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Great Architects of International Finance

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6 Robert Triffin's supranational central bank

A plan to stabilize liquidity

The enormous expansion of the objectives and techniques of state intervention in economic life seems to be incompatible with the restoration and maintenance of [currency] convertibility on the basis of uncoordinated national decisions and policies of several scores of independent sovereign states. . . . A collective organization and effective standard are particularly essential . . . if we are to eschew . . . pitfalls . . . sadly demonstrated by events in the early 1930s.

(Triffin 1957: 303)

Intellectual background

Robert Triffin cultivated an interest in international financial problems during studies at the University of Louvain, Belgium, in the late 1930s. Born in Belgium, Triffin was a US resident and citizen for all of his professional life as an economist. After a period of study in Harvard where he was influenced by John Williams and Alvin Hansen, he produced some important research on central banking, exchange controls and banking systems in less developed countries first as head of the Latin American Unit at the Federal Reserve Board and later as Chief of the Exchange Control Division at the IMF. From the time he assumed a professorship at Yale in 1951 until his retirement in 1978, Triffin devoted his energies to international economic problems and, specifically, to reforming the international financial order.¹

To begin with, we can foreshadow some of the chapter's conclusions and locate Triffin in the doctrinal line-up presented in the previous four chapters. Along with the BW architects, Triffin shared a deep distrust for free international capital markets and free exchange rates. From the late 1950s the BW system (as opposed to the ideal order in the BW blueprint) had evolved into a *de facto* key currency arrangement (James 1996: 155–6). This evolution drew Triffin's fervid denunciation. Indeed, his international financial reform proposals were to run completely counter to the key currency ideas promoted by his Harvard instructor, John Williams. That Triffin not once in his extensive writings cited the contributions of

Williams favourably on this subject perhaps attests to his dissatisfaction with Williams's ideas.²

The key currency approach had been dismissed in one ill-tempered comment by Keynes because it supposedly looked after the interests of the United States and Great Britain while letting the rest of the world 'go hang'. Likewise, Triffin harboured profound misgivings about the necessary conditions enabling the key currency approach to work. The rehabilitation of sterling was an essential prerequisite and the Anglo-American loan agreement in 1946 was supposed to help reinstate sterling as a key currency. Unfortunately, the loan 'was too niggardly, however, to allow war-impooverished Britain to bear alone the burden placed on its shoulders' (Triffin 1957: 142). The loan proved so inadequate that sterling was not restored to its leadership status as a widely convertible currency until the late 1950s.

In the meantime there was something rather perverse about allowing the international financial system to be operated along single, US dollar key currency lines. The BW order permitted an outcome such as to make life better in the short term for the 'rich men's club' of leading industrial countries such as the United States. And it did not, on Triffin's prognosis, serve the broader aims of stability, peace and economic prosperity for all countries in the long run. To consider how he arrived at this conclusion we need to review his early work up to the late 1940s on the international gold standard pre-1914, on interwar financial events and on the BW Agreement.

Triffin's revisionist views on the operation of the gold standard

Triffin's assessment of the classical gold standard *in operation*, rather than the pure textbook doctrine which rationalized that standard, coloured his perspective on what ought to be done post-1945 to change the international financial architecture. Prior to 1914, central bankers, policy-makers and most economists agreed that currencies should have a commodity (preferably gold) basis and that international payments imbalances must be settled by shipments of gold. The textbook depiction of how gold standards in general operated was, in Triffin's 'revisionist' perspective, full of mythmaking.³ One of the more enduring myths was that gold, as a form of international money, managed itself, with central banks simply reacting passively as ancillary facilitators of the monetary forces propelled by nations' payments imbalances. Thus,

International balance, if disturbed, would be restored because of the effects of the ensuing domestic contraction or expansion on relative cost and interest levels at home and abroad and the resulting shifts in trade and capital movements. The automatic monetary contraction

produced by gold exports would raise interest rates and attract capital from abroad. It would at the same time exert a downward pressure on domestic prices and costs, thus stimulating exports and discouraging imports. Both of these movements – capital and trade – would tend to correct the balance of payments deficit in which they originated.

(Triffin 1947a: 48)

A surplus would also be self-corrective but the process would begin with gold imports. Gold flows would affect price levels in trading nations; gold inflows would raise price levels and vice versa. Relative prices between trading nations would change and thereby change competitiveness. The amount of gold in each country automatically tends towards an equilibrium at which exports and imports of goods balance. In short, payments imbalances were automatically adjusted in the long run. All this was a faithful rendering of David Hume's classical, price-specie flow doctrine which remained entrenched in textbooks on the subject well into the twentieth century.⁴ In its unadulterated form the classical explanation of the automatic adjustment process leaves 'no room for national sovereignty over currency or money'. Furthermore, gold as *the* accepted international money is 'impervious to national manipulation or management' (Triffin 1947a: 49). In honouring the tacit rules of the classical gold standard order, central banks could use discount rate policies and open market operations to expedite the self-correcting effects of market forces upon which the gold standard was founded. In doing so, they were to depart from the purest form of the rules, though the effects appeared innocuous. Interest rates would rise as credit was tightened in deficit countries and the opposite would occur in surplus countries. While logically consistent, this 'simplified digest' of the theory of international adjustment in an international financial order based on gold was far from being descriptively accurate.⁵

The existence of central banks in the nineteenth century, coupled with deposit banking and legislated fractional reserve private banking systems, created very real conflicts between central bank practice and the classical, Humean doctrine or the automatic gold standard and its associated rules. The incidence and degree of monetary volatility in national economies was influenced by existing banking institutions and superstructure. Using the Bank of England as an example, Triffin demonstrated how, operating on a narrow gold base, the Bank interfered in the pure gold standard process and greatly increased monetary disturbances by comparison with what would have occurred under a pure gold standard. The Bank 'was led to follow credit policies which not only permitted but also reinforced' the automatic economic responses resulting from the retirement or disbursement (as the case required) of its legal tender notes in exchange for gold. The fractional reserve banking effects were pronounced. For instance, using an official ratio of 33 per cent, any net change in the gold reserve held by a central bank was able to create a threefold change in the credit

base. Yet under the pure Humean gold standard rule, international payments imbalances 'produced only an equivalent amount of expansion or contraction in the monetary circulation'; it did not foster some multiple change in either direction. While consistent with the requisite direction of gold flows and economic adjustment dictated by a pure gold standard, such responses were exaggerated by existing monetary institutions and practices (Triffin 1947a: 52). Bank of England officials defended multiple contraction or expansion as a way of speeding up economic adjustment so as to conserve international gold reserves. However, a gold standard purist would maintain that much greater domestic monetary instability resulted: investment activities were deleteriously affected and output fluctuations became needlessly pronounced.

