3. For a small open economy exchange rate adjustments are less effective because the feedback effects on domestic prices are greater.
4. Countries need fairly similar trends in their tendencies to inflate or need to be prepared to make major changes in domestic policies to bring these trends in line.
5. The patterns of shocks may also be important. The relationships can be complicated and depend on the degree of international capital mobility. Where capital mobility isn't too high, fixed rates will help dampen domestically generated income fluctuations, while flexible rates will help protect a country from income fluctuations abroad.

International Monetary System

The "Holy Trinity" analysis shows that one cannot sustain a system with fixed exchange rate, no controls, and independent monetary policy.

The three key features of international monetary systems are their provisions for

1. Balance of payments adjustment mechanisms, for example, fixed or flexible exchange rates
2. International reserves and balance of payments financing
3. Governance issues--especially the extent to which international rules and organizations like the IMF limit the autonomy of national governments in order to avoid beggar-thy-neighbor policies, promote policy cooperation, etc.

The Triffen Dilemma refers to the potential problems in the Bretton Woods system caused by the growth of gold reserves which was too slow to meet the growth in demands for international reserves over time. This liquidity problem could be met by expanded holdings of dollars abroad through U.S. balance of payments deficits, but this would eventually result in a crisis as U.S. dollar liabilities began to substantially exceed their gold backing. In an attempt to resolve this problem the IMF created "paper gold," the SDR (Special Drawing Rights), but the system broke down soon after anyway because of the large U.S. balance of payments deficits associated with the inflationary financing of the Vietnam War.