

Central Bank Independence: Mandates, Balance Sheets and Governance

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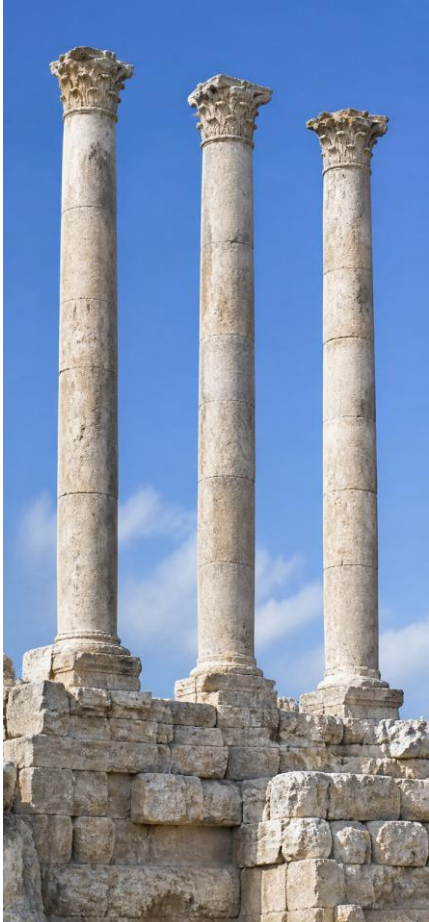
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Independence is not a technocratic blank cheque



“Independence” is operational freedom to use legally founded set of **policy tools** to pursue a **clear publicly-given mandate**, paired with **hard accountability** (and other safeguards, such as financial autonomy, etc.).

— Pillars of CBI



Mandate

Different mandates, different framework

Balance sheet/Tools

Normal times, lower bound, and stress

Governance/Accountability

Flexibility without mission creep

Monetary policy and financial stability: related, but not twins

Dimension	Monetary Policy	Financial Stability
Objectives	Clear and "measurable": inflation and full employment (albeit not directly observable). Independence converts into a verifiable public contract (Balls, Howat & Stansbury, 2018).	Multiple and probabilistic: safety, stability, resilience, and crisis prevention; success often counterfactual (Tarullo, 2024).
Time Horizon	Lags, but still frequent feedback via inflation data and expectations, allowing deviations to be explained in real time.	Long fuse: vulnerabilities and losses can surface years later, creating forbearance risk; independence at supervisory levels remains essential (Steele, 2025).
Perimeter and Fiscal Line	Policy rate straightforward, but tools such as QE and emergency facilities can blur into fiscal territory, and have distributional consequences.	Tools are granular and legalistic: buffer calibration, stress tests, LoLR and enforcement shape credit allocation (Tarullo, 2024).

Balance sheet and tools: separate the questions

Normal times

Purpose: implement monetary policy and control short-term rates

Size: smallest balance sheet consistent with effective implementation, money-market stability, and credible crisis capacity

Asset mix: shorter-term Treasuries may better match short-term interest-bearing reserves and reduce fiscal optics

Remuneration: interest on reserves is part of the operating framework, not just a transfer to banks

Tradeoff: smaller footprint versus rate control, money-market volatility, and routine liquidity access

Lower bound and financial stress

Purpose: provide macro stimulus when rates are constrained, or restore market functioning/address financial stability threats

Capacity: enough flexibility to act quickly when the policy rate or T-bills are not enough

Tool choice: market-functioning purchases should be targeted and temporary; QE for stimulus needs a separate monetary-policy justification

Governance: public rationale, comprehensive cost-benefit assessment, risk assessment, and exit strategy

Tradeoff: flexibility in stress versus duration risk, fiscal risk, credit allocation, and distributional consequences

Governance: flexibility without mission creep

Risk	Governance discipline
Blurring purposes	Identify the mandate: monetary policy or financial stability; avoid any fiscal role unless acting as Treasury's agent
Weak ex ante discipline	Require a comprehensive net-benefit assessment, including fiscal, distributional, and financial-stability risks relative to a credible base case
Balance-sheet creep	Separate balance sheet policy for normal operations from extraordinary operations (e.g., QE and emergency market-functioning tools)
Open-ended stress tools	Require public rationale, escalation rules, exit strategies and, where appropriate, indemnities
Weak ex post accountability	Commit to external and independent reviews, public lessons learned, and framework adjustment

Independence requires governance, not legal protection alone

Mandates: Monetary policy cannot function without financial stability

- But the frameworks still need to be distinguished in design and communication

Balance sheet/tools: Choices involve tradeoffs

- Size, asset mix, and reserve remuneration each come with costs and benefits, but the framework must still preserve the capacity to act at the lower bound and in stress

Governance/accountability: Disciplined flexibility is critical in stress

- Powerful tools need clear mandates, fiscal boundaries, exit strategies, and external reviews