Flash Economics

N° 75
August 4th, 2026

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Why does the Triffin dilemma not (yet) apply to the United States?

Robert Triffin set out the paradox that bears his name in 1960. The argument runs as follows: the country issuing the international currency (the dollar) must run an external deficit in order to meet the growing international demand for its currency, which serves as a reserve currency and as an invoicing currency for trade. Moreover, that country is induced to conduct expansionary policies that generate an external deficit, since it can borrow easily from the rest of the world. This results in a continuous accumulation of external debt (as is the case in the United States today), and Robert Triffin's contention is that, in the long run, economic agents' confidence in the solvency of that country is eroded, as is the role of its currency as an international currency.

Why does the Triffin dilemma not apply today to the dollar, despite the deindustrialisation of the United States and the scale of its external and fiscal deficits? Probably for two reasons.

- No currency is able to substitute for the dollar in its role as the international currency;
- The return on capital is high in the United States, supported by the innovation effort, which attracts international capital.

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In theory, the Triffin dilemma applies to the United States

In his book Gold and the Dollar Crisis: The Future of Convertibility (1960), Robert Triffin describes the paradox that bears his name.

- The country issuing the reserve currency, that is to say the United States, must run **an external deficit** and therefore **accumulate external debt** in order to meet global demand for its currency. This demand stems from the financing of international trade and from the store-of-value function of its currency.
- Moreover, that country, benefiting from considerable ease in borrowing from the rest of the world, is induced **to implement expansionary economic policies**, which widen the external deficit and external debt still further.

It is clear that the United States has:

- implemented **a durably expansionary fiscal policy** (**Chart 1**);
- conducted a monetary policy that has strongly supported **equity market valuations** (**Chart 2**), which has led to a decline in the household saving rate (**Chart 3**);
- benefited from **strong demand for dollar-denominated securities,** both equities and bonds (**Chart 4** shows the stock of Treasury securities held by non-residents);
- continued to benefit from the dollar's **role as a reserve currency** (**Chart 5**).

Chart 1
General government deficit (as % of GDP)

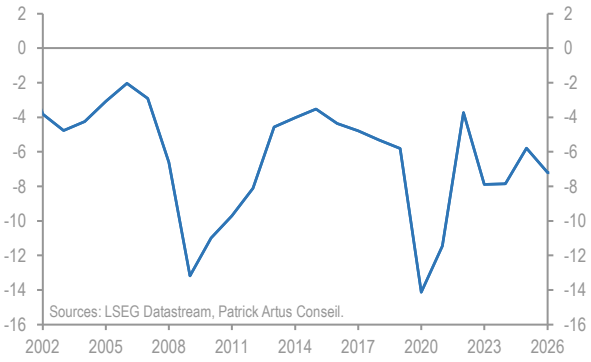


Chart 2
Stock market indices (01.01.2002 = 100)

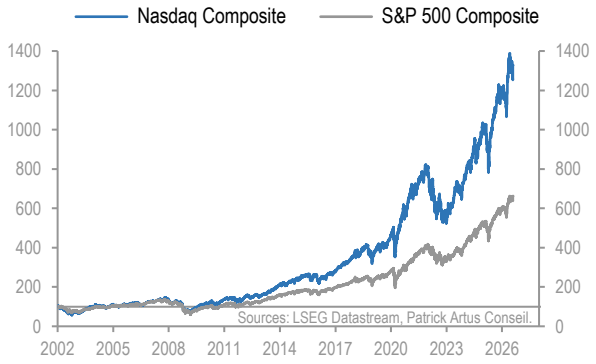


Chart 3
United States: personal saving
(as % of disposable personal income)

