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Why the Triffin Plan was Rejected and the Alternative Accepted? – A Heterodox Analysis

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When Burton Malkiel (author of A Random Walk down Wall Street and a member of the Bellagio Group) wrote his analysis of the Triffin Plan in 1963, those working toward monetary reform were coming down strongly in favor of a multiple currency approach. The Triffin Plan, which had attracted so much initial attention after the publication of Gold and the Dollar Crisis (1960), had been rejected. From the vantage point of history, we know that the multiple currency approach did not win the day. Robert Triffin would later claim that no one did more to ensure that floating exchange rates emerged the winner in the policy debate than Fritz Machlup because of his influence on academic economists and policy makers through the Bellagio Group conferences. This paper is motivated by the research question: what role did Fritz Machlup and the Bellagio Group play in the reform and development of the world monetary system? The findings tell a nuanced story of the move from fixed to flexible exchange rates, and discover the Triffin Plan alive and well in the scaffolding of the current hybrid system.

Field of Research: International monetary economics; economic history

JEL Codes: B 22, B31; F31, 33

1. Introduction

Whatever the value of hindsight provided by ex-post analysis, there is no question that many policy makers and academic economists in the US and Europe perceived a potential crisis for the dollar by 1960. Presidents Dwight Eisenhower, John F Kennedy and Lyndon Johnson considered US payments deficits a problem as critical to US security as the nuclear threat. Kennedy calculated that the US payments deficit in 1962 was equal to the cost of maintaining US troops in Europe and weighed the advantages of eliminating the deficit by recalling the troops or negotiating with the French as the US had with Germany to pay for the troops via US armaments purchases, thus allowing the US to use the cash received to retire the deficit. (Gavin 2004) Cold War Presidents were concerned that the Soviet Union might pursue an alliance with Germany or that France might pursue an alliance with Germany, pushing the US out of European affairs.

European policy makers feared restrictions on or termination of all sales of gold by the US monetary authorities; restrictions on international payments through the introduction of foreign exchange controls and prohibitions of capital transfers; import restrictions of all sorts; the blocking of deposits of foreign nationals; the end of convertibility; elimination of key-currencies from the official reserves of central banks and consequently a drastic reduction in "liquidity" everywhere and, ultimately,

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reductions in production and employment resulting from import restrictions and export reduction (Dyson and Featherstone 1999, p. 83).

No one offered a more fearful situation analysis than Robert Triffin, Belgian monetary economist, Yale professor and architect of the European Payments Union created to deal with Europe's trade and payments problems. Triffin argued that the growth of foreign countries' reserves had taken place in recent years largely as a result of a vast redistribution of net reserves from the United States to the rest of the world and that such a movement could not continue indefinitely without eventually undermining confidence in the dollar itself. (Triffin 1957, pp. 296-297).

After a review of the literature and brief discussion of the methodology, the findings reveal the overlapping stories of European integration and world monetary system reform that played out simultaneously, sometimes involving the same cast of characters, which generated some fears about motive and potential gain. A discussion of the Triffin Plan and its defeat in Europe and on the world stage is followed by the launch of a new initiative, the non-governmental economist conferences (also called the Bellagio Group conferences) led by economists Fritz Machlup, Robert Triffin and William Fellner. The conferences reintroduced many of Triffin's ideas and gave new life to his system of credit reserves. Conclusions, implications and limitations of this study follow.

2. Literature Review

Throughout much of the period covered by this paper, the Bretton Woods system was in full gear. It differed from the prior period's gold-exchange standard in three ways. Instead of pegged exchange rates, Bretton Woods established adjustable exchange rates to eliminate balance-of-payments deficits, subject to the existence of what was known as "fundamental disequilibrium," (although the term was associated with crisis and countries sought to avoid sending a message of crisis to their trading partners). Capital controls were permitted in order to potentially volatile international capital flows. The International Monetary Fund was created with the resources to monitor national economic policies, extend balance-of-payments financing to countries at risk, sanction governments responsible for policies that destabilized the international system and compensate countries that were adversely affected (Eichengreen 2008, pp. 91-92). In practice, despite the adjustable peg, parity changes were rare. Exchange controls substituted for the absence of an adjustment mechanism until the restoration of current-account convertibility in 1959. Nevertheless, maintaining the system's viability for as long as possible was highly desirable given the high rate of growth in international trade (Toniolo 2005, p.350). To support such trade, required the creation of increasing international liquidity, primarily in the form of central bank reserves. Insufficient means of international payments would obviously reduce trade and therefore output growth and therefore employment. Full employment and growth required trade liberalization. Individual countries would proceed with a program of trade liberalization only if they felt comfortable with a level of reserves believed to be capable of cushioning the domestic economy from international monetary shocks (Toniolo 2005, pp. 351-352). Hence, the provision of international liquidity largely depended on the US balance of payments deficit, but managing the size of those deficits was critical to confidence in the international currency. This was not a problem given the dollar shortage that prevailed through much of the 1950s, caused by US balance-of-payments surpluses.