Just as John Williams had seen the gold standard pre-1914 as a sterling standard, Triffin made the very same claim but with a crucial twist which set his approach on a collision course with Williams's. The gold movements initiated (say) by rising British interest rates brought changes in Great Britain's balance of payments but not through major effects on the British economy; the greatest impact was felt by Great Britain's trading partners, especially the agricultural and raw materials-producing countries. Capital flows accentuated these effects – flowing towards the latter countries in times of prosperity and away in times of depression. Major financial centres and countries, far from being equal in the balance of payments adjustment process, were fair weather friends to small exporting countries. Triffin (1947a: 60) was beginning to formulate a critique of the key country, key currency doctrine as it played out in practice during the gold standard era. The financial centres could in fact 'shift part of the burden of adjustment upon the weaker countries in the world economy'. The 'sterling standard' rather than the pure gold standard offered a salutary lesson: larger countries (in an economic sense) could transmit cyclical fluctuations – price, income and employment changes – on to other, smaller countries less able to defend themselves without resorting to protectionist trade policies and foreign exchange controls.

A broad feature of nineteenth- and early twentieth-century experience, which could not be explained by textbook explanations of the gold standard, related to parallel cyclical movements in imports and exports for *one* country compared with trade movements for other trading countries. Such parallel movements (as against divergent movements) were commonly observed between surplus and deficit countries.⁶ Balance of payments disturbances are explained by the pure classical approach in terms of cost and price disparities between one country and the rest of the world. All trading countries were co-equal as far as their trading capabilities were concerned. Obviously this was not a realistic assumption for the actual operation of the gold standard up to 1914. Triffin (1947a: 55–6) observed that many of the 'most spectacular disequilibria in the balance of payments are worldwide in scope', showing parallel cyclical patterns rather than divergent,

single-country (or regional) price and cost maladjustments. Up to 1914, large cyclical fluctuations tended to be synchronous in all major industrial countries, circumstances that classical doctrine was not equipped to explain.⁷ It was therefore scarcely surprising for Triffin that even the manufactured rules of the gold standard game were increasingly violated, all the more so from the 1920s onwards.

With increasing national monetary management after 1920, international gold movements which financed trade imbalances had a diminishing influence on domestic monetary expansion and contraction. The total value of money could no longer be controlled by gold movements. Now the gold standard as such was definitely not operating smoothly; national stabilization policies alongside more rigid wages and prices thwarted the self-correcting changes in price and cost competitiveness usually associated with the gold standard mechanism whatever form it assumed in practice. International payments imbalances observed in major cyclical downturns tended to be corrected by general income adjustments rather than price changes.⁸

The dynamics of balance of payments adjustment changed dramatically in the 1920s and 1930s for the following reasons:

- 1 international capital movements began to dampen, and in some cases stimulate, large and persistent surpluses and deficits in international payments on current account;
- 2 variations in long-term capital movements were erratic and did not play a stabilizing role in all instances;
- 3 all countries were not of equal economic size so that smaller, open, more export-dependent economies were increasingly subject to major price and quantity changes, along with associated 'perverse fluctuations' in long-term capital imports (which they needed for economic development) and violent terms of trade changes over the course of any normal business cycle (Triffin 1964a: 7–8);
- 4 monetary authorities wished more stridently than before to intervene in the adjustment process by emphasizing immediate attainment of domestic policy objectives; and
- 5 given the alleged shortage of gold to back the growing volume of national currencies and facilitate trade in the 1920s, a broad consensus emerged from various international financial conferences to expand the use of credit money as international reserves to supplement gold.

Major financial centres were to take the lead in respect of (5) above, making their currencies gold convertible. This

solution was particularly favored and propagandized by British experts who rightly expected to see sterling – the most prestigious cur-

rency of the largest and oldest trading and financial center of the world – play the major role: it would enable the United Kingdom to finance its deficits and/or strengthen its slender gold reserves through the acceptance of its own paper IOUs as international reserves by other central banks.

(Triffin 1969b: 402)

Currencies became more acceptable as international reserve media. Currency and gold reserves continued to permit fixed exchange rates and give countries more time to make orderly internal adjustments to payments imbalances. Monetary authorities in the 1920s were given an opportunity to play a broader macroeconomic stabilization role pending these adjustments without using exchange control or currency devaluation. The opportunity was widely taken up and applauded by international organizations (Endres and Fleming 1999). Nevertheless, Triffin noticed that 'a dangerous instability was built into the system': one reserve currency could be substituted without delay into another, depending on the view taken by the monetary authorities of a particular currency. Gresham's Law was always in the wings, threatening to apply to one or another key currency used as a reserve.⁹ In a situation where gold coexisted with several key reserve currencies (sterling and the US dollar), one key currency could be dispensed with quickly for the other or gold could be demanded, depending on the degree of confidence held in a currency. Without labouring the details here, in Triffin's view the 1920s' gold exchange standard (in which gold was progressively removed or replaced by national currencies masquerading as international money in reserve holdings) had a primary role in the world cyclical downturn of 1929–33. Sterling convertibility into gold (and other currencies) was severely undermined during this period. For that reason alone, national moneys could not sustain a long-term position as international money or as a liquidity stabilizer in the reserves of a central banking authority. Major key currency countries will from time to time fall from grace as economic powers. To rely on the questionable stabilizing capacity of a key currency would not provide the basis for a sound international financial order.¹⁰

New 'canons' of international financial behaviour: qualified support for BW

When the postwar debate had settled and the BW Agreement had finally been consummated Triffin reflected on these developments, offering 'new canons' for international financial behaviour diverging somewhat from the guidelines established by BW architects. In some cases he offers distinctive interpretations of otherwise vague BW guidelines.¹¹ The following nine points are prominent:

- 1 All national currencies have to be 'managed currencies'.
- 2 Domestic policy goals have primacy in the design of an international order.
- 3 Policymakers in the largest industrialized countries must assume greater responsibilities in adopting 'anticyclical monetary policies' and in preventing the 'contagious' effects of depression originating in their economies.
- 4 Domestic demand management policies must be used to counter temporary imbalances in international payments.
- 5 International reserves should be fully utilized in deficit countries to deal with temporary imbalances and support fixed exchange rates; they should *not* be thought of anachronistically as domestic currency 'backing'.
- 6 Exchange controls should be actively used 'as an instrument of monetary policy' when temporary foreign exchange shortages make the alternatives either currency devaluation or deflationary policies.
- 7 A dual exchange rate system should be operated in situations of temporary imbalance to control the use of foreign exchange on current account transactions.¹²
- 8 'Fundamental disequilibrium' in a country's external accounts may not imply an observed current account *deficit*.
- 9 Exchange rate 'devaluation is not necessarily the only, or most appropriate remedy for fundamental disequilibrium'.

Of these nine general points of principle, the last four, that is 6–9, depart from or are interesting interpretations of the BW Agreement. We shall discuss each of these in turn. Notable is Triffin's silence when elaborating on point 5, and to a lesser extent point 4, on the adjustment responsibilities of *surplus* countries. This accords well with BW, though the emphasis he placed on the responsibilities of larger industrialized countries seems stronger than what can be found in the BW Agreement.

