Do central bank reforms lead to more monetary discipline?

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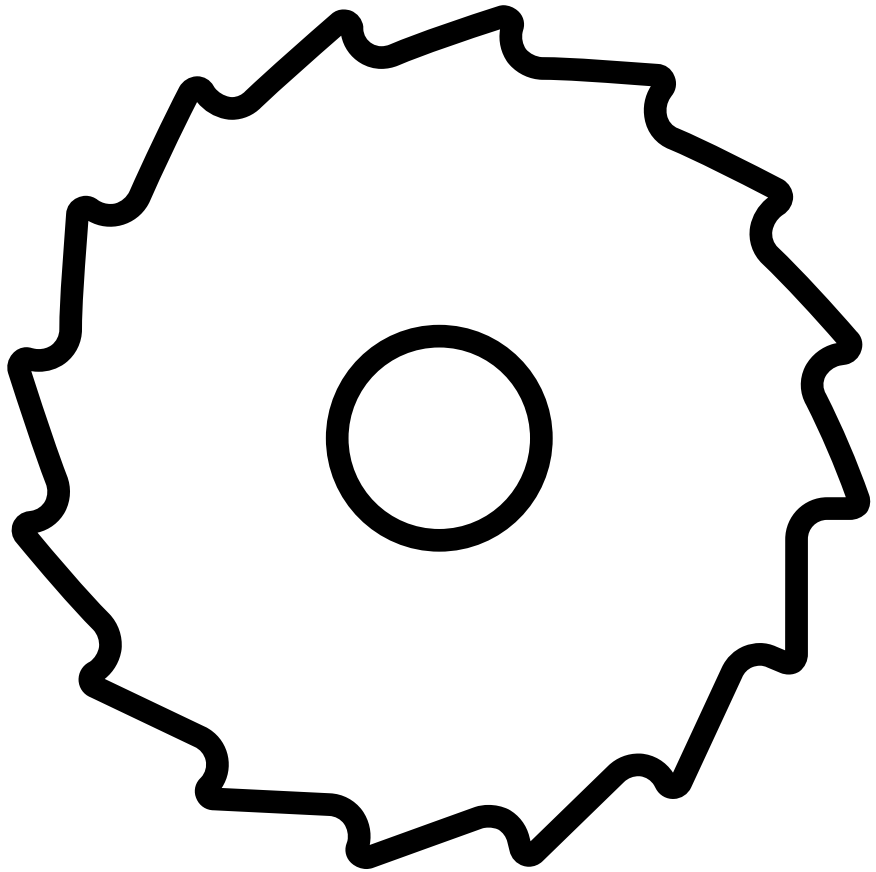
Political pressure for lower policy rates is a challenge for central banks.

“We’re never going to be influenced by any political pressure… Our independence is a matter of law.”

(Jerome Powell, 16 April 2025, Economic Club of Chicago)



Aim of the presentation

- **Why** central bank reforms support price stability
- **How** independence contributes to price stability
- **What** political and institutional constraints matter

