Triffin Dilemma and International Monetary System
: Evidence from Pooled Mean Group Estimation

Long-Fei Guan1, Wee-Yeap Lau2

Received: September 5, 2017. Revised: April 12, 2018. Accepted: May 5, 2018

Abstract
This study is motivated based on concern from some renowned scholars and central bankers whom have raised the issue of the sustainability of the International Monetary System (IMS). Using the panel data set of four major international currencies, USD, JPY, EUR and GBP from 1973 to 2013 with Pooled Mean Group (PMG) estimator, to re-examine whether Triffin dilemma still exists through investigating the relationship between the reserve share, current account balance and real effective exchange rate. The evidence from the result indicates that Triffin dilemma exists only in the long run, and shows that in the long-run, current account balance is proportionate to the increased real effective exchange rate while varies inversely with the reserve shares. However, the estimation for the short-run is not significant to prove the existence of Triffin dilemma. In addition, we investigated the non-dollar panel sample and found that the international monetary system still suffers from Triffin dilemma even without the dollar. To overcome Triffin dilemma, immediate step such as having currency swap mechanism is recommended. In medium term, a multi-polar Monetary System is suggested, and in the longer time, a supranational currency will be used to replace all the currencies in the world.

Keywords: Triffin Dilemma, International Monetary System, Pooled Mean Group, Real Effective Exchange Rate, Current Account Balance, Malaysia.

JEL Classification Code: F33, E42, G15.

1. Introduction
In the context of cultural pluralism and globalisation, the world has been changing with each passing day and most of the countries, particularly the developing countries, have been unleashing their potential to achieve economic prosperity. However, economic globalisation has out-stepped the development of governmental institutions and rules, especially in the fields of financial and monetary systems (McMillan & Rodrik, 2011). The 2008 global financial crisis has raised doubt on the sustainability of the international monetary system (IMS) as it exposed the instability of dollar-based international monetary system where the dollar is used as the major international currency (Eichengreen, 2011). Indeed, with the economic development of the export-oriented emerging countries for the past few decades, a seemingly unending supply of dollar assets have been put out from the issuing country for use in international trade, storage of value, and accounting units, which has been resulted in the increasing accumulation of dollar reserve in the emerging countries. This is also true for other major international currencies, such as the euro, yen and so on.

In order to hedge the exchange rate risk, the emerging countries like China have purchased a huge amount of the U.S. Treasury bills to build their dollar reserve. This has caused the U.S. domestic cost of capital to sharply decrease, and therefore investment is overheated. Coupled with sense of irrational exuberance by the investors whom are optimistic on the stock market, and also the managers in financial institutions who keep on lending to borrowers irrespective of their credit worthiness have set the stage for the occurrence of Global Financial Crisis in 2008.

To a holding nation, the Federal Reserve and the U.S. government should be blamed for the current state of affairs as they were unable to stabilise the value of the dollar in order to play the role of an international currency. This issue