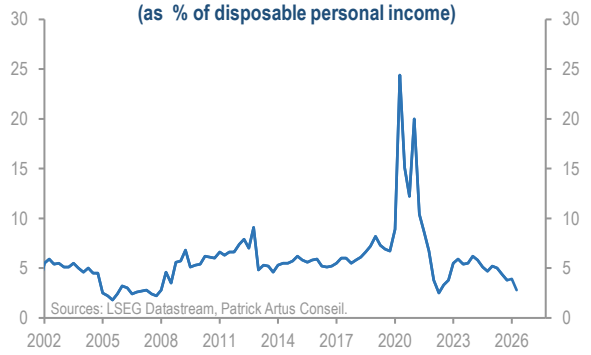


Chart 4
United States: Treasury securities held by non-residents
(USD bn)

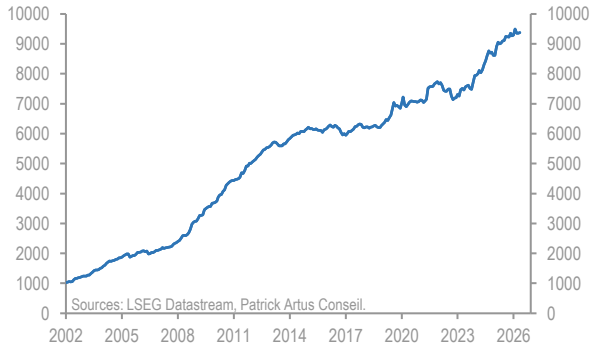
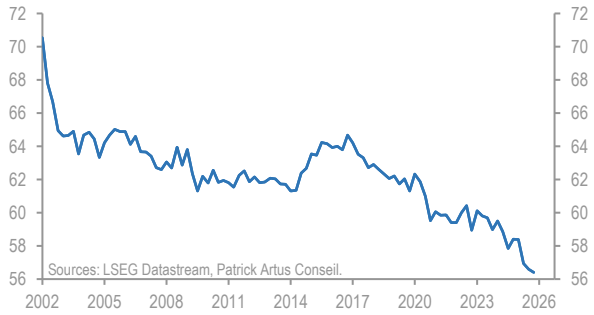


Chart 5
World: Weight of US dollar in the global foreign exchange reserves (as %)

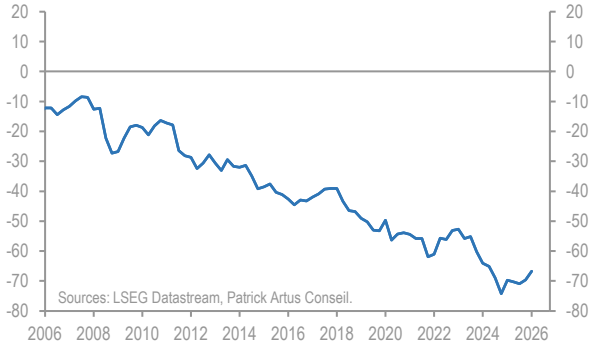


As a result, **the external deficit is chronically high and net external debt is rising continuously** (**Charts 6** and **7**).

Chart 6
United States: Current account balance (as % of GDP)



Chart 7
United States: Net international investment position (as % of GDP)



But the dollar crisis foreseen by Robert Triffin has still not occurred

In line with Robert Triffin's analysis, the United States, as the issuer of the dominant international currency, has been led to accept a large external deficit and a continuous increase in its external debt. International demand for dollars has risen, and the ease with which the United States can borrow from the rest of the world has led it to conduct economic policies with an expansionary bias.

Robert Triffin concluded from this **that confidence in the dollar would decline** and that, in the long run, there would be a dollar crisis resulting from a fall in global demand for dollars. **This judgement, made 66 years ago, has not yet proved correct. Why?**

- **No currency is able to substitute for the dollar in its role as the international currency**. The euro-denominated debt market is segmented rather than unified; the Chinese renminbi is not fully convertible; the Japanese economy is too small to issue the international currency. Beyond its role as a reserve currency (see **Chart 5** above), the dollar carries a considerable weight across the other functions of an international currency. The dollar is the **invoicing currency** for 74% of exports in Asia and 79% of exports outside Asia, Europe and the Americas; lastly, 61% of international debt issuance is denominated in dollars.
- **The innovation effort is very substantial in the United States** (**Chart 8**), which keeps the return on capital very high (**Chart 9**). The only country competing with the United States in innovation is China, whose currency cannot become an international currency.