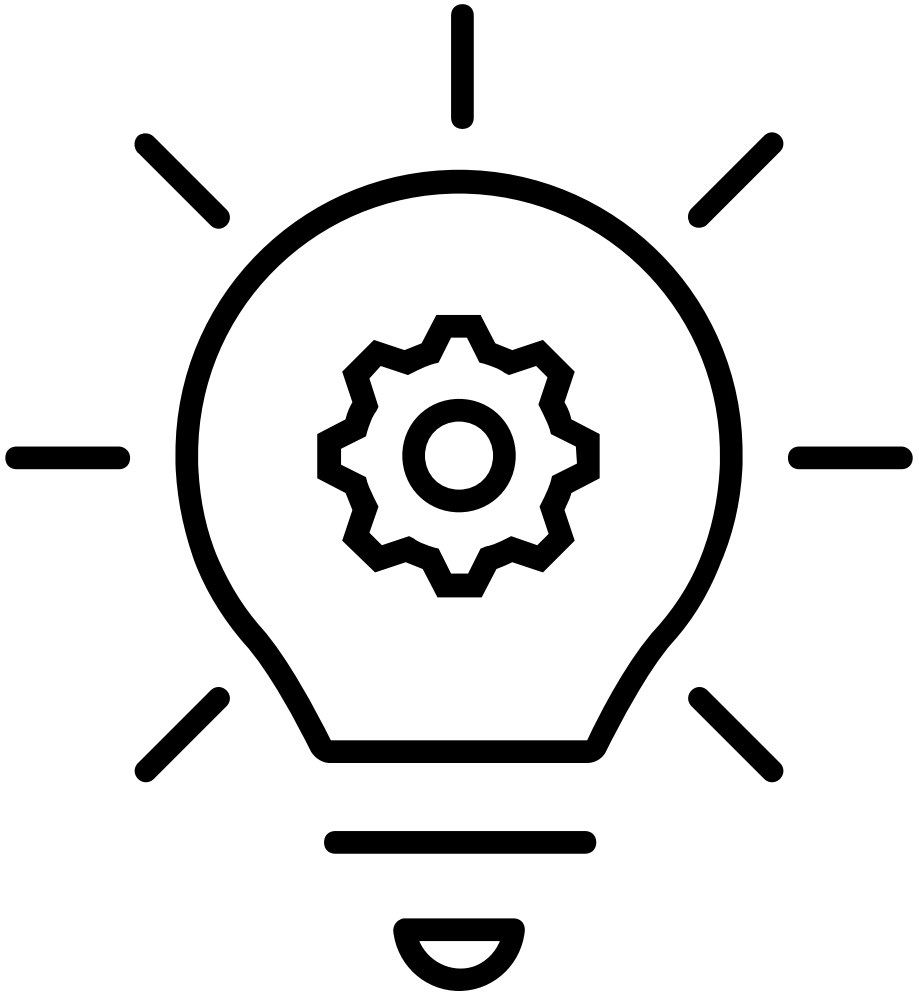
What does the literature say?

"Society can sometimes make itself better off by appointing a [conservative] central banker who does not share the social objective function, but instead places 'too large' a weight on inflation-rate stabilization relative to employment stabilization"

(Kenneth Rogoff, 1985)

"Monetary discipline associated with central bank independence reduces the level and variability of inflation but does not have either large benefits or costs in terms of real macroeconomic performance"

(Alberto Alesina and Lawrence Summers, 1983)



Knowledge gap

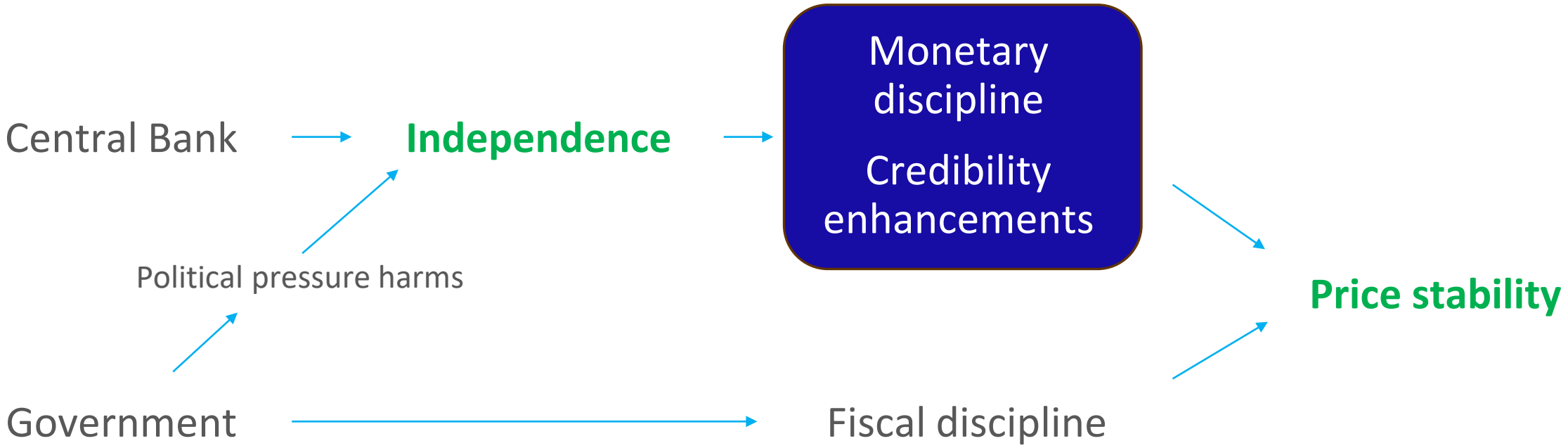
- Empirical literature has shown that there is a close correlation between central bank independence (CBI) and low inflation, worldwide.

