Research Paper

Central Bank Independence: An Inevitable Choice for Sustainable Economic Governance

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Abstract

Central Bank Independence (CBI) has increasingly become a global policy norm, transcending variations in geography, political systems, and economic structures. While the theoretical literature highlights independence as a cornerstone of credible and effective monetary policy, empirical evidence from both advanced and emerging economies suggests that CBI plays a pivotal role in promoting price stability, controlling inflation, and strengthening macroeconomic resilience. This paper examines CBI through two critical dimensions, political independence and *economic independence*, and analyzes how these factors interact to shape institutional effectiveness. Drawing on comparative case studies and cross-country evidence, the study demonstrates that higher levels of CBI are strongly associated with sustainable economic governance and long-term fiscal discipline. The findings underscore that central bank independence is no longer a discretionary policy choice but rather an inevitable institutional requirement for safeguarding economic stability and credibility in the globalized era.

Keywords: *Central Bank Independence, Monetary Policy, Economic Independence, Political Independence, Inflation*

INTRODUCTION

Making the central bank independent, a sign of the government's commitment to price and macroeconomic stability (Cukierman et al., 1992; Ftiti et al., 2017), appears as a popular trend, especially from the 1990s all over the world, either by introducing legislation or announcing commitments (Pollard, 1993; Romelli, 2022). This movement of entrusting monetary policy to an unelected but expert body (Haan & Eijffinger, 2016) releases political pressure from the central bank and introduces central bank independence (CBI), a combination of the political independence of a central bank and the economic independence of a central bank (Grilli et al., 1991). This paper is a holistic approach to finding how the two major characteristics of central bank independence (CBI)- political independence and economic independence in some specific countries influence the monetary stability and financial stability. With a brief discussion of the global trend of CBI and its measuring components, the article provides a deep analysis of the political and economic independence of central banks and their effect, wrapping up with the importance of the central bank's accountability and transparency.

Research Problem

Despite the widespread adoption of Central Bank Independence (CBI) across diverse political, geographical, and economic contexts, significant debates remain regarding its actual effectiveness in ensuring sustainable economic governance. While theoretical perspectives strongly

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advocate for independence as a mechanism to enhance policy credibility and reduce political interference, empirical evidence reveals variations in outcomes across countries. In some cases, high levels of independence have been associated with improved inflation control and macroeconomic stability, whereas in others, the results have been less conclusive due to weak institutional frameworks, political pressures, or limited economic capacity. This raises critical questions about the conditions under which CBI can function as an inevitable and effective choice for economic stability. Specifically, the problem lies in understanding how the dual dimensions of political independence and *economic independence* interact in different contexts, and why certain economies benefit more from CBI than others. Addressing this gap is essential to determine whether CBI is universally inevitable or contextually contingent as a policy imperative for sustainable economic governance. The objectives of this research can be divided into the following specific objectives:

1. How do the two dimensions of CBI, political independence and *economic independence*, influence monetary policy credibility and macroeconomic stability?
2. What institutional, political, or structural factors mediate the effectiveness of CBI in emerging versus advanced economies?
3. Can CBI be considered an inevitable policy choice for all economies, or is its success contextually contingent?

LITERATURE REVIEW

Central Bank Independence (CBI): Global Trends

The world is moving towards the independence of the central bank (Romelli, 2022b). For example, within the timespan from 1972 to 2017, a study on 155 countries shows that the decree of central bank independence has an increasing trend over time all over the world, despite having region-based differences (Romelli, 2022a). Besides, in terms of the expansion of political and economic independence of central banks, it has been expanded twice (Arnone et al., 2009). Measuring the degree of independence within a range of 0 to 1, no central bank is found either fully independent or dependent, but the mode of independence is moving upward over time (Figure 1). Here, the degree of CBI varies across different regions, but countries with more economic stability, like Europe, Central Asia, and the developed countries, have a more independent central bank than the others, though at the beginning of 1970, the degree of independence prevailing among the different regions was closer to one another.