Prior to reflecting on BW arrangements Triffin had spent most of the period 1943–6 studying Latin American monetary problems. During that time he had been strongly influenced by the work of Raul Prébisch. Later Triffin viewed his own reaction to BW, perhaps in part because of Prébisch's influence, as providing 'some highly unorthodox policy advice for the newly born International Monetary Fund' (1966a: 141).¹³ The issue of exchange controls was highly controversial at BW and the IMF Articles of Agreement grudgingly permitted controls on capital account transactions only. Triffin (1947a: 81) demurred; he was wary of the contemporary trend towards 'blind and dogmatic rejection of exchange control'. In small, open economy cases – those with narrow export bases, price inelastic demand for exports and poorly developed capital markets – he recommended active use of exchange control on current and capital account transactions where necessary to avoid income contraction and reduction in

import demand. Imports were often needed for investment and development purposes in these countries. Selective controls on expenditures by residents on foreign goods can be preferable to indiscriminate, damaging income adjustments. By late 1946 the IMF had not developed objective criteria for exchange control policy. It was imperative that 'objective rules and principles of policy' were formulated without delay. Rules must be contingent on country circumstances such as balance of payments experience, export trade patterns and level of economic development. In Triffin's mind, temporary or cyclical disequilibrium in the balance of payments of a particular country referred to abnormal *imbalances* in the external accounts and not necessarily major deficits or surpluses; these warranted imposition of exchange controls on both current account, that is ordinary trade, transactions and capital account transactions. The precise criteria for identifying a 'temporary' or 'cyclical' imbalance were elastic – countries with extremely volatile or highly seasonal patterns of export receipts might need higher average foreign exchange reserves per year as a percentage of the 'normal requirements for payments abroad, i.e. the total annual sales of exchange by the banks [including the central bank]', than countries with a less volatile pattern of receipts. Triffin then speculated that an 'objective indication' of an appropriate percentage critical for IMF permission to use exchange control might be derived from a measure of the variation in exchange receipts from the past one or two decades. Where there was insufficient evidence, the 'deficit country should probably be given the benefit of the doubt', receive IMF assistance and be permitted to introduce exchange control as another line of defence so that 'foreseeable deficits' could be financed without resort to devaluation or significant income reductions. The IMF would also need a rule to guard against permanent use of exchange control, including a periodic country review schedule.¹⁴

Temporary payments imbalances could well be alleviated by multiple currency practices in a manner satisfying the BW Agreement. Triffin proposed some specific rules for such practices, giving greater scope for the use of limited market processes as against haphazard, complex and costly administrative practices. A central bank could permit payments for 'all essential and urgent imports of goods and services and of contractual obligations, dividends, or reasonable amortization on approved foreign investment'. The residual foreign exchange could then be auctioned to the highest bidder wishing to purchase imports from any other country. Multilateralism is preserved, consistent with BW. Bidders would be permitted to purchase any currency in the auction. Indeed, Triffin's 'multiple currency' idea does not constitute a genuine multiple currency practice 'if the term is interpreted to imply the setting up of different exchange premiums as between currencies'. The only discrimination employed is between types of transactions – those for authorized imports and the rest. However, major questions are begged: who decides on the degree of urgency for

authorized imports, on what basis, and what administrative machinery would be required for this purpose? Preserving both multilateral and non-discriminatory principles is laudable but the practice of rationing foreign exchange by government administrators, which is what he is in fact advocating, is akin to creating a new form of trade barrier.¹⁵ Nevertheless, multiple currency practices dispense with the need to impose other import restrictions or new and more discriminatory selective tariffs. In Triffin's currency scheme there would be two foreign exchange markets: the official market with a fixed exchange rate and an 'official' free market with a variable exchange rate depending on importers' bids. Triffin (1947a: 70) was pleased to report that in principle the 'higher rates prevailing on the free market in times of crises would, moreover, tend to discourage capital exports and encourage capital imports'. Growth and development in such circumstances would not be so badly affected.

As we saw in Chapter 2, the BW definition of 'fundamental disequilibrium' in a country's balance of payments remained unsatisfactorily opaque. Triffin addressed this matter directly, defining fundamental disequilibrium as

a maladjustment in a country's economy so grave and persistent that the restoration or maintenance of satisfactory levels of domestic activity, employment, and income would prove incompatible with equilibrium in the balance of payments if not accompanied by extraordinary measures of external defense, such as a change in exchange rates, increased tariffs or exchange control protection.

(1947a: 77-8)

Triffin did not rank exchange rate changes very highly in the list of measures taken to affect economic adjustment from fundamental disequilibrium. Unlike the BW architects, he regarded exchange rate policy as 'a blunt indiscriminate instrument' (1947a: 78). Selective policies designed to target specific payments imbalances on current account would minimize the impact on production, costs and economic activity in general which were only very indirectly connected with these imbalances. Microeconomic policy changes were important here, as were carefully planned exchange controls and international commodity agreements to prevent monopolistic discrimination in markets for food and raw materials and to smooth out prices. Triffin understandably disagreed with Gottfried Haberler's (1944) view (which was a faithful rendering of the BW guidelines) that currency devaluation should be used only when policies designed to alleviate temporary payments imbalances confined to normal conditions lead to an observed *deficit* irrespective of its origin. First, the deficit may be due either to accidental political crises or to economic shocks in commodity markets. Second, tighter monetary and fiscal policies may have limited effectiveness and cause unnecessary hardship. Third, exchange

control considered as a dimension of monetary policy must be given time to work in the short to medium term and its corrective effect on the imbalance in the external accounts was likely to be less dependent on creating an economy-wide contraction in income and employment. Fourth, exchange rate changes disrupt the pattern of production, consumption and labour demand, all the more so in countries with narrow production and export bases.

Triffin's definition of 'fundamental disequilibrium' accords with Alvin Hansen's (elaborated in Chapter 3); it could apply when a country was in deep recession with abnormally low output and high unemployment yet 'enjoying' a balance of payments surplus on current account or even something close to external balance. Significant internal imbalances could therefore outweigh balance of payments considerations and point towards major policy changes. The BW financial order drew Triffin's qualified approval for giving primacy to national policy objectives. Table 6.1 on p. 118 fully summarizes Triffin's policy hierarchy. Triffin's policy discussion related mostly to countries tending towards (but not necessarily with) deficits on current account. The desired policy response sequence was: first, use international reserves and domestic compensatory policy to deal with temporary imbalances which depart from 'normal'; second, use exchange controls as an integral part of monetary policy primarily to protect international reserves and the exchange rate setting, and preserve some semblance of internal balance in the second instance. Exchange controls will help minimize economy-wide income contraction in conditions where there is no impending danger of rising inflation. IMF borrowing facilities and multiple currency practices, coupled with recommended microeconomic policy reforms and active participation in international commodity agreements (where applicable), may be used concurrently. If the imbalance persists, give more time for exchange controls to work before resorting to an exchange rate adjustment. Last, if all else fails use deflationary policies. Despite Prébisch's early influence on Triffin's other policy prescriptions there is no room here for a relapse into greater trade policy activism in the direction of increased import protection though multiple currency practices and exchange controls contained obvious protectionist elements. Additional direct trade restrictions other than those in place in the late 1940s were definitely not favoured. In general, he wished for the 'construction of a stable and freer system of world trade' and tighter management of both capital movements and exchange rates (Triffin 1960: 7).¹⁶