However, not much is known about:

- the exact mechanisms through which CBI reforms affect domestic inflation dynamics and

- the extent to which their impact depends on political and institutional frameworks

Key channels



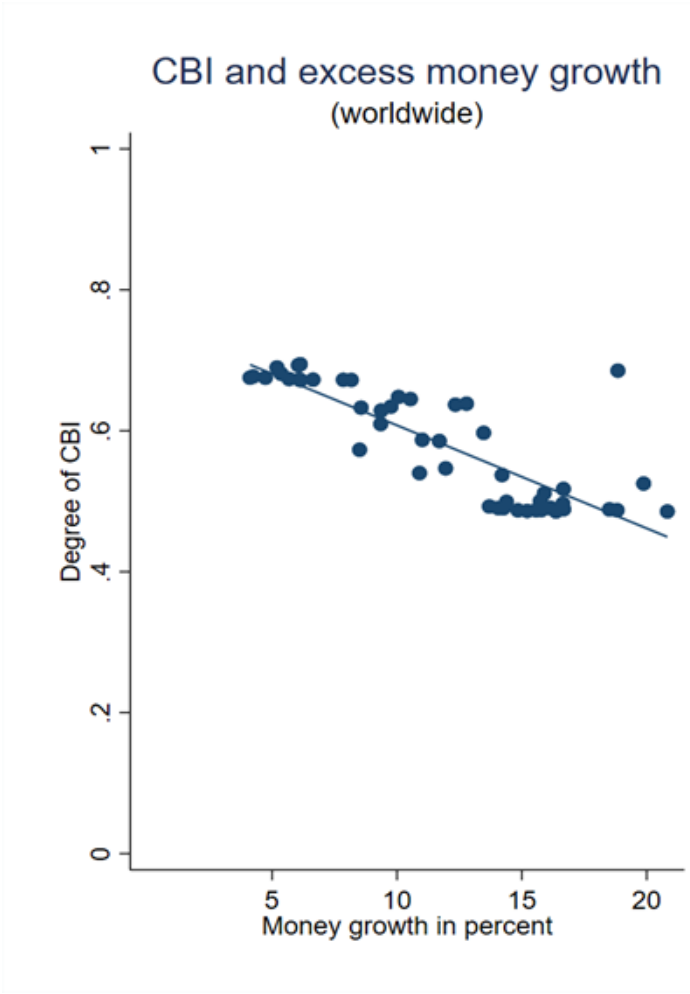
A correlation between Independence and …