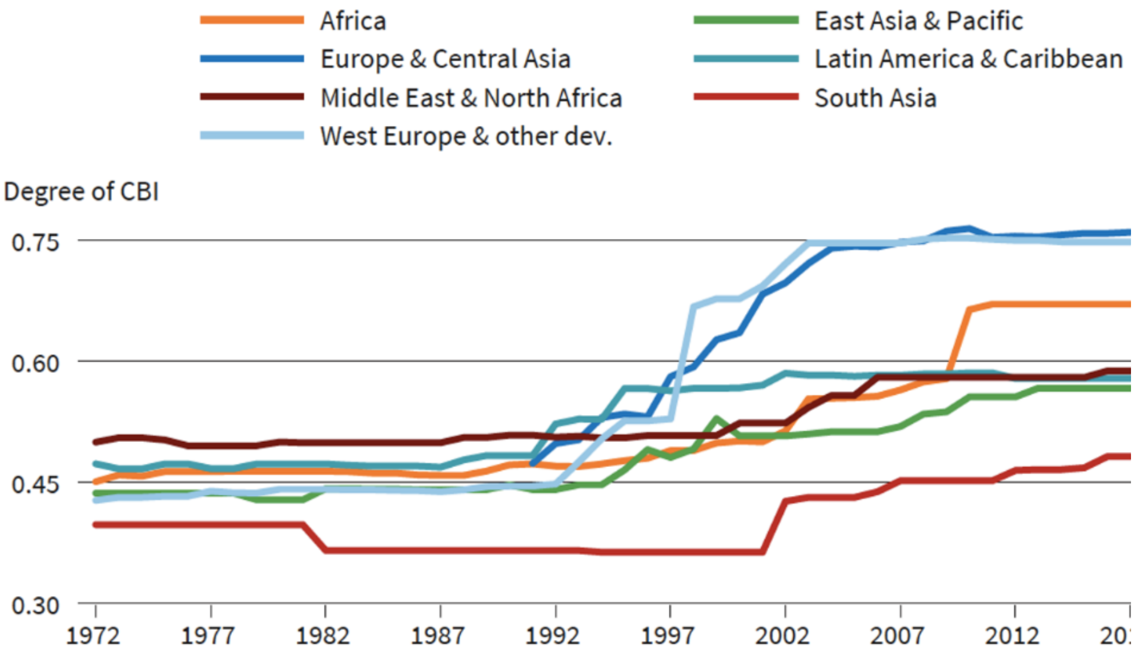

Figure 1. Increasing trend of CBI in different regions of the world
Source: (Romelli, 2022a)

Measuring Components of Central Bank Independence

Central bank independence (CBI), the catchphrase in the 1990s, was analyzed by Bernhard (2022) as the freedom of central banks from government interference (Walsh, 2010). This independence presents the 'institutional independence' of the central bank, free from external interference, where the freedom of using monetary policy tools as 'functional independence', the appointment of the governing body as 'personal independence' and the autonomy over financial resources as 'financial independence' constitute the 'institutional independence' of a central bank (Issing, 2006). On the contrary, Buiter (2005) argues with the concept 'independence' in a sense that the concept 'independence' doesn't comfortably suit the economic model, rather the government-central bank relationship as 'Principal-Agent' status; where the government acts as 'Principal' through the Treasury and the central bank acts as 'Agent' to perform the delegating task by the government (Buiter, 2005). However, how far a central bank is independent is justified by the independence experienced by a central bank on two fundamental grounds in most studies; one deals with the decisive power on monetary policy, and the other deals with the freedom to use the monetary instruments that a central bank has. Grilli et al. (1991) termed the first one as the political independence of a central bank, with a measuring scale from zero to eight, and the second one as the economic independence of a central bank, with a measuring scale from zero to seven (Grilli et al., 1991).

Political independence of a central bank, central bank's capacity of deciding the monetary objectives independently (Binder, 2021), can be measured on whether the government appoints the governor or not, whether the governor is appointed for more than five years or not, whether the government provides a mandatory representative in the board of the central bank or not, whether the board members are appointed for more than five years or not, whether the monetary policy need to be approved by the government or not, whether a central bank is constitutionally empowered or not, whether there are any legal directions or not to move for a procedural solution of not being overruled by the government in case of arising any conflict between the government and central bank (Grilli et al., 1991). All these factors combinedly form the political independence of the central bank.

Economic independence of a central bank relies on the terms and conditions applied to the government borrowing from the central bank, and in this case, if a government cannot borrow from the central bank automatically, if the specific amount of loan for a temporary period with market interest rate defined by the central bank is provided to the government, it brings higher economic independence. Along with these, if the central bank doesn't take part in the primary market as a buyer, if the central bank defines the interest rate, and if the central bank doesn't require banking supervision, economic independence increases (Grilli et al., 1991). Similarly, Cukierman et al. (1992) think that four attributes, such as the central bank's chief executive appointment, the central bank's independence to set objectives, formulating policy, and approving government loans, indicate the CBI (Cukierman et al., 1992)

Political Independence of Central Bank

The study of Grilli et al. (1991) depicts the scenario of political independence in eighteen developed countries towards the late 1908s, and with a comparison to this, the study of Arnone et al. (2009) finds the overall improvement of the political independence in twenty-seven developed countries that include those eighteen countries. Considering the components of political independence, such as appointing the governor, in most sample countries (Grilli et al., 1991), either the governor is appointed by the executive body of the country or the influence of the government plays a key role in appointing the governor, and the governor is appointed for four to five years, with a few exceptions.

