Chairman REUSS. Mr. Machlup does not have a written paper but will give his ideas orally, and then I and other members of the subcommittee who will be here later would like to engage in discussion with the members of the panel.

Mr. Mundell, would you proceed now orally to either summarize your papers or give any additional views which you think should be placed before this subcommittee as a basis for further discussion?

STATEMENT OF ROBERT A. MUNDELL, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. MUNDELL. Thank you.

I don't think it would be useful if I summarized my plan for world currency at the present time except to point out that I believe that now, with the implied expression of willingness on the part of IMF member countries to go ahead with the SDR's is an appropriate time to pursue a more imaginative plan for reform and to complete the process which it has, by implication, already begun.

I would like instead to mention today two other factors that are of even greater urgency. My first point relates to the problem of the exchange markets; my second point deals with gold. There is currently a state of disequilibrium in the exchange markets and in particular a general belief that the Deutsche mark is severely undervalued, and that the French franc is overvalued.

The market is in large part a victim of a great deal of speculative rumor based on policy statements by various authorities. These rumors themselves, even if they are not founded on fact, can have a fundamental effect on the system. Funds are currently moving into the Deutsche Mark out of the French franc—and to a certain extent out of the pound sterling—and the speculative movements can induce later on basic changes in exchange rates which we may or may not want.

It is with that in mind that I think the steam should be taken out of the speculative rush to the mark. The IMF could do this if it permitted the Bundesbank to widen the exchange margins on the mark. I would suggest a spread from DM 3.7 to DM 4.3 to the dollar in order to allow the mark to appreciate temporarily. Eventually it can be allowed to, as I think it will, come back closer to its current parity after sufficient time has lapsed for internal adjustments to take place.

I think it is important that a widening of the exchange margins, if it is to take place, should take place not all at once with all currencies at once, but allowing for the special circumstances currently involved with the mark and, perhaps, the franc, and that this should be done in sequence, with the mark being allowed to appreciate somewhat temporarily through these widened margins. The widened margins from 3.7 to 4.3 would give ample room for the amount of undervaluation that does exist, and allow the German authorities, to reduce the value of the mark toward parity through internal adjustments as that becomes necessary.

Later, if it seemed desirable, these margins could again be closed. There is no need to keep the margins that wide, but during the present state of rumor in the markets, it would be useful to hold them open at the present time.