Period 1972 – 2023

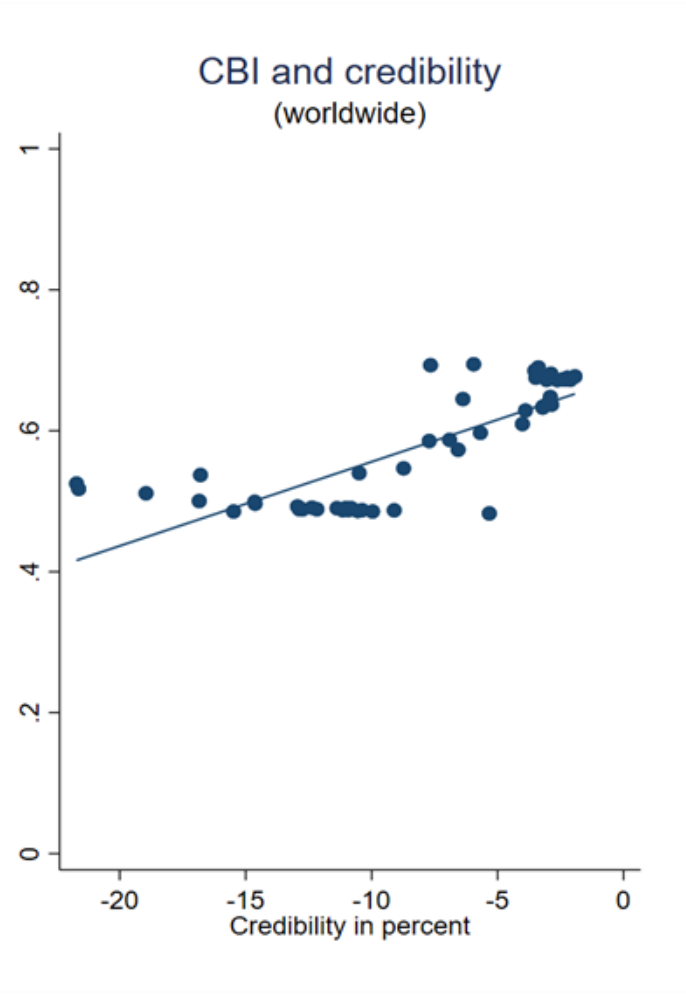
Sample 155 countries

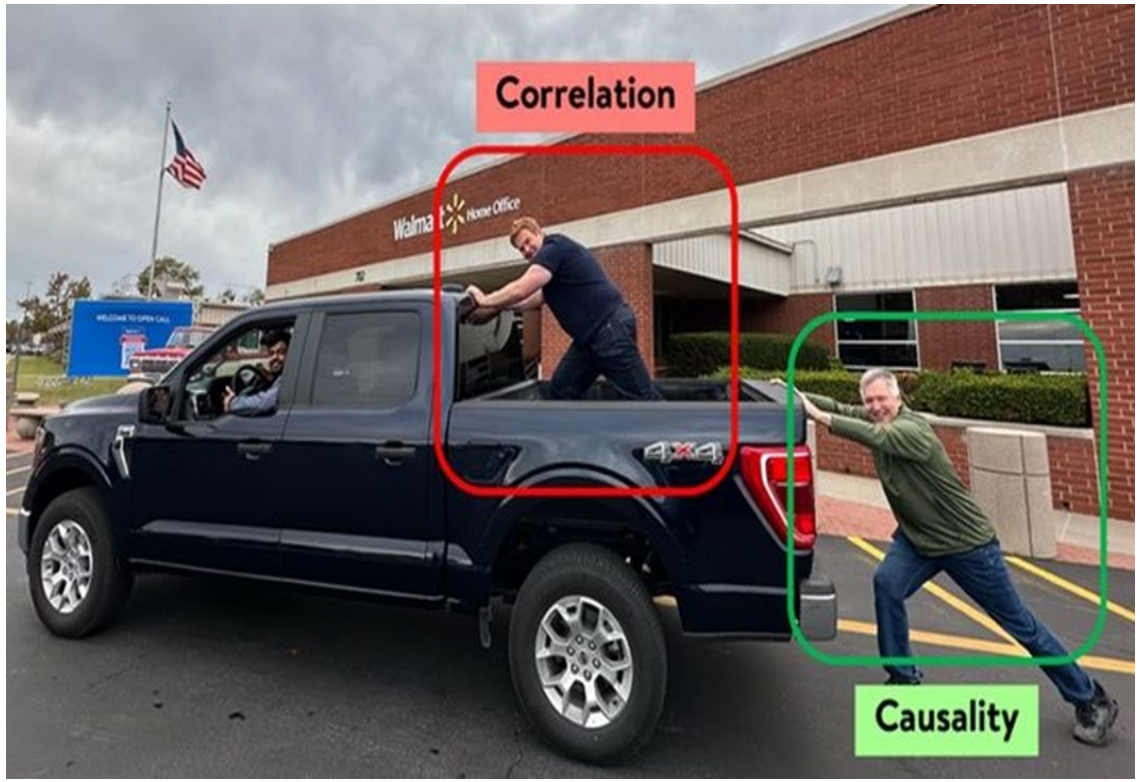
Notes: The figure shows observations for an average of 155 countries. The LHS chart shows annual growth rates for broad money aggregates. Excess money growth is the difference between nominal and real GDP growth. The RHS chart shows average credibility, measuring how much the public expects policy outcomes to deviate from prior policy announcements. The data have been winsorized at the 1st and 99th percentiles to reduce the influence of outliers.