Table 1. Political Independence of Central Bank

Countries	Factors of Political Independence								Overall Output
	1	2	3	4	5	6	7	8	
Australia		*					*	*	3
Austria						*	*	*	3
Belgium				*					1
Canada	*	*					*	*	4
Denmark		*				*	*		3
France		*		*					2
Germany		*		*	*	*	*	*	6
Greece			*					*	2
Ireland		*				*	*		3
Italy	*	*	*		*				4
Japan							*		1
Netherlands		*		*	*	*	*	*	6
New Zealand									0
Portugal					*				1
Spain				*	*				2
Switzerland		*			*	*	*	*	5
UK					*				1
US				*	*	*	*	*	5

Source: (Grilli et al., 1991)

Notes:

Column 1	The governor was not appointed by the government
Column 2	The governor was appointed for less than five years
Column 3	All the board members appointed by the government
Column 4	Board appointed for less than five years
Column 5	No mandatory participation of a government representative on the board
Column 6	No government approval of monetary policy
Column 7	Statutory requirements that the central bank needs
Column 8	Legal provisions that strengthen the central bank's position

In Germany, a governor is appointed for eight years, and in Ireland, the Netherlands, Australia, and Canada, it is a seven-year term. Thinking of the formation of the central bank board, except Germany, Italy, the Netherlands, the UK, Spain, Switzerland, and the US, the provision of incorporating a government representative with voting power is present, which reduces the political independence of a central bank, and the term-time varies with a range of four to eight years. Besides, for monetary policy, central banks in Austria, Denmark, Germany, Ireland, the Netherlands, Switzerland, and the US don't require approval from the government, which enhances the political independence of the central bank. Countries like Belgium, France, Italy, New Zealand, Portugal, Spain, and the UK don't provide any constitutional position or legal provisions to central banks that strengthen the position of a central bank. So, the study of Grilli et al. (1991) shows that the highest rate of political independence is found in Germany and the Netherlands, Italy, the US, Switzerland, and Canada, whereas the central banks in Japan, Belgium, the UK, New Zealand, and Portugal experience the lowest level of political independence. Based on the data mentioned above, for the developed countries, the overall political autonomy measured as 0.36 within the measuring range from zero to one in the late 1980s (Grilli et al., 1991) moved to 0.70 in 2003 when the sample size was 27 (Arnone et al., 2009). So, within a decade, the political independence of central banks in the sample countries increases twice.

Economic Independence of Central Bank:

The factors that define the economic independence of a central bank can be categorised into two sections: financing to the government to cover the budget deficit and monetary instruments (Grilli et al., 1991). Economic dependence in terms of financing to the government can be measured through the indicators mentioned in 1-5 in Table 2, which actually represent the nature of the government's access to a loan from a central bank.

Table 2. Economic Independence of the Central Bank

Countries	**Factors of Economic Independence**							**Overall Output**
	1	2	3	4	5	6	7	
Australia	*	*	*	*	*	*		6
Austria			*	*	*	*	**	6
Belgium		*		*	*	*	**	6
Canada	*	*	*	*		*	**	7
Denmark		*			*	*	**	5
France				*	*	*	**	5
Germany	*	*	*	*	*	*	*	7
Greece				*		*		2
Ireland		*	*	*		*		4
Italy				*				1

Countries	Factors of Economic Independence							Overall Output
	1	2	3	4	5	6	7	
Japan	*		*		*	*	*	5
Netherlands			*	*	*	*		4
New Zealand			*	*	*	*		3
Portugal				*		*		2
Spain			*	*			*	3
Switzerland		*	*	*	*	*	**	7
UK	*	*	*	*		*		5
US	*	*	*	*	*	*	*	7

Source: (Grilli et al., 1991)

Notes:

Column 1	Non-automatic credit facility from the central bank
Column 2	Credit facility with market interest rate
Column 3	Temporary credit facility
Column 4	Limited credit facility
Column 5	Non-participation of the central bank in the primary market
Column 6	Discount rate by the central bank
Column 7	** for no supervision of the banking system by the central bank
	* for supervision on the banking system, but not the central bank alone