The problem began to be manifest when “the rapid expansion of Japan and Western Europe, their buoyant export trade and US overseas investments and military expenditures translated into larger US balance of payments deficits” (Toniolo 2005, p. 353). DeGaulle criticized America’s “exorbitant privilege” and threatened to liquidate the French government’s dollar balance. France was at that time s large creditor of the US Treasury (Eichengreen 2008, p. 115).

Harold James (2010) disputes the prevailing wisdom that the 1960s collapse of Bretton Woods was inevitable, instead James considers the demise of the Bretton Woods a “reaction in the United States to the surge of exports from the ‘emergers’ of the time, in particular from Japan....Exchange rates were to be used as a weapon to secure market opening in Japan and Europe at a time when the question of Japanese textile exports to the US was producing major congressional pressure for immediate action, and was likely to be a central issue in the 1972 election. The dollar crisis, and the associated temporary import surcharge, was used by an administration that was not particularly engaged in multilateral international financial diplomacy, in order to deal with a pressing issue in domestic politics” (James 2010, p. 305). His argument supports the hypothesis introduced by Eichengreen and James (2003, p. 515), namely, “that a consensus on the need for monetary and financial reform is likely to develop when such reform is seen as essential for the defense of the global trading system. They argue, however, that Europe did have a sufficient trade motive to fight for reform (Eichengreen and James 2003, p. 535).

3. The Methodology

Taking an historico-biographical approach, this paper draws on the archives and published works of Robert Triffin and his contemporaries.

4. The Findings

Much of the back story of the Triffin Plan involves efforts toward European integration, which were ongoing through the period covered in this paper and deeply affect the discussion of financial instability and the potential solutions.

Born in Belgium and educated at the Catholic University of Louvain and later Harvard University, Robert Triffin was a renowned Yale economist (1951-1977).[1] While Triffin was committed to the reform of the Bretton Woods system, he was also a member of Jean Monnet’s Action Committee for the United States of Europe. In 1958, Triffin was an advisor to Robert Marjolin, deputy of Jean Monnet at the French Planning Office and the first Secretary-General of the Organisation for European Economic Cooperation (OEEC). Marjolin was also a senior macroeconomic policy maker at the European Commission in charge of economic and monetary matters (Maes 2004).

In the late 1950s and 1960s, the balance of payments adjustment and liquidity problems that were raising fears worldwide were also the concerns of the European Commission, particularly the concerns of France (a deficit country) and Germany (a surplus country). According to Maes (2004, p. 14): “Marjolin, in collaboration with Triffin, drew up a proposal for the creation of a European Reserve Fund by pooling 10% of the international reserves of the Member States' central banks. The Fund would provide for different types of loans, both to assist countries with balance of payments difficulties and also to support economic growth. Marjolin also proposed that the accounts of the Fund would be expressed in a new unit of account." The European Reserve Fund is clearly a prototype of the Triffin plan and, the special reserve assets (special drawing rights) which were proposed by the Ossola Committee, studied by Fritz Machlup, Robert Triffin and the Bellagio Group at the request of Otmar Emminger, chairman of the deputies of the Group of Ten, and adopted by the International Monetary Fund in 1969.

Similarly, and on a larger scale, the Triffin Plan would have required all members to hold a certain proportion of their gross monetary reserves in the form of Fund deposits. All would have to 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 wished, any deposits accrued to their Fund account in excess of their minimum requirement. (Triffin 1960, p. 106) He considered a minimum requirement of 20% to be acceptable and achievable mostly through net claims of $2.6 billion already held by members of 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% 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% or $11.2 billion would have been held in Fund deposits, but countries could have retained if they wished 61%, or $34.5 billion, in gold and 19% or $10.5 billion in foreign exchange (Triffin 1978, p. 6).