While the foregoing policy response sequence stood the test of time in Triffin's work, by mid-1949 these prescriptions were overshadowed in one of his IMF memoranda. BW, he complained, placed an 'exaggerated emphasis ... on exchange-rate stability' (1954: 206).¹⁷ Events were now conspiring to place this BW emphasis in a difficult position. Much expected premature currency devaluations were a non-issue 'in the face of

the actual, and reverse, threat of *currency overvaluation*' propped up by 'cancerous' restrictions, misused and long-entrenched exchange controls, rampant bilateralism and trade discrimination. To be sure, the BW objective of exchange stability had been achieved but only because various restrictions and controls had nullified the impact of exchange rates on prices and directed trade into inefficient channels: an 'embarrassing victory' for BW architects (Triffin 1949: 182, 184, 191).¹⁸ Exchange rates as Triffin observed them were stable but not effective.

The key currency convertibility crisis

'Convertibility' was a commonly used term in international finance and its meaning was transformed in the BW order. Triffin had long exhorted fellow economists to provide a meaningful and realistic definition of convertibility. The BW Agreement obliged. Earlier, under a pure gold standard regime, convertibility simply meant the 'material equivalence of the various national currencies in terms of their gold . . . content' (Triffin 1960: 21). With the creation of bank notes, convertibility meant the ability of banks to discharge their paper currency debts in gold which was *the* ultimate legal tender money. The stability of rates of exchange between national moneys was guaranteed with respect to all gold standard countries. Banks remained responsible for converting currency into gold at a fixed rate. A currency became *inconvertible* when the issuing bank was not able to honour its gold redemption commitment, whereas private markets may well do so at a different rate than originally promised by that bank. In short, the rate of redemption or rate of exchange would become simultaneously flexible and *unstable* – meaning *inconvertible* at the old, agreed rate.

It may seem strange that by the 1920s at the earliest and the 1950s at the latest, a request to restore currency 'convertibility' meant, in nineteenth-century gold standard parlance, *inconvertibility*, or at least the potential for it. This is because flexible exchange rates between national currencies may not settle down in the market to some stable equilibrium rate for very long. As well, various trade and payments restrictions (e.g. exchange controls), and regulations on capital movements, denied currency holders completely free convertibility. The perniciousness of the other extreme – complete *inconvertibility* – was not lost on Triffin (1957: 235):

True *inconvertibility*, i.e. the impossibility of legally converting the national currency into foreign goods or currencies at any exchange rate whatsoever, is a relatively modern phenomenon whose consequences can be incomparably more destructive of international competition than those of mere exchange fluctuations in a free market.

Economic philosophy, institutions and policies had altered the content of the concept of convertibility at BW. Indeed, BW architects wished to incorporate in their notion of convertibility 'feasible goals of international economic policy, susceptible of concrete implementation in a concrete historical environment', thus defining convertibility in 'relative, rather than in absolute terms' (Triffin 1954: 24). The relative aspects which varied between countries and currencies over time included the degree of multilateralism permitted in trade and payments and the extent of stability in international trading activities. BW architects interpreted convertibility precisely in this manner; they realized that practical convertibility aims made room for feasible compromises among these criteria.¹⁹ Triffin approved. So was convertibility not incompatible with the maintenance of *some* trade and payments controls in the BW order? There is an ambiguity here which is not removed in Triffin's work. The acceptable *level* of trade controls is not clarified.²⁰ And since the removal of currency convertibility restrictions is worthwhile because it will lead to more trade and more efficient utilization of the world's resources, it will not have much point if not accompanied by liberalized trade.

The complete, multilateral clearing of debt and credit balances was not provided for in the initial BW Agreement. In borrowing from the IMF, a member country must exchange its own currency for a currency needed to settle its deficit on current account. Currency inconvertibility in the 1940s and early 1950s did not enable a country to use earnings with some countries to settle deficits with others.²¹ Notwithstanding this severe limitation, Triffin believed that BW had at least initially restored workable convertibility by condemning competitive devaluations and eliminating unbridled bilateralism in trade and payments while sanctioning organized payments discrimination only in special circumstances (exchange controls, scarce currencies) and requiring, *eventually*, equal transferability of *all* currencies.²² By the 1950s Triffin was playing a major role in advancing the cause of regional convertibility in the European Payments Union (EPU). He learned in the process how West European nations were 'highly interdependent (exports to the EPU area account for nearly three fourths of member countries' exports)'. Given this keen, conscious economic interdependence, these countries were better 'able to understand each others' problems and policies', thereby creating favourable conditions for economic growth and regional cooperation on convertibility. For the sterling area countries the same argument applied. Convertibility should be made freer gradually, starting from regional arrangements and leading to greater international convertibility. Key currency agreements, by contrast, set rules to be imposed from above on the rest of the world. That hegemonic approach was emphatically not the best way forward since it would not muster genuine international financial cooperation (Triffin 1954: 212–14, 228, 1956: 387–90).

The BW approach to convertibility was loose enough to allow any

national currency – either singular or plural – to evolve into acceptable, convertible international reserve media. Reserve accumulation (or liquidity) was of course pivotal in the BW order. Reserve measurement and adequacy were complex matters; they needed to be developed on a country-by-country basis. Two things were certain: reserves must be higher both in an unstable economic environment and in less developed economies facing more volatile export prices and requiring large, discrete demands for capital imports. Poorer nations were more likely ‘to assign lower priority than the more developed countries to a reserve level adequate to eschew or minimize undesirable resort to devaluation or restrictions’ (1960: 35). Be that as it may, the BW order had bigger issues to deal with by the end of the 1950s than the problem of poor countries.

The global composition of reserves had become concentrated in a single key currency – too concentrated, on Triffin’s reading of the evidence. The problem was not the sufficiency of reserves per se but the excessive dependence on US dollars for the growth of reserves. Monetary authorities had become enamoured of the US dollar, and this posed a danger of instability for the BW order. A hallmark of Triffin (1960) was its strong statistical support base; it provides extensive, data-driven illustrations of the so-called ‘dollar crisis’.²³ The actual BW system was founded (as we saw in Chapter 2) on a key currency, gold exchange standard, with the US dollar in particular substituting for a shortage of gold in the reserve holdings of central banks. Those US dollars were always ultimately convertible into gold at US\$35 per ounce whenever confidence in the US dollar as a substitute diminished. The US dollar, or any other currency for that matter, was never going to be a perfect substitute for gold.²⁴ The key currency system was therefore periodically indicted for creating international financial instability.