Similarly, in terms of monetary instruments, the indicators mentioned in columns 6-7 represent the central bank's discretion in setting the discount and supervising the banking sector. Considering all the indicators mentioned in columns 1-7 in Table 2, the output suggests that central banks in Canada, Germany, Switzerland, and the US enjoy the highest rate of economic independence, where central banks in Australia, Austria, and Belgium occupy a very close position to the highest rate of economic independence. On the contrary, central banks in Italy, Greece, and Portugal get the lowest rate of economic independence (Grilli et al., 1991). Considering the findings from Table 2, in the developed countries in the late 1980s, the overall economic autonomy measured as 0.59 within the measuring range from zero to one (Grilli et al., 1991) increased to 0.81 in 2003 (Arnone et al., 2009). So, the economic independence of central banks in developed countries is on an increasing trend.

Effects of CBI:

The study of Grilli et al. (1991) depicts the overall CBI in the sample countries as 0.48 in the late 1980s, which increases to 0.75 within the measuring scale from zero to one in 2003 (Arnone et al., 2009). In the analysis of individual scores, the central banks of Greece, New Zealand, Portugal, and Spain get the lowest degree of political and economic independence, and on the other hand, Germany, the Netherlands, Switzerland, the US, and Canada experience the highest, as shown in Figure 2.

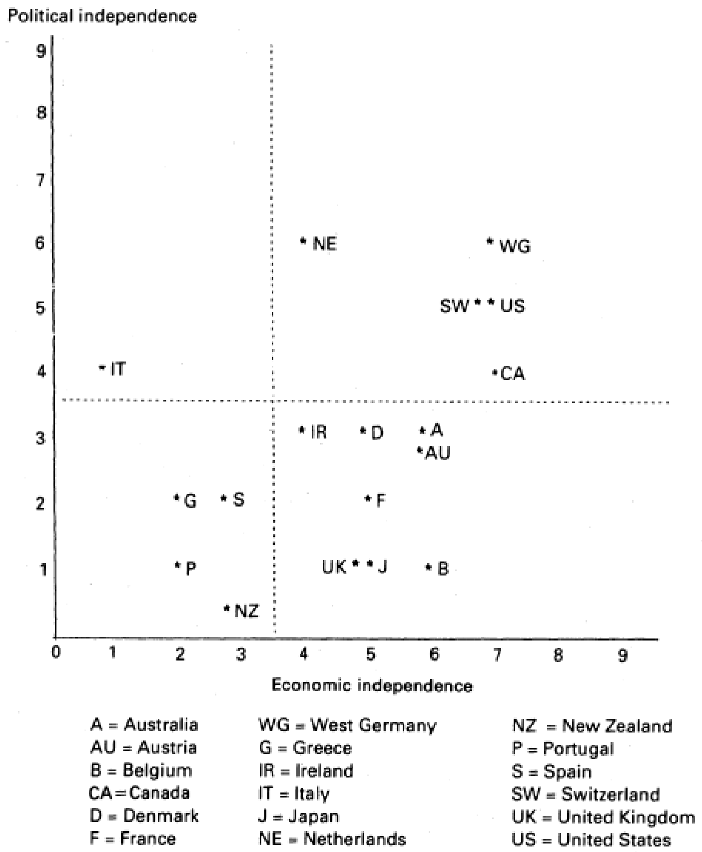

Figure 2. Political and Economic Independence
Source: (Grilli et al., 1991)