Monetary discipline



Credibility





Correlation versus Causality

"It is a true case when a picture is worth a million words."

(John List, 30 June 2025, Facebook post)

Main method

Local projections with instrumental variables (as in Jordà and Taylor, 2025)

First stage: $$\Delta CBI_{i,t} = \mathrm{a}_i + \mathrm{d}_t + \mathrm{b}\,\Delta Z_{it} + c\ \Delta X_{it} + \varepsilon_{i,t},$$

Second stage: $$y_{i,t+h} - y_{i,t-1} = \alpha_i + \delta_t + \beta_h \widehat{\Delta CBI_{it}} + \gamma_h X_{it} + \nu_{i,t+h},$$

Dependent variable (y): Excess money growth or Credibility

Independent variable (CBI): (Annual) change in the CBIE index

Controls (X): Exchange rate stability, the debt-to-GDP ratio, changes in monetary policy transparency, the ZLB dummy, and dummies for crises events

Instrument (Z): Regional peer pressure

Impact of Independence on ...

Period 1972 – 2023

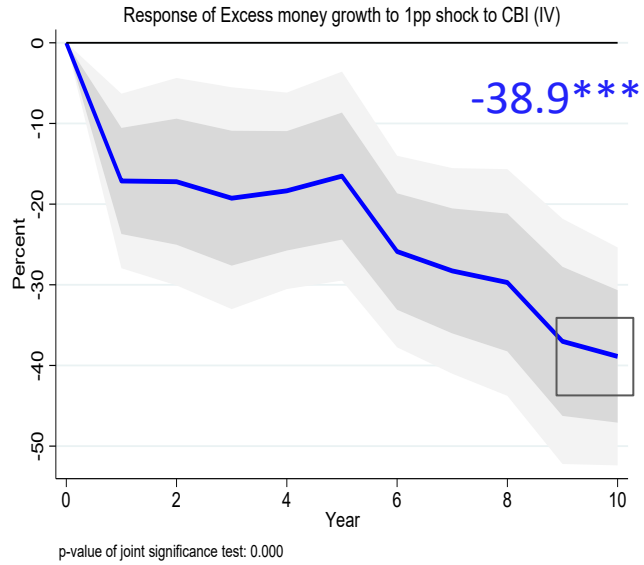
Sample 155 countries

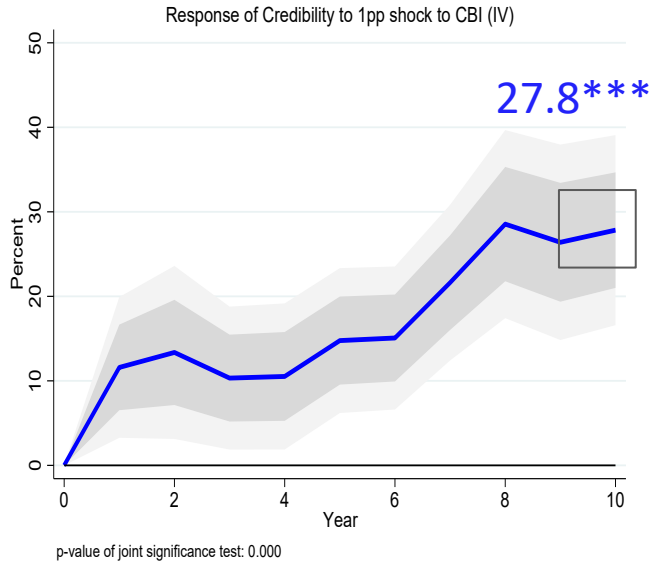
Notes: The estimation is for the sample 1972-2023. Monetary discipline is measured by excess money growth. Credibility measures how much the public expects policy outcomes to deviate from prior policy announcements. Regional peer pressure is used as the instrument for LP-IV. The confidence intervals are 68% and 90%. The data have been winsorized at the 1st and 99th percentiles to reduce the influence of outliers.