The world financial situation in the late 1950s became fragile and precarious and it is in this context that the famous ‘Triffin dilemma’ arose: world economic growth had created a growing demand for convertible currencies (as gold substitutes) to be used for financing international transactions, and to act as liquidity in support of the BW, fixed exchange rate rule. As a proxy world central banker, the United States’ authorities had fixed the value of the US dollar to gold; all other currencies could convert into US dollars and then to gold at a fixed rate at any time. As long as the United States could supply dollars to support liquidity demands all would be well, though it must normally run a current account deficit in order to supply sufficient dollars to the rest of the world. When US dollar liabilities increased, the supply of gold to back them did not keep pace. As the ratio of US dollar liabilities to gold fell, the guarantee of convertibility into gold lost credibility.²⁵ Conversion of US dollars into gold would expedite ‘international monetary chaos’ if not a 1930s-style liquidity crisis and depression (Triffin 1960: 145). The world financial system would inevitably collapse if dependence on US deficits continued. On the other hand, policymakers in the United States could engineer a set of circumstances which reduced the

United States’ demand for imports and cut the trade deficit. However, this response illustrated the other horn of the Triffin dilemma. A US dollar shortage would be precipitated as the deficit was reduced, a liquidity crisis would occur and international trade and growth would decline. In the worst-case scenario, trade restrictions would increase, and deflation and depression would follow (Triffin 1960: 64–77).²⁶ For Triffin, the dilemma was so compelling and so pressing that he called for immediate reconsideration of the BW Agreement. He takes for granted that IMF finance was insufficient; it was indeed minuscule relative to liquidity supplied by the United States’ deficit and by gold in that order. He offered a gloomy prognosis for the lending capacity of the IMF.²⁷

A collapse of the US dollar would result in a collapse of the BW order. Imperfectly as it operated in practice, the BW system still contained a rationally designed architectural structure which was potentially fair and just. Triffin concurred that, indeed, exchange rates should be fixed, currencies treated equally, capital movements controlled, the risks of output losses in the balance of payments adjustment process minimized, and trade gradually liberalized in the interests of smaller, less developed countries; finally, the financial imperialism so commonly associated with hegemonic key currency schemes should be expunged. That large-scale intervention was required did not mean interference by heads of state in operational matters including design of the financial architecture. The latter is best left to financial experts, economists and technocrats. International financial diplomacy has a place in treaty-making and pact-building which gives legitimation to a particular international financial architecture and sanctions enforcement procedures.

Cooperative efforts spawned by the so-called ‘dollar crisis’ from the late 1950s attempted to institute *inconvertibility* of key currencies into gold. Triffin dismisses these efforts as mere ‘gentlemen’s agreements’; they elicited from major central banks loose restraints on gold conversions which were not durable, especially where central bankers were not independent of their political masters. The BW gold exchange standard had in fact become highly politicized at this point. Politicians, alarmed by an impending ‘crisis’, delved into the day-to-day operations of the BW system. Triffin was unimpressed:

The survival of the gold-exchange standard has now become dependent on the *political* willingness of foreign countries to finance, through their own monetary issues, the deficits of the countries whose *national* currency is accepted by them as international reserves. Compliance with such a system becomes more precarious every day, because central banks are being called upon to finance debtor countries’ policies in which their own governments have no voice, and with which they may profoundly disagree.

(1965b: 349–50, his emphasis)

Central bankers were not able to act and cooperate across countries in accordance with a deeper understanding of the technicalities pertaining to the international financial architecture and its operations. Even worse, governments apparently had no inkling that in acquiescing to certain operations for political reasons, they would be undermining the entire BW architecture.

The supranational bank proposal and its limitations

The architecture of the BW financial order was in desperate need of revision by the early 1960s; it had evolved to a stage of 'utter irrationality' and 'international monetary anarchy'. Why had this alleged outcome come to pass? For Triffin, the universal bogy was the domination of international reserves by key currencies. Speculative switching between these currencies (as confidence in them waxed and waned) proved to be a source of instability. He tirelessly insisted that the 'absurd Monte Carlo roulette game dignified under the name of "gold-exchange standard"' must be brought to a close (1969c: 10).²⁸

Three objectives set the background to Triffin's redesigning of the BW architecture: (i) to remove speculative fear and greed by controlling short-term capital flows associated with destabilizing substitutions between key reserve currencies; (ii) to provide a new means of international liquidity not so reliant on the liquidity-creating deficits of key currency countries; and (iii) to remove threats to the stability of the BW order by 'internationalizing', through a central international organization, member countries' currency reserves.²⁹

World liquidity was a major pillar of BW; it needed reinforcing so as to sustain the growth of trade and payments. Once it had been reinforced, confidence would become less problematic and balance of payments adjustment issues would be squarely dealt with. Triffin wished to centralize international reserves at a newly constituted, credit-creating IMF. The 'new' IMF would possess more 'modest and feasible' functions than the 'broadly similar' Keynes (1943a) plan for an International Clearing Union presented at the BW Conference. Triffin's 'new' IMF would, he thought, end the practice of key countries 'being able to palm off their short-term IOUs upon the world reserve pool'. Key countries were getting 'too much rope to hang themselves', thereby imperilling the BW order. It was no accident that key countries persistently failed to adjust their external imbalances. The imbalances were 'nearly unavoidable' when a country assumed a reserve currency role; the key country could then escape for long periods the full pressure of its deficits at the cost of accruing greater indebtedness and risking sudden international crises of confidence (Triffin 1969a: 59). Furthermore, key countries such as the United States and Great Britain tended to be insulated against large-scale conversion of past IOUs into gold. As leading economic engines in the world economy, these

countries would be able to conduct monetary and fiscal policies with domestic objectives in mind, rather than with concern for the external acceptance of their currencies held by foreign monetary authorities. Triffin proposed to replace key currencies held by monetary authorities by claims against the IMF.³⁰

Main architectural renovations

A new charter should be created for the IMF with a facility for member countries by which they would make foreign exchange deposits backed by an IMF gold-value guarantee. The IMF guarantee would protect deposits against exchange rate changes and inconvertibility of the currencies concerned. Each member would agree to hold a fixed (and high) proportion of its international reserves in the form of IMF deposits. Existing capital subscriptions to the IMF (negotiated at BW) would be replaced by this deposit requirement. Such deposits would become genuine international money, expressed in an IMF currency or 'gold units' at an agreed, fixed rate (Triffin 1960: 105). Parities of national currencies would be expressed in gold units. Foreign exchange risk otherwise attached to holding reserves in the form of national currencies would be eliminated. Gold units could be counted as part of member countries' national reserves, though they would be held by the IMF. Interest would be paid on IMF deposits. Interest would act as an inducement, along with the gold value guarantee, encouraging central banks to hold most of their reserves at the IMF.

