threat of a gold and dollar crisis. Even so, I was totally wrong in underestimating the duration and the size of the U.S. deficits that foreign central bankers would be willing to absorb, at the cost of an inflationary explosion of world monetary reserves and of a multiple expansion of the money supply in their countries under the traditional system of fractional reserve requirements.

Measured in U.S. dollars, the world reserve pool rose moderately from $58 billion at the end of 1959 to $79 billion at the end of 1969, but it doubled in the next three years to $159 billion at the end of 1972, increasing as much in this short span of three years as in all previous years and centuries since Adam and Eve. World reserves doubled again in the following five years to $319 billion at the end of 1977 (see Table 1).

TABLE 1

THE INFLATIONARY EXPLOSION OF INTERNATIONAL LIQUIDITY
(dollar figures in billions)

	End of 1969	*End of 1972*	*End of 1977*	*Mid-1978*	*Mid-1978 in % of 1969*
Foreign dollar claims	**$ 78**	**$146**	**$363**	**$373**	**478**
On U.S. government and banks	49	85	210	221	451
On foreign branches of U.S. banks	29	61	153	152	524
International monetary reserves	**79**	**159**	**319**	**330**	**418**
Foreign exchange	33	104	244	256	776
Dollars and Eurodollars	20	81	197		985
Other currencies	7	15	27		386
Other	7	8	22		314
Other[a]	46	55	75	75	163
Commercial-bank foreign liabilities	**121**	**217**	**658**	**700**	**579**
In dollars and Eurodollars	94	157	481		512
In other currencies	27	60	177		656

SOURCES: These rough estimates are derived from various tables published by the International Monetary Fund (*International Financial Statistics* and *Annual Reports*), by the *Federal Reserve Bulletin,* and by the Bank for International Settlements (*Annual Reports* and quarterly releases on Eurocurrency and other international banking developments). They are not fully comparable, owing particularly to the different definition of "foreign" liabilities in U.S. and European reporting.

[a] World monetary gold, SDR allocations, and IMF loans and investments.

World monetary gold holdings contributed scarcely at all to this ex-

[2] Notably Dr. Otmar Emminger. See, for instance, his (1973, p. 35) Per Jacobsson lecture.

plosion of world reserves. Measured at their last official price, they rose from $40 billion in 1959 to $49 billion in 1977, but this slight increase is more than accounted for by the bookkeeping impact of the two official dollar devaluations. In physical terms, they remained practically unchanged over these twenty years.

Allocations of Special Drawing Rights (SDRs) and IMF lending contributed barely 10 per cent to the global $262 billion increase of world reserves between 1959 and 1977. The overwhelming source of this increase was foreign-exchange holdings ($228 billion), of which traceable dollar and Eurodollar holdings accounted for more than 80 per cent, having risen *nearly twenty times*, from $10 billion in 1959 to $197 billion at the end of 1977.

The willingness of foreigners to absorb such huge dollar amounts, and to continue to do so even after the dollar became inconvertible, is too often ascribed to U.S. political pressures on unwilling dollar accumulators—the threat, for instance, to withdraw U.S. troops from Germany if Germany withdrew gold from Fort Knox. Such pressures undoubtedly played a part in the process, but other types of motivation were probably more important.

One motivation was merely bureaucratic routine, inherited from the days of the dollar shortage, and the convenience with which foreign central banks could invest their surpluses in the hugest financial market in the world.

Another was the fear of "rocking the boat" and repeating the disastrous experience of the 1930s, when the refusal to accumulate and hold sterling-exchange holdings led to the first collapse of the ill-fated gold-exchange standard and aggravated immensely the world depression of that decade.

Last, but not least, was the reluctance to accept the appreciation of its exchange rate that would flow from a country's refusal to accumulate dollars. The consequent deterioration of the country's competitiveness in world trade might have been bearable if all, or at least most, surplus countries *had acted together* and preserved exchange-rate stability between their currencies. This, however, would have required more mergers of national sovereignty over exchange rates than could be negotiated even between the members of the European Community. President de Gaulle might have been willing at times—and even happy?—to let the French franc appreciate vis-à-vis the dollar, and to let the French automobile industry become less competitive vis-à-vis the U.S. automobile industry. Even he, however, could not accept the deterioration of competitiveness vis-à-vis Volkswagen, Fiat, and other strong European com-

petitors that would occur in the absence of a parallel appreciation of the mark, the lira, etc., vis-à-vis the dollar.

Prescription. While I confess that the basic outline of my suggestions for world monetary reform remained about the same in the years following 1959, it was modified in some important respects, particularly the role of gold in the system.

My 1959 proposal would have required "all members to hold in the form of Fund deposits a certain proportion of their gross monetary reserves. All would agree to accept such deposits in settlement of their international claims without limit, but would have the right to convert at any time into gold, if they so wish, deposits accrued to their Fund account in excess of their minimum requirement" (1960, p. 106).

As of the end of 1958, I considered a minimum requirement of 20 per cent to be adequate and achievable mostly through net claims of $2.6 billion already held by members on the Fund and by transfers to the Fund of about one-third, or $5.3 billion, of the $15.8 billion in foreign-exchange reserves then in existence. Only a handful of countries—primarily the United States, which held no foreign-exchange reserves—would have had to satisfy their minimum deposit requirements by gold transfers ($3.4 billion, or less than 10 per cent of the $37.9 billion in world monetary gold holdings at the time). Of total gold reserves of $56.2 billion, a minimum of 20 per cent, or $11.2 billion, would have been held in Fund deposits, but countries could have retained if they wished 61 per cent, or $34.5 billion, in gold and 19 per cent, or $10.5 billion, in foreign exchange.