Members of the Monetary Committee of the European Economic Community, whose president Otmar Emminger was also chairman of the deputies of the Group of Ten, found fault with Triffin's prescription for change, although not with his diagnosis. Dr. Emminger would write that the Triffin plan would encourage continued US deficits by putting the International Monetary Fund in charge of correcting short-term imbalances. The International Monetary Fund continued to be linked too closely with the US for European comfort. Triffin, therefore, suggested an alternative scheme: reserves might be deposited with the OECD or EEC, going so far as suggesting that the US and Canada join the EEC (Triffin Papers, MS 874, Box 1 folder 1).

The Triffin Plan was a good as dead when, at the Annual Meeting of the World Monetary Fund in Washington, DC on October 2, 1963, then Secretary of the Treasury and Governor of the International Monetary Fund Douglas Dillon announced at a press conference the launching of two studies on "the outlook for the functioning of the international monetary system," one to be undertaken by government economists of the Group of Ten; the other study was to be made by International Monetary Fund economists. The New York Times reporter Edwin Dale who was at the press conference asked Secretary Dillon whether the Group of Ten intended to hold hearings, particularly whether individual economists outside the governments would be heard. (Triffin 1978, p. 147) The answer was no. Three academic economists attending the Fund meeting as guests (Fritz Machlup, William Fellner and Robert Triffin) felt challenged to embark on a study themselves, involving economists of widely divergent views with no problem or proposal considered "out of bounds" (Machlup 1964, p. 8). The Bellagio Group conferences, named for the Rockefeller Foundation conference center in Lake Como where the group often convened, gave new life to the Triffin Plan.

Invited to participate in what was framed as an experiment to determine why economists disagreed on solutions to the payments, liquidity and confidence issues bedeviling the Bretton Woods system, nearly every one of the economists invited to join what became known as the Bellagio Group conferences had a preferred solution to the payments imbalance problem, had played an active public policy role before moving into academe. All were drawn from one of the Group of Ten countries. Some of the same economists who would become important to international monetary system reform as members of the so-called Group of 32 nongovernmental economists (the Bellagio Group) were also involved in European integration, including Jacques Rueff, monetary economist and close advisor to French President Charles de Gaulle; German economists Herbert Giersch, member of the Kiel Institute of World Economics, and Egon Sohmen; Belgian economists Alexandre Lamfalussy and Robert Triffin, and Italian economist Pierre Uri. Additionally, a number of the policy officials important to international monetary system discussions played key roles in European integration and would attend extended Bellagio Group meetings (called Joint Meetings of Officials and Academics). Among these were Otmar Emminger, chairman of the deputies of the Group of Ten, but also president of the monetary committee, and Boyer de la Giroday of the European Economic Community.

The scheduling of the conferences and the publication of its final report in June 1964 were timed to coincide with the Group of Ten's report on the functioning of the international monetary system published in August 1964, and with the report presented at the annual meeting of the International Monetary Fund in Tokyo in September 1964. Thereafter, there was much sharing of drafts between the Bellagio Group, members of the Group of Ten and the International Monetary Fund, particularly Working Party 3 of the Organisation for Economic Cooperation and Development, as well as mutual meetings and conferences (Robert Triffin Papers, MS 874, box 12, folder 2).

We learn from Triffin's notes that Group of Ten members saw the usefulness of the Bellagio Group as a non-governmental, independent think tank. Otmar Emminger, Chairman of the Deputies of the Group of Ten, found the Bellagio Group conferences invaluable to policy deliberations. Rinaldo Ossola, chairman of the Ossola Committee on Creation of Reserve Assets (Special Drawing Rights) of the Group of Ten, liked the Bellagio Group's connection between liquidity and payments adjustment, and Robert Roosa, deputy secretary of the US treasury and member of the Ossola Group, found the Bellagio Group's contribution important to the "evolution" of emerging public policy. Emminger, Ossola, Roosa and van Lennep, chairman of Working Party 3 of the Organisation for Economic Cooperation and Development, would become exceptionally close working partners with the academic economists of the Bellagio Group, joining them for seminars under the "Bellagio Group" name some 15 times through 1972 (Robert Triffin Papers, MS 874, box 12, folder 2).

In its March 1964 conference deliberations, the Bellagio Group had put together a consensus platform on improving the efficiency of the adjustment mechanism. Planks included the continued addition to reserves in the hands of the international monetary authorities, and the importance of international reserve assets other than gold ("credit reserves") whose volume, composition, and policies regarding balance of payments problems would be coordinated by the monetary authorities of large reserve-holding countries. Conferees also agreed that stability of the international monetary system would be improved by agreement among the major countries on the long-run rates of change in total reserves held by participating countries and on the “normal” composition of these reserves; on the terms and criteria for extending special credit facilities to participating countries to cope with strains and crises resulting from international capital movements, and on the need to choose an international body to manage reserve use (e.g. International Monetary Fund, Group of Ten, etc.). The Bellagio Group’s platform had drawn the attention of the Chairman of the Deputies of the Group of Ten, Otmar Emminger, who was beginning meetings to discuss or “negotiate” (Solomon 1977, p. 128) the Ossola Group report on Special Drawing Rights, published in June 1965.