Monetary discipline

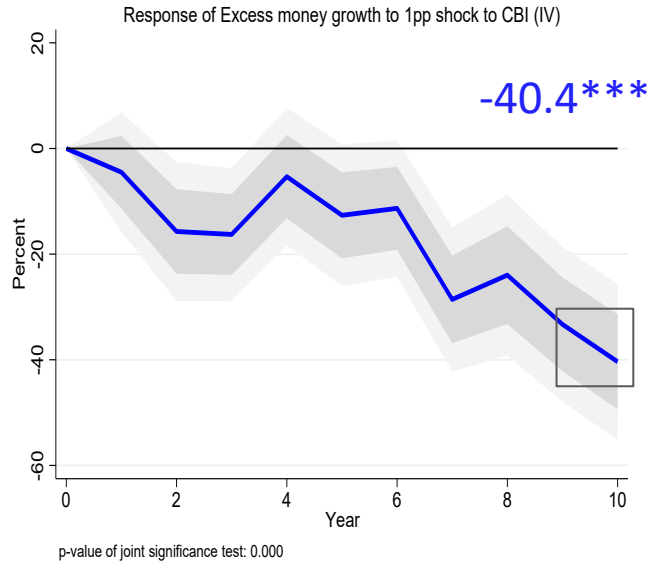
Credibility

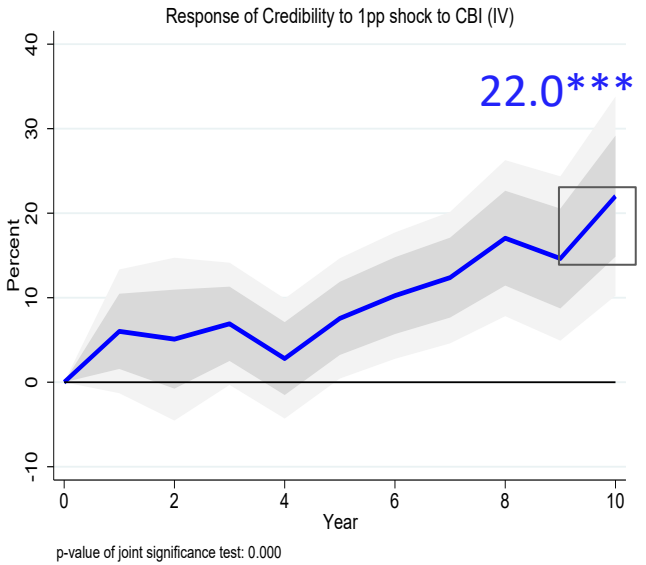
Baseline





Reform countries without reversals





Political and institutional frameworks matter

Cumulated long-run effect: 10 years		Monetary discipline	Credibility
Political system	Democratic	-54.3***	33.3***
	Autocratic	-9.4	0.5
Monetary policy strategy	Inflation targets	6.8	0.3
	No monetary policy targets	-38.6***	26.3***
Exchange rate regime	Flexible	-45.6***	36.8**
	Fixed	-8.5	5.9

