under flexible rates and discourage speculative attacks under fixed rates.

These arguments are evaluated below. We now examine the feasibility and the effectiveness of the proposed restrictions on capital flows.

3.2. Feasibility and Effectiveness of Capital Controls

Serious doubts have been raised about the ability of a country to effectively regulate transactions involving its currency in foreign-exchange markets.[12] Even the advocates of the Tobin tax acknowledge that it would be impractical to implement this tax on a unilateral basis. If the tax was imposed only by one country, there would be a strong incentive for the foreign exchange market of the country to move offshore. Thus, it is generally agreed that for the Tobin tax to be feasible, it has to be implemented and enforced in all countries at the same time. However, a multinational agreement to impose a global Tobin tax, would be difficult to negotiate and enforce.

As an alternative, it may be easier to enforce a unilateral deposit requirement (or a tax) on international borrowing or lending involving transactions with banks (or other financial institutions) within the country's jurisdiction. However,

- Regulations of capital flows are likely to divert cross-border credit to banks outside the country's control or non-bank channels that would be difficult to police.

There would be a number of opportunities available for speculators to evade a country's restrictions on international capitals flows. For example, suppose that a firm in country A is interested in short-term speculative investment in country B but would like to escape this country's deposit requirements on capital inflows. For this purpose, A's firm could purchase B's currency from a firm in B (that has need for A's currency for normal trading activities), and then lend these funds to the same firm at B's interest rate. The firm in B could offset this loan by investing an

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[12] For a further discussion of this issue, see Peter Garber and Mark P. Taylor, "Sand in the Wheels of Foreign Exchange Markets: A Sceptical Note" **Economic Journal**, 105, January 1995, 173-180.