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Robert Triffin's 'dilemma' didn't pan out, but it holds sway over some of the president's key advisers.



POLITICAL ECONOMICS

The Defunct Economist Who Shapes Trump's Trade Policy

John Maynard Keynes quipped that otherwise intelligent men usually are slave to some defunct economist. So it is with the Trump administration and a Belgian named Robert Triffin (1911-93). Economists in Mr. Trump's orbit care a lot about Triffin's theories, which means you need to, too.

I've previously explored the intellectual basis for Mr. Trump's trade theories, such as it is. The crux is a comprehensive but heterodox interpretation of the relationship between global trade and capital flows. The issue is worth revisiting because this is the essence of a paper Stephen Miran—chairman of the Council of Economic Advisers and recently nominated to a seat on the Federal Reserve Board of Governors—wrote in November, apparently to audition for a job in the administration.

The specific idea animating these folks is something called the "Triffin dilemma," a theory the Belgian first posited in 1959 when the Bretton Woods gold-exchange system was in place. Under Bretton Woods, other governments fixed their currencies to the U.S. dollar, while Washington fixed the dollar to gold. Other governments needed to accumulate dollar claims (including U.S. Treasury debt) to provide the liquidity they required in their own currencies to fuel postwar reconstruction and economic growth.

Triffin believed this arrangement eventually would force a choice between two bad options. The U.S. could satisfy global demand for liquidity by allowing other governments to accumulate ever more dollar-denominated assets. But this would cause America's foreign liabilities to exceed U.S. gold reserves, triggering a run on gold. The fix would be punishing interest-rate increases at home. Or the U.S. could narrow its balance-of-payments deficit, thereby depriving the rest of the world of vital liquidity.

This theory seemed prescient after Bretton Woods collapsed in the 1970s. It wasn't. Triffin had predicted the system would end one way or another in crippling deflation. He didn't anticipate a third option: U.S. lawmakers, preferring to run fiscal defi--cits unconstrained by any monetary standard, would abandon gold. Bretton Woods ended in a series of inflationary crises.

But it takes more than empirical failure to kill an economic theory, so the concept of a Triffin dilemma keeps resurfacing. A popular modern form posits a link between U.S. provision of global liquidity and trade flows: The U.S. trade deficit is the

mechanism by which we export the dollars the rest of the world needs for liquidity. This inflicts a parade of horrors on the U.S., such as a hollowing-out of manufacturing. Were we not to allow it, the rest of the world economy would grind to a halt. A related iteration holds that global demand for dollar safe assets forces the U.S. to run big fiscal deficits.

Mr. Miran's November paper, citing the ^{Note} Triffin dilemma, emphasized how these trade and capital flows force the dollar's value upward, hamstringing U.S. exporters. He has variously suggested a "user fee" or tax on foreign official holdings of U.S. Treasury debt, or proposed that foreign governments "simply write checks to Treasury" to compensate America for the economic costs of providing the world with safe assets.

Before Washington does anything so drastic, it's worth asking whether the underlying Triffin theories are true. They probably aren't.

Clocking the precise relationship between the current-account deficit and foreign demand for dollars is difficult because economists first must try to estimate what the current-account deficit "should" be. This is a perilous econometric procedure vulnerable to bad modeling and dubious data.

Economists nonetheless often conclude the U.S. current-account deficit is larger than theories predict. Yet this mysterious "extra" deficit doesn't appear to be correlated with periods of more rapid foreign dollarreserve accumulation. Sometimes foreign governments amass dollar reserves faster while the U.S. trade deficit is narrower. At other times the U.S. trade deficit becomes larger while foreign reserve accumulation of dollars slows.

^{Note}
The narrower fiscal version of the Triffin dilemma fares no better. Foreign official accumulation of Treasury debt has slowed to a trickle since 2015. During the same period the current-account deficit deepened. Nor is there a global dearth of safe assets that an unwilling Congress must ameliorate by running fiscal deficits against lawmakers' will (ha!). Holdings of Treasuries in foreign-government reserve funds have fallen for a decade, to around 16% of the total float held outside the Federal Reserve from a peak of about 40% in the aftermath of the 2008 financial panic.

If the various Triffin theories don't hold up, try this alternative: The central fact of the global economy is that the U.S. is an engine of productivity growth and attracts investment to match. These capital inflows, which enrich the U.S., also allow America to run trade deficits that it can finance relatively cheaply.

The principle challenge of U.S. policy—our burden, as it were—is to ensure the U.S. remains a hospitable destination for this investment. Exotic and disproved 20th-century theories are a diversion.

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