Fiscal expansion may influence the link

Period 1972 – 2023

Sample 155 countries

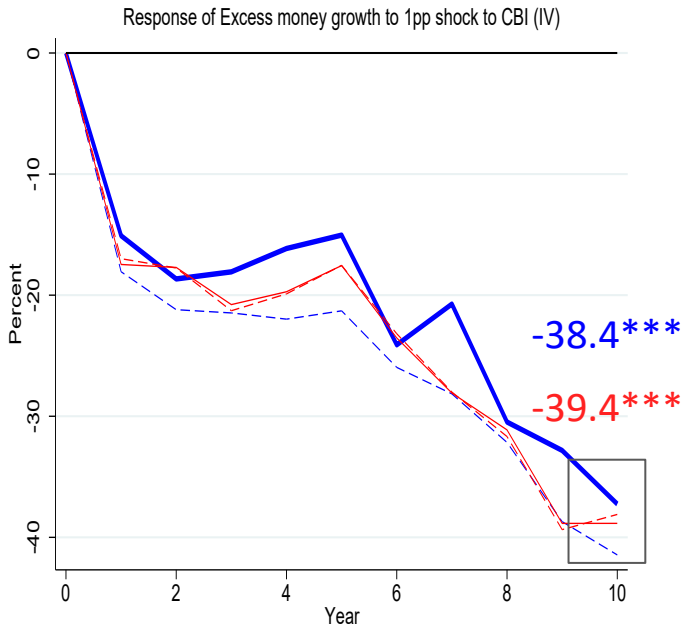
Blue solid line: debt-to-GDP ratio≤ 60%

Blue dashed line: debt-to-GDP ratio≤ 90%

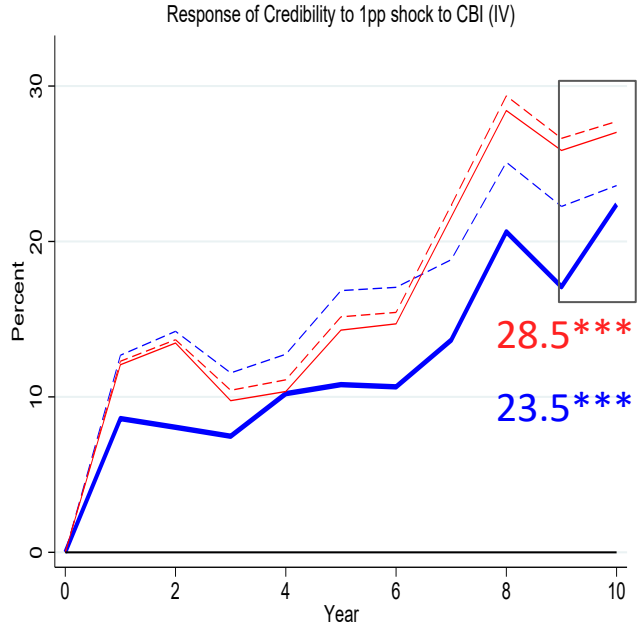
Red solid line: debt-to-GDP ratio≤ 120%

Red dashed line: debt-to-GDP ratio≤ 150%

Monetary discipline

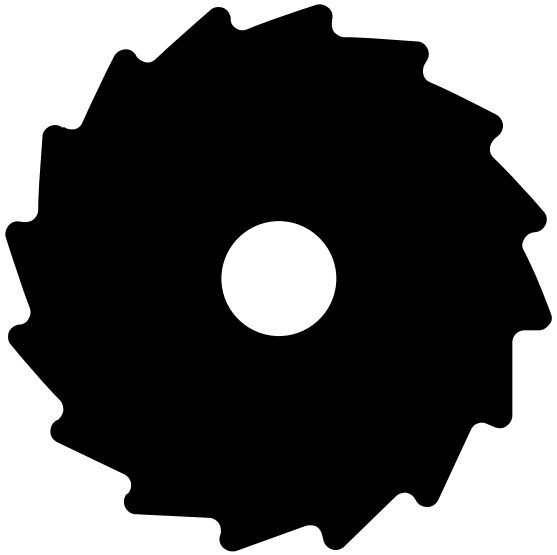


Credibility



Notes: (LHS) Monetary discipline is measured by excess money growth. Regional peer pressure is used as the instrument for LP-IV. (RHS) Credibility measures how much the public expects policy outcomes to deviate from prior policy announcements.

Conclusion:
An agenda for central bank reforms



1. Strengthen legal autonomy
2. Promote learning from best practice
3. Maintain reform continuity
4. Consider monetary and fiscal regimes
5. Be mindful of political contexts

Thank you for your attention

Link to the: *ECB working paper, SUERF Policy Brief*