In November 1965 Otmar Emminger requested that the Bellagio Group put some focus on devising adjustment policies for countries in payments imbalance and the creation of new reserve assets with fixed exchange rates a given. Bellagio Group leader Fritz Machlup asked the Bellagio conferees to consider and rank order their preferred exchange rate solutions and adjustment, liquidity and confidence mechanisms that would effectively knock out the payments adjustment, liquidity and confidence problems. The Triffin plan with modified flexible exchange rates emerged as the number 1 choice of conferees; the Triffin plan alone emerged as number 2 (Robert Triffin Papers, MS 874, Box 12 folder 2).

In this respect, aspects of the Triffin plan (including increased credit reserves under the control of the International Monetary Fund as international reserve center) became embedded in the Bellagio Group’s recommendations to the Group of Ten. The extended Bellagio Group’s meetings on balance of payments adjustment issues resulted in a set of papers published as *Maintaining and Restoring Balance in International Payments* (1966). In all there were 19 Bellagio Group conferences, 17 of them joint meetings of officials and academic economists, focused on specific issues or solutions to problems, beginning 1963 and continuing through 1977. The officials who attended these conferences were largely the Deputies of the Group of Ten,

5. Summary and Conclusions

Research reported here reveals that the (potential) shortage of liquidity exposed by Triffin in his congressional testimony and in *Gold and the Dollar Crisis* had an important influence on the plan to ensure credit availability in the event of a future financial crisis by creating Special Drawing Rights (the special reserve assets originally recommended by Triffin, later by Ossola and again by the Bellagio Group working at Emminger’s behest). The paper is limited to a discussion of the world monetary system and the Bellagio Group in terms of the Triffin Plan. It presents what might seem a heterodox view to those who believe the Triffin Plan was never adopted. The decision to opt for a hybrid solution that puts the primary focus on market mechanisms (flexible rates) with SDRs as a backup is a reflection of the importance of liquidity and confidence in the world financial system. The SDR was originally envisioned “as a means of alleviating a shortage of international reserves, or maintaining confidence in the convertibility of U.S. dollar denominated foreign exchange assets into gold” (IMF 1987, p. 12). While the suspension of gold convertibility, elimination of par values and development of international credit markets during the 1970s eliminated the role of the SDR in helping to maintain gold convertibility, there were other aspects of the SDR that became more salient, including reserve supplementation, reserve refinancing, lack of access or reduced access to international financial markets and potential control over international liquidity. While the use of SDRs remains limited,[2] the SDR remains a potential source of costless, lower-risk, owned reserves, an existing system that might still evolve to become a “supernational” currency.

Endnotes

[1] Triffin was also a former member of the Federal Reserve Board, serving as chief of the Latin American section of the Board of the Federal Reserve System from 1942 to 1946. From 1946 to 1949, Triffin played various roles at the International Monetary Fund, first as Director of Exchange Control Division, Observer, later as US Representative to the Intra-European Payments Committee of the Organization for European Economic Cooperation (which became the Organization for Economic Cooperation and Development) from 1948 to 1951, and served as US Alternate Representative to the European Payments Unit from 1950 to 1951(Blaug 1985).

[2] The first allocation was for a total amount of SDR 9.3 billion, distributed in 1970-72 in yearly installments. The second allocation, for SDR 12.1 billion, was distributed in 1979–81 in yearly installments. The third general allocation was approved on August 7, 2009 for an amount of SDR 161.2 billion and took place on August 28, 2009. The allocation increased simultaneously members’ SDR holdings and their cumulative SDR allocations by about 74.13 percent of their quota. The IMF’s Board of Governors approved a special one-time allocation of SDRs in September 1997 through the proposed Fourth Amendment of the Articles of Agreement. Its intent is to enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that countries that joined the Fund after 1981—more than one-fifth of the current IMF membership—had never received an SDR allocation. A one time allocation of 21.5 SDRs was made by the IMF in August 2009 in response to the financial crisis of 2008. See Clark and Polak 2004 and Alessandrini and Fratianni 2009.

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