There were several versions of the so-called Triffin plan. A strong version required compulsory reserve requirements with the IMF in proportion to each country's total international reserves (up to 20 per cent in one version). These reserves could *not* be drawn down, for example, to pay international debts. In any case, all member countries would have to transfer to the IMF three types of assets:

- 1 existing net creditor claims accumulated on the IMF;
- 2 foreign exchange holdings – mostly US dollars and UK pounds; and
- 3 gold (Triffin 1960: 107).

The IMF, like a bank, would hold deposit liabilities in a large reserve pool comprising its lending capacity as well as a clearing fund for international settlements among national central banks and a resource to assist currency stabilization activities of central banks. The IMF would, in short, centralize world reserves. Finally, gold would retain a place in this renovated version of BW; it would help sustain the popular illusion that gold alone could act as an ultimate pillar and barrier against inflation of national currencies, and as a backing for IMF liabilities.³¹

Operational characteristics of the new IMF

The IMF would now control international monetary reserves. It might expand or contract the volume of its assets through open market operations (purchasing and selling securities) in member countries' financial markets; lend to members, subject to specific conditionality requirements; permit operation of limited overdraft facilities and purchase bonds issued by the WB to assist in financing viable projects in less developed countries. The IMF would have new powers to lend reserves and create credit for members on the basis of those reserves (see Table 6.1).

Triffin assumed that the international financial system requires steady growth in currency reserves in line with expanding world trade. The IMF would therefore tend to make more open market purchases of securities (in return for liquidity) than sales as expanding trade and rising economic growth demanded. As indicated in Table 6.1, IMF open market purchases in selected countries increase the reserves of national central banks held at the IMF. The IMF's lending capacity also grows accordingly. Would this practice be inflationary? Not according to Triffin, so long as the IMF set an upper limit to the increase of centralized reserves of the order of '3 to 5 per cent a year' (1960: 103).³²

The IMF's functions as an international lender for temporary balance of payments imbalances on current account would not change fundamentally. As under the BW Agreement, the IMF could support agreed adjustment policies and permit exchange rate changes as the case demanded to counter persistent deficits. Triffin seemed to favour limiting the maturity and duration of IMF lending and tougher enforceable guidelines so as to allay lingering doubts among some of its members about the safety of its deposit liabilities. He also believed that the IMF's open market operations in different markets could counterbalance 'undesirable movements' of short-term capital.³³

Table 6.1 The Triffin plan: reserve creation through purchase of securities

<i>IMF</i>			
Securities purchased in open market	+100	Deposits of central banks	+100

Source: adapted from Machlup (1962: 31), 'T-account set 5'.

Assumptions:

- 1 An expanded IMF, whose deposit liabilities are part of the member countries' monetary reserves, purchases securities in the open market.
- 2 The seller of the securities deposits the IMF cashier's cheque with the seller's bank; this bank deposits it with its central bank; and this central bank deposits it on its account with the IMF.
- 3 The increased credit balances with the IMF constitute increased monetary reserves of the member countries.

The Triffin plan amounted to a credit reserve standard. The requirements were formidable. All IMF member countries must negotiate, cooperate and then adhere to a treaty setting out a reorganized IMF. Just as with the BW Agreement, Triffin believed in 'producing a blueprint' for international financial reform (1969c: 6).³⁴ Critics of his world central bank idea, which is what his plan was essentially offering, were quick to find fault. We turn next to the most cogent arguments against various versions of Triffin's plan.

Main criticisms of the supranational bank

The first major criticism struck at the heart of Triffin's empirical approach. He always marshalled copious statistical evidence demonstrating impending crises arising from international financial trends. Did he exaggerate the impending liquidity problem and the associated risk of exchange rate instability? The shortfall in supply of world reserves (liquidity) relative to demand was questioned by Altman (1961: 49), for whom the issues were evidential rather than doctrinal:

[Triffin's] proposals are based upon a simplified view of the statistics on reserves and trade that does not reflect such important factors as the distribution of reserves, the change in the quality of exchange assets, the state of balance of international trade and exchange rates.

Clearly, contemporary market participants were not nervous or alarmed, so perhaps Altman's claims of simplification were valid? In fact the US dollar-gold ratio was in steep decline from the late 1950s, but critics observed through the 1960s that large-scale switching of reserve currencies – such as substituting gold for US dollars – did not occur. As the 1960s wore on, the predicted liquidity crisis remained as much a chimera as ever. A supranational bank constructed for the purpose of expanding international reserves would have been redundant precisely because the United States did not experience a genuine disequilibrium on its balance of payments until the late 1960s at the earliest. In the meantime, the United States did not have a pressing adjustment problem which in the event could have seriously depleted world liquidity. The BW order remained largely intact.

It turned out that Triffin had overlooked the role of the United States as an international financial intermediary disbursing a distinctive 'commodity' called liquidity. The conventions defining 'deficits' are crucial for understanding the role of key reserve currency countries. The important concept in international finance of relevance to key countries such as the United States is the 'international settlements balance'. This balance comprises the current account of the United States plus its balance of capital flows excluding any changes in foreign official (central bank) holdings of

short-term claims on residents of the United States (Triffin 1963: 114–15, Isard 1995: 50 note 64). The balance of capital flows is complicated by the fact that loans to non-residents can be offset by non-residents placing their own money in liquid US dollar-denominated assets in markets *outside* the United States. These assets acted as a desired store of value. In Europe during the 1960s markets developed to supply long-term finance and investments denominated in US dollars to enterprises, private savers and governments. The United States, through the 'Euro-dollar market' as it was known, became a financial intermediary *par excellence* with an elastic supply of dollars on offer; it was in fact lending for the medium and long term and borrowing short from the rest of the world. A profitable trade had developed in US dollar-denominated financial assets and liquidity itself – just like any other commodities. A US dollar market evolved, with Europeans generally preferring to hold long-term financial assets with short-term liabilities remaining against them. Europeans on average had high liquidity preference. The opposite profile held for US residents.³⁵ These financial asset-trading activities did not create a genuine disequilibrium in the United States' balance of payments. Trading on the Euro-dollar market did not undermine confidence in the reserve currency system which placed the US dollar at its centre. That the short-term claims of the rest of the world on the United States increased each year with the development of the Euro-dollar market was not a reason for nervousness. Residents of the United States were not in a position of *net* indebtedness. Indeed, contrary to Triffin's fears, the more the US dollar was used as a reserve asset by foreign savers and as a means of long-term finance for foreign enterprises, the greater the familiarity with that currency and the lower the costs of information, and the lower the transaction costs associated with using it.