After explaining my reasons for considering this minimum proposal as likely to be sufficient at the time, I added that "provision would have to be made to safeguard the Fund's liquidity both against unforeseen conversions of excess deposits into gold and, in the long run, against the increasing gap between the probable level of world gold stocks and the desirable expansion of overall monetary reserves" (1960, p. 114). I considered various alternative ways to meet the problem, the simplest of which was "to authorize the Fund to raise uniformly the 20 per cent deposit requirement to a higher ratio of . . . gross monetary reserves . . . [or] to leave the basic 20 per cent requirement unchanged—or to increase it more moderately—but to impose higher deposit requirements upon that portion of each member's reserves which exceeds the average ratio of world monetary gold to world imports" (1960, p. 114). As of June 1978, the implementation of the first of these suggestions would have increased the minimum deposits with the Fund to about two-thirds instead of 20 per cent, reduced gold holdings (valued at the last official

price) to 20 per cent and reduced maximum foreign-exchange balances to 14 per cent.

This would be in line with the still piously proclaimed objective of our officials to make SDRs (now 3 per cent of gross reserves) the major reserve instrument and to phase out reserve currencies, as well as gold, from the world monetary system.

The policies actually followed by the United States over this twenty-year period were, of course, very different. Robert V. Roosa, Under Secretary of the Treasury for Monetary Affairs, and Charles A. Coombs, at the Federal Reserve Bank of New York, deployed enormous skill and ingenuity to slow down the mounting conversions of dollar claims into gold by exchange guarantees to creditors in the form of "Roosa bonds" and "swap agreements," the creation of the "gold pool" and its replacement by the "two-tier" gold-pricing system, etc., etc. These palliatives postponed the day of reckoning much longer than I would have expected but did not prevent it. It came, on August 15, 1971, with a radical and —to my mind—disastrous reorientation of U.S. postwar foreign economic policies under the iron hand of Secretary of the Treasury John Connally.

Tribute should be paid, however, to the courage and skill with which an earlier Secretary of the Treasury, Henry H. Fowler, succeeded against tremendous odds in steering the negotiation of the first IMF amendment, which created about $9.5 billion of SDRs very similar in effect to my proposed reserve deposits with the IMF. The SDRs, however, were an *addition* to, rather than a *substitute* for, gold and foreign-exchange holdings. I commented, in a number of speeches and articles, and particularly in my November 22, 1967, testimony before the Joint Economic Committee of Congress, on this basic shortcoming of the Rio Agreement:

> General agreement on sensible and viable reforms of our anachronistic world monetary system depends . . . on the development of . . . a comprehensive approach, encompassing the respective role to be assigned in the future to all *three* components of world reserves, *i.e.*, to gold and foreign exchange as well as to collectively created reserve assets. . . . Rational decisions . . . regarding the amounts of new reserve assets to be created will remain out of reach as long as no parallel agreement is reached regarding the additions to overall reserves to be expected from gold and foreign exchange. New reserves well in excess of $3 billion a year might have to be created if foreign central banks not only refuse to pile up more dollar and sterling balances as reserves, but convert into gold—as they did in 1965—large amounts of such balances accumulated over fifty years past. On the other hand, any creation of new reserve assets would be objected to by many countries as inflationary if dollar and sterling accumulation were to be resumed on a substantial scale in the future.
>
> Although improbable at first view, this second possibility cannot be ruled

out in view of the enormous financial economic and political leverage which the United States can use on many countries to deter conversions of these dollars into gold (Joint Economic Committee, 1967, pp. 129-131).[3]

Under Secretary Roosa, who, as late as 1962, opposed my proposal for reserve deposits with the IMF as a "fruitless exercise" whose outcome might be "utter chaos and impairment of normal transactions among nations" (Roosa, 1962; 1967, pp. 102, 103), was among the first officials to admit, as one of the "main lines of inquiry" one year later, the possibility of reconstituting the IMF "by endowing it with the capacity to create credit and the power to allocate such credit among members" (Roosa, 1963; 1967).

The brunt of U.S. official policies, however, remained to phase out gold, but not dollars, from international reserve creation. The American negotiators of the SDR agreement desperately tried to shape it in such a way as to make it "better than gold, but not as good as the dollar"—a squaring of the circle, indeed! They may have received unintended encouragement from the greater stress placed by most of my academic friends (first and foremost, Professor Fritz Machlup) on the need to demonetize gold rather than on the need to control the flood of dollars into the world reserve pool. Most of the academic enthusiasm, however, was centered on floating exchange rates, which I shall discuss briefly in the next section.

Today: November 1978

Current developments and prospects give me little reason to modify the *fundamental* diagnosis and prescription outlined above, but they do force me to modify and supplement both in some important respects.

Diagnosis. For the United States, the inflationary proclivities of the system have been amply demonstrated, and they have not been restrained so far by the adoption of floating exchange rates. The U.S. government's indebtedness (mostly Treasury securities) and U.S. banks' liabilities to foreigners (including those of their branches abroad) nearly doubled in the years 1970-72, rising from $78 billion at the end of 1969 to $146 billion at the end of 1972, and increased two and one-half times more in the following five years to $363 billion at the end of 1977 (see Table 1 above). The total increase in indebtedness of $285 billion over these eight years is exactly equal to the total increase of the U.S. federal debt over this period, from $279 billion at the end of 1969 to $564 billion at the end of 1977—a bizarre coincidence but arguably not entirely accidental!

[3] This second possibility was to materialize indeed, on an undreamed-of scale, soon after the first allocation of SDRs in January 1970.