The study of Grilli et al. (1991) shows that the net debt in proportion to GNP in Germany, the Netherlands, Switzerland, the US and Canada is 21.9%, 57.2%, 10.4%, 29.2% and 38% in 1989, whereas Greece, New Zealand, Portugal and Spain experience 79%, 74.7%, 71.8% and 29.3%. In case of inflation rate (%), the best performer in CBI measurement, Germany, Netherlands, Switzerland, the US and Canada has 2.9%, 3.1%, 3.3%, 5.6% and 6.7% which provides a better indication than Greece (20.1%), New Zealand (12.5%), Portugal (18.2%) and Spain (10.6%). So, significantly it is found that central bank independence (CBI) helps to keep a lower rate of inflation (Alesina, 1988; Grilli et al., 1991) and in general, central banks turning from no independence to full independence have been successful in reducing inflation rate by about fifty percent as found in 163 countries in 2003 (Arnone et al., 2009). A similar study in this regard identifies that lower inflation comes with the policy and financial independence of central banks in democratic countries (Garriga & Rodriguez, 2020). Here, other determinants except CBI, such as fiscal policy, which sometimes creates pressure for inflation and a non-fixed exchange rate, which invites inflation, act as influential factors in controlling inflation (Arnone et al., 2009). On the contrary, it is also claimed that the idea that CBI reduces the inflation rate is experienced in developed countries (Alesina & Summers, 1993; Klomp & Haan, 2010), but it is quite inappropriate in the case of developing countries (Crowe & Meade, 2007; Klomp & Haan, 2010). Within the developed countries, in relation to central bank independence and economic excellence, the history of Japan and Germany is quite opposite and astonishing (Pollard, 1993). In spite of having arguments on reducing inflation, policymakers still consider CBI as a vital issue for price stability. Study shows that the turn of a central bank into an independent one from a dependent one brings a decrease in the inflation rate, more specifically the inflation rate decreases in terms of personal independence, objective independence of the central bank, policy independence and financial independence as 60.5%, 59.1%, 39.7%, 46.2% respectively (Garriga & Rodriguez, 2020). The reason is that a central bank that is independent and free from political pressure prevents the manipulation of monetary policy during the pre-election period (Willet & Keil, 2004) or any short-term boosts in employment that raise inflation (Garriga & Rodriguez, 2020).

RESEARCH METHOD

This study employs qualitative methodology to examine the contemporary literature on the global trend of CBI. This study's research architecture establishes a systematic framework by synthesizing existing evidence, identifying trends, and uncovering research gaps related to CBI. The iterative design accommodates emergent insights through procedural adaptability. By analyzing the present CBI worldwide context and output of this, the approach facilitates deep thematic exploration. Data collection in qualitative research involves gathering textual information from secondary sources to address the research questions and objectives. In this study, data collection primarily entails a comprehensive review of existing literature related to CBI and its acceptance and application. The researcher employs systematic search strategies with the consultation of experts to identify relevant literature. The selected literature is then critically evaluated to extract key concepts, arguments, and empirical findings

FINDINGS AND DISCUSSION

CBI with Transparency: An Inevitable Choice:

'Having an independent central bank is almost like having a free lunch, there are benefits but no apparent costs in terms of macroeconomic performance' (Grilli et al., 1991). Thinking of the two choices, whether the central bank should be independent or not, central bank independence is an inevitable choice, and from the economic point of view, it has been recognized as a 'truth of economics' universally (Wachtel & Blejer, 2020). Besides, the International Monetary Fund (IMF) urges the absolute independence of the central bank in connection with the traditional monetary policy (Blanchard, 2015)