The Triffin plan was also subject to scrutiny by another group of critics who were alarmed at the thin layer of confidence provided by the proposed supranational bank's 'gold unit'. No international blueprint could prevent monetary authorities from ultimately abandoning the gold unit, just as they would desert any national currency used as a reserve medium. Gresham's Law could apply so long as attractive alternative reserve media – national moneys and gold – were still available.³⁶ Triffin attempted to build into his architecture narrow limitations against the danger of excessive depletion of the IMF's gold resources by, in some circumstances, allowing only partial convertibility of the gold unit (1960: 112–13).³⁷ None of this removed the danger of a gold run on the IMF when a crisis of confidence supervened.³⁸ Confidence among member countries in the underlying assets of the IMF could ebb and flow since the assets were in part to consist of loans to countries which could have questionable creditworthiness (e.g. less developed countries with dubious productivity records). Rules of IMF loan disbursement and enforceability had not been clearly established in Triffin's plan. The IMF acting like a bank may not be in a

position to lend on the same criteria as ordinary commercial banks.³⁹ Alvin Hansen chimed in with doubts on this score: 'Triffin believes that ideally it is a primary function of an international credit creating institution to provide capital to countries that are capital poor.' On the contrary, for Hansen a 'credit creating bank ... cannot afford to be a foreign-aid, soft-loan agency' (1965: 136).

The sacrifice of monetary policy independence in the Triffin plan was predicted to be greater than under the BW Agreement. According to Leland Yeager (1961: 294) that sacrifice might be equivalent to the loss of independence under the gold standard pre-1914. Two levels of monetary management were involved in Triffin's plan: domestic monetary management and the IMF's international monetary policy. If countries relinquished monetary policy independence completely they would simply conduct a passive policy to keep their balance of payments in balance on current account; exchange rate stability would be assured, though avoidance of periodic deflation would not, depending on price level movements elsewhere. If, as was customary in the 1950s and 1960s, and as intended by Triffin, domestic monetary policy was assigned in part to maintaining high aggregate output and employment then some domestic inflation would have to be accepted. At the international level, the IMF would lend to countries with deficits of a size and duration that might otherwise not have been experienced so as to protect domestic policy goals. Yet the creation of international money, that is IMF 'gold units', could strengthen world demand and raise price levels. Hence the oft-repeated claim that the Triffin plan had an inflationary bias.⁴⁰ The delicate balancing act between domestic monetary policy and IMF monetary policy presents a problem for policymakers in Triffin's financial architecture: they must coordinate domestic money and IMF credit creation in order to minimize the effect of rising price levels that go hand in hand with emphasis on Keynesian-type policy goals. Any restriction on IMF credit to deficit countries may well bring more trade restrictions to protect national employment objectives, rather than an international liquidity crisis. Even so, the new IMF as a supranational bank faced the difficult task of preserving the sovereignty of national policy goals while simultaneously attempting to stabilize international liquidity without precipitating greater trade barriers or excessive inflation.

Economic policy coordination among IMF member countries was an indispensable pre-condition for the Triffin plan.⁴¹ Agreed limits on international reserve growth were also vital to minimize inflation. Yet there were no formal limits in the plan, the only real control being the confidence and forethought of IMF officials about their policies. Also crucial was the IMF member countries' willingness to accept the new international gold units.⁴² These factors were rather shaky foundations upon which to renovate the BW order.

In sensing that his full-fledged supranational bank and new IMF charter

might be ill-fated on political grounds (given the perceived threat to national sovereignty), Triffin searched for other opportunities to apply his ideas at the regional level.⁴³ His plan could be rendered politically feasible – contemporary European monetary cooperation was an exemplar of the type of financial architecture envisaged by Triffin for the international economy. The EPU had been a prime example of the possibilities and Triffin was instrumental in providing intellectual foundations for this regional arrangement. The EPU was a short step from full monetary and currency unification in Europe, with a European Central Bank of central banks likely once political obstacles were overcome. Triffin favoured a European clearing house or centralized reserve fund in which each member central bank would hold a proportion of its international currency reserves.⁴⁴

Concluding reflections on Triffin's policy assignment guidelines

While Triffin's renovation plan for the BW financial order was confounded by complications introduced by private capital flows coupled with competing definitions of a genuine imbalance in the United States' external accounts, his ideas seemed more prophetic from the vantage point of the late 1960s. Vietnam war expenditure, among other things, led to inflation and excessive expenditure in the United States and a significant deficit on the current account of the balance of payments which called for genuine economic adjustment.⁴⁵ The international financial order was now more vulnerable to sudden confidence problems inducing massive conversions of key currencies, especially from the US dollar into gold. To dramatize matters, Triffin suggested that the 'divisive and destructive international monetary and economic chaos of the 1930s' could soon be revisited (1969c: 8).⁴⁶ Certainly, the outstanding stock of US dollar reserves more than doubled from \$16 billion to 33 billion in the ten years 1959–69, and the US price level rose 40 per cent over the same period.⁴⁷ High US inflation made US dollar-denominated assets far less attractive than they had been at the beginning of the decade. With the US Federal Reserve willing to trade gold with foreign central banks at US\$35 per ounce throughout the 1960s, obviously Gresham's Law would again apply. Speculation in the private gold market focused on the unsustainability of the fixed gold convertibility value of the US dollar; gold was driven out of international monetary reserves and US dollars began to replace it. This central pillar of the BW order finally collapsed on 15 August 1971 when President Nixon ended the US undertaking to trade gold at a fixed rate. Gold prices then increased rapidly, nearly doubling in the next twelve months.⁴⁸ The BW gold exchange standard was dismantled and replaced by what Triffin called 'man-made credit-moneys and reserves' (1969b: 480). Contrary to Triffin's original expectations, the collapse of the BW order had little

connection with a shortage of international reserves; it had much more to do with undisciplined monetary and fiscal policies in key countries, notably the United States and Great Britain. Indefensible fixed exchange rates were prevalent throughout the 1960s and early 1970s, yet central banks continued to defend them for long periods only to make belated, large, discrete currency adjustments (in some cases before moving to more flexible exchange rates).

Triffin remained adamant throughout the 1960s on the need for centralizing international reserves to preserve both liquidity and confidence. Early initiation and coordination of balance of payments adjustment policies to avoid exchange rate instability must follow centralization. His overall policy assignment guidelines are outlined in Table 6.2.

The normative message embodied in Table 6.2 is that central control of international reserves is desirable to distribute more wisely the fruits of both international investment and expanding international trade. Triffin longed for an international financial order 'that will gradually improve man's control over this crucial basis of his economic life in an increasingly interdependent world' (1969b: 492). Earlier he insisted that international financial stability 'cannot be achieved by a return . . . to the ideals of international laissez faire'. Indeed, 'positive action and policy' are required to *establish* an international order. Furthermore, it was to his mind nonsensical to rely on the spontaneous creation of international financial order as a result of the 'happy coincidence of unilateral decisions' (1947b: 179). The unflinching, freely chosen, pursuit of common or 'correct' policies at the national level created instability in the international realm (1957: ix).