Chart 8
Gross domestic expenditure on R&D (as % of GDP)

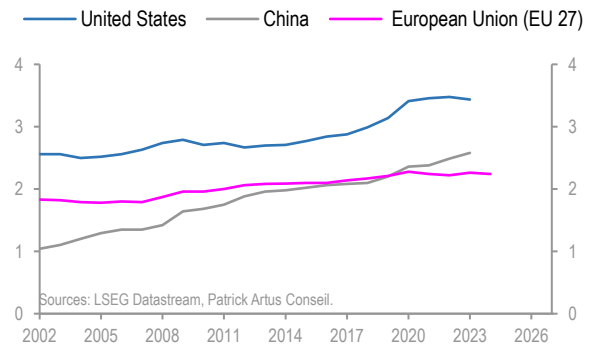
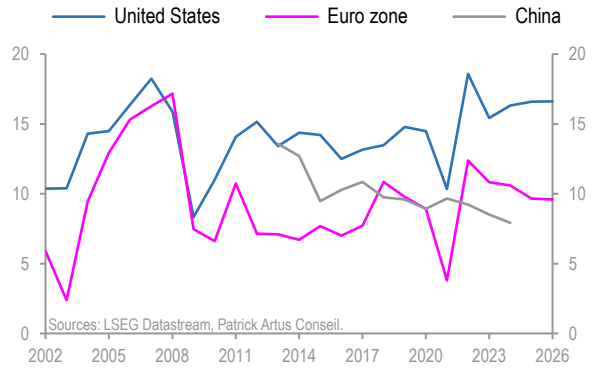


Chart 9
RoE



Summary: the dominant role of the US dollar is not under threat for the time being

In the absence of any currency capable of playing the role of international currency, and thanks to the technological lead of the United States in many areas, the Triffin dilemma has not applied to the United States, with demand for dollars remaining strong. **The dollar exchange rate is, moreover, not weak** (**Charts 10, 11** and **12**).

Chart 10
Euro-US dollar exchange rate (EUR 1 = USD...)

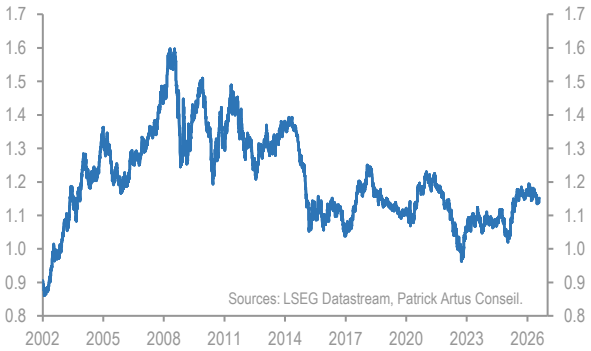


Chart 11
US dollar-yen exchange rate (USD 1 = CNY...)



Chart 12
Dollar-renminbi exchange rate (USD 1 = CNY...)



A share of foreign exchange reserves has admittedly shifted from the dollar into gold, which helps explain the rise in gold price (**Chart 13**); this diversification is nonetheless minor and does not affect uses of the dollar other than reserve holdings (trade invoicing, debt issuance).

Chart 13
Gold price (USD per Troy Ounce)



Central bank digital currencies denominated in renminbi or in euro would only reduce the outstanding amount of other financial assets (bank deposits) in those same currencies. The issuance of stablecoins, which are overwhelmingly denominated in dollars (97% of the outstanding amount), helps to channel savings from the rest of the world into US Treasury securities, thereby reinforcing the weight of the dollar.

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