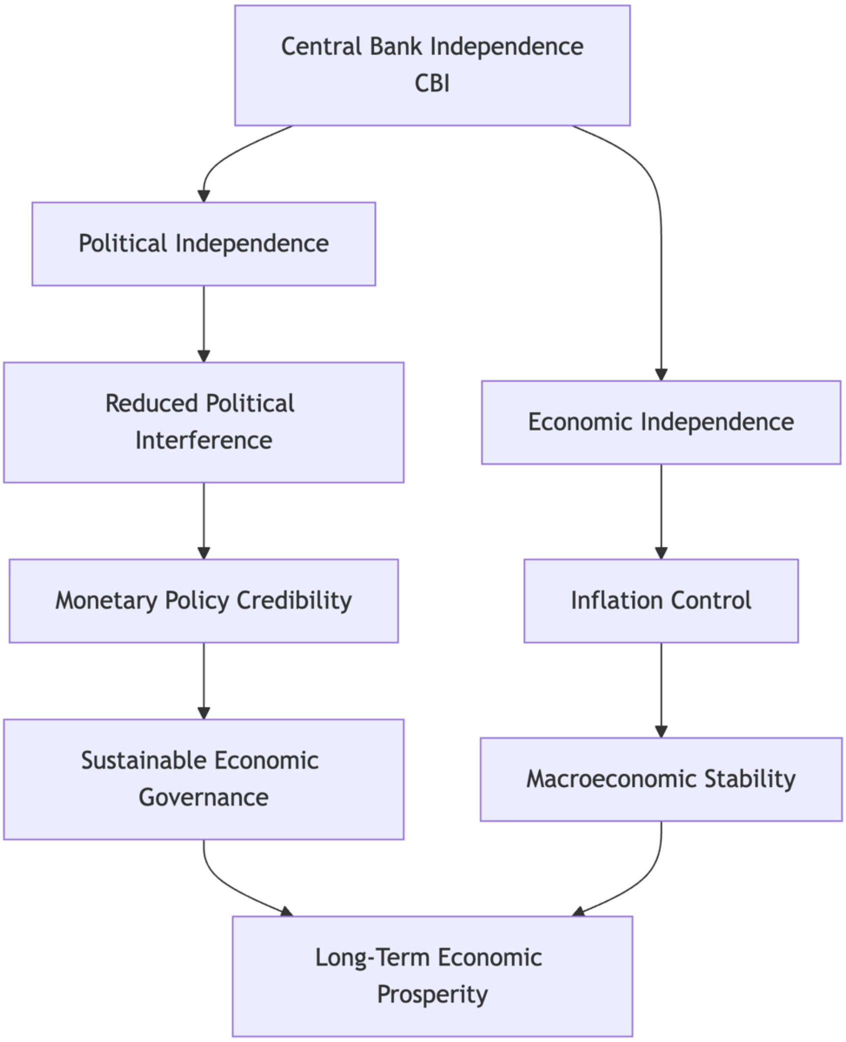

Figure 3. CBI Impact

In the case of macroeconomic advantages, both developing and developed countries moving to greater central bank independence experienced better outcomes as a result of CBI in the last few decades, but the main challenge is in boosting the political independence of central banks (Arnone et al., 2009). The reason behind the conflict between the government and the political independence of the central bank is that the government wants to boost the employment facility during the pre-election period by increasing money flow and investment, which invites inflation. This tendency is impeded when central bank independence exists. Another challenge is that the fiscal policy and monetary policy are not formulated in the same tone and target affects the total financial discipline (Arnone et al., 2009). Though it is also claimed that this is true only for those countries that haven't attained the absolute stage of CBI.

The prime criticism of absolute CBI is that it requires democratic accountability (Stiglitz, 1998), though it is claimed that democratic accountability and absolute CBI are conflicting. For accountability, transparency is a must (Stiglitz, 1998), which provides the justification of monetary policy decisions to the public to enhance credibility (Issing, 1999). But, other than the essential ambiguity for policy making and implementation (Stiglitz, 1998), no significant increase is experienced in terms of political transparency, economic transparency, procedural transparency, policy transparency, and operational transparency for the developing countries (Crowe, 2008). In a democratic country, parliament can play a vital role, where, as a legal obligation, the central bank can explain its policy actions (Stiglitz, 1998). In developed countries, the transparency of central banks is rated higher. For example, Haan et al. (2005) find that within the measuring range from zero to fifteen, New Zealand and the UK are the best performers, and the best performer in terms of CBI, as found in this essay, Germany is experienced as more transparent than the European Central Bank (Haan et al., 2005).

CONCLUSIONS

The prime findings of this article indicate that granting political and economic independence to central banks has a close association with monetary stability and can be used as an efficient tool to reduce inflation. The best output can be assured when the accountability and transparency of a central bank are ensured with the gradual increase of central bank independence (Crowe, 2008). At the same time, it is challenging that absolute dependence on central bank independence places more importance on macroeconomic policy than on fiscal policy, which can create challenges during a recession, and here lie the central bank–government joint initiatives to influence the banking structure and banking behaviour (Dow, 2017), as at the end of the day, central banks act as 'the lender of last resort'.

LIMITATIONS & FURTHER RESEARCH

This study is constrained by its reliance on qualitative methodology and secondary data, which limits the ability to capture real-time dynamics and country-specific variations in central bank independence (CBI). Since the findings are derived primarily from existing literature, potential biases in the reviewed sources and definitional inconsistencies across contexts may have influenced the interpretation of results. Moreover, the analysis remains largely thematic and conceptual, without the support of empirical data or cross-country quantitative comparisons that could validate the theoretical arguments presented. The study also focuses on general global trends, which may overlook region-specific institutional, cultural, and political factors shaping the effectiveness of CBI.

Future research could address these limitations by adopting a mixed-methods approach, integrating qualitative insights with robust quantitative analyses. Comparative case studies across developing and developed economies may provide a deeper understanding of how political structures, democratic accountability, and transparency mechanisms influence the success of CBI. Furthermore, longitudinal research examining the evolution of CBI within specific regions could highlight the changing interplay between monetary independence and fiscal policy coordination. Expanding research into emerging economies and incorporating stakeholder perspectives—such as policymakers, financial institutions, and civil society—would also enrich the discourse, ensuring that the debate on CBI remains grounded in both theoretical rigor and practical realities.

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