The tradeoff for greater collective control over world reserves was significant sacrifice of domestic policy autonomy although in the conditions prevailing during the 1950s and 1960s harmonization of general policy goals did not seem impossibly difficult (e.g. full employment and high rates of economic growth took priority in most IMF member nations). The means and time horizon for reaching these goals were more controversial. An important addition in Table 6.1 compared with parallel tables in previous chapters is inclusion of the incomes policy instrument. Incomes policies comprised price, wage and rent controls in some countries where they were institutionally more applicable and implementable, such as Great Britain in the early 1960s. Triffin (1965a) had no problem recommending such controls where wages and other costs were fuelling historically high inflation rates. Moreover, like BW, timely external financing methods including foreign reserve utilization and IMF finance were preferred to second-best corrective policies such as exchange controls and further trade restrictions. Exchange controls were acceptable provided it could be demonstrated that capital flows were causing disruptions that had little connection with economic fundamentals, that is with the existing degree of price and cost competitiveness evident in a particular country (Triffin 1966b). What is notable about Triffin's contribution compared to other leading architects of

Table 6.2 Triffin's guidelines for national policymakers and the SCB

<i>Policy instrument</i>	<i>Time horizon</i>	<i>Primary assignment</i>	<i>Secondary assignment</i>	<i>Guidelines</i>
Exchange rate				
i) SCB	All	-	-	<ul style="list-style-type: none"> • Fix parities of national currencies against IMF 'gold unit' • Use multiple currency practices • Fixed adjustable exchange rates as under BW (see Table 2.1)
ii) All countries	Short term Medium-long term	External balance External balance	- -	<ul style="list-style-type: none"> • Use actively on capital and current account transactions • Use to control speculative capital controls
Exchange controls	Short term Medium-long term	Internal balance External balance	- -	<ul style="list-style-type: none"> • Use as credit-creating base operations • Augment by open market operations • Use as buffer for financing current transactions • Use as indicator of 'fundamental disequilibrium' • Deposit as much as possible at SCB
International reserves				
i) SCB	All	-	-	<ul style="list-style-type: none"> • Conduct open market operations, mostly purchasing securities to augment world liquidity • Coordinate with SCB • Use anticyclically • Coordinate with SCB • Accommodate fiscal policy
ii) National central banks	Short term Medium-long term	Exchange rate stabilization External balance	- -	
Monetary policy				
i) SCB	All	-	-	
ii) National central banks	Short term Medium-long term	Internal balance Internal balance	External balance -	
Fiscal policy				
	Short term	Internal balance	External balance	<ul style="list-style-type: none"> • Support monetary policy sterilization of exchange market interventions • Maintain high aggregate domestic expenditure
Trade policy				
	Medium-long term	Internal balance	-	<ul style="list-style-type: none"> • Liberalize slowly • Liberalize in surplus countries first
Investment policy				
i) SCB	All	-	-	<ul style="list-style-type: none"> • SCB to lend widely, not just to deficit countries • Directly support IBRD • As BW, see Table 2.1 • Intervene in capital markets to direct growth
ii) All countries	All	Internal balance	-	<ul style="list-style-type: none"> • Apply where institutional conditions permit to control inflation
Incomes policy				
	All	Internal balance	-	

international finance discussed so far in this book is his abiding faith that a collective, centralized design for international finance would extinguish the problem of confidence weakening the existing BW order. Unfortunately, unlike our other architects surveyed thus far, Triffin offered few, if any, clear policy rules for national policymakers and only rather loose guidelines for the custodians of the supranational bank (or new IMF). In remaining implacably opposed to what he considered inevitably *unstable flexible* exchange rates, he completely ignored the very real possibility that the liquidity shortage (dearth of international reserves) could be dissolved in one fell swoop. For some architects of international finance the solution was simple: instituting floating exchange rates internationally.⁴⁹ The IMF could then be reassigned exclusively to lender of last resort and crisis management functions as opposed to exchange rate surveillance. Contrary to Triffin's dire predictions, the key currency dollar standard (which he reluctantly endorsed only after the link to gold was severed in August 1971) could look after itself. If policymakers in the United States concentrated on keeping the national inflation rate relatively low, as urged by John Williams in the 1950s, there would be little danger that a United States current account deficit would trigger a flight from the US dollar, forcing interest rates up and bringing widespread economic contraction and deflation. The US dollar would then have enjoyed broader credibility and acceptance as a medium of international exchange and payment, a transaction currency and a store of value.

In summary, Triffin preferred a regime of international finance which emphasized strong, active coordination of macroeconomic policy between nations bound, in turn, by the direction of a supranational central bank or the new IMF. The latter would ultimately control the growth of world reserves. Exchange rates would be fixed though adjustable. There would likely be some joint decision-making between international officials at the IMF and national monetary policymakers because of the interdependencies between credit creation at international and national levels. Within these bounds, national policymaking regimes could be highly activist along Keynesian lines, as before under the BW order. All this amounted to an extension and reformation of the BW architecture rather than a stand-alone alternative.

For all its logical coherence, like so many other reform proposals, the Triffin plan had become an 'also ran' by the 1970s. Not only were events turning against Triffin's bold plan to centralize international reserves and give the IMF power to create reserves; doctrinal forces in favour of a freer international economy founded on flexible exchange rates, previously unthinkable in the BW order, were becoming more popular and influential. These doctrinal forces gave rise to a completely different architecture for the international financial order, promising to solve the problems experienced during the BW era. We will now consider leading examples of this alternative doctrine.

7 A Chicagoan international financial order

The U.S. should renounce any commitment to peg exchange rates. We could then eliminate at once the growing restraints that are becoming imposed on what U.S. citizens can do with their dollars. Why should you be free to make any deal you want with a used-car salesman – but not with a Frenchman offering francs?

(Friedman 1968b: 246)

A Chicagoan tradition on international financial reform?

The purpose of this chapter is to investigate the main elements of a Chicagoan view on international economic policy from the 1940s to the 1970s. This task has been made easier by well-established literature both on the stylized modes of thought in the Chicago 'School' of economics (Miller 1962; Reder 1982) and the Chicago 'tradition' of monetary thought pre-1945 (Patinkin 1969; Tavlas 1997; Laidler 1999). That there were common themes in the thinking of University of Chicago economists on BW and on post-BW international financial problems has not yet been demonstrated by those interested in doctrinal lineages in twentieth-century economics.

Unlike the single economist focus of previous chapters, discussion in this chapter will be devoted to leading architects of international finance and policy considered as a group. This group consists of five economists who were trained or taught in Chicago over the period under review: Henry Simons, Jacob Viner, Lloyd Mints, Milton Friedman and Harry Johnson. We shall take for granted that a Chicago 'tradition' was formed on the subject of the international financial architecture even if the economist identified would not have found this designation meaningful at the time.¹ While their thinking on the architecture may have been specially focused on a contemporary aspect of the BW system or policy we still find it meaningful to identify common elements in their architectural preferences and normative views on international economic policy. There was definitely an overarching 'Chicago view on economic policy' in general in the postwar decades up to the 1970s which won over many disciples