Independence for Monetary Policy vs. Financial Regulation and Supervision

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Independence is not a technocratic bank 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.).

Two pillars of trust

	Monetary Policy	Prudential Policy
Goal	Guardrail against short-termism; stronger independence = lower inflation (Alesina & Summers, 1993).	Defense against forbearance and capture; delaying tough decisions raises future costs (Steele, 2025).
Outcome	Anchors expectations and supports long-term stability.	Reduces systemic risk and improves financial resilience.
Shared Value	Together they help to sustain global confidence in U.S. institutions and the dollar (Gourinchas & Rey, 2007; Eichengreen, 2011).	

Monetary policy and prudential regulation/supervision are cousins, not twins

Dimension	Monetary Policy	Prudential regulation/supervision
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, and consumer protection; 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 — losses surface years later, creating forbearance risk; independence at supervisory levels is essential (Steele, 2025).
Perimeter and Fiscal Line	Policy rate relatively straightforward but tools such as QE and emergency facilities can blur into fiscal territory.	Tools are granular and legalistic — buffer calibration, stress tests, and enforcement shape credit allocation (Tarullo, 2024).

Short list of ideas to strengthen the framework

Monetary Policy

a) ***2025 framework update:*** improved robustness and accountability by moving away from open-ended 'make-up' strategies and clarifying how to balance employment and inflation goals (Federal Reserve 2025; Powell 2025; Wessel 2025).

b) ***Increase transparency about policy reaction function***: Extend dot plot to matrix that shows, in anonymous form, how each participant's expected unemployment, inflation, and policy rate outcomes line up.

c) ***Institutionalize governance for nonstandard tools:*** published cost-benefit analyses, guardrails for QE and emergency facilities, explicit indemnity arrangements, and 'explain-your-framework' reports when breached (Tarullo 2024; Australia 2023).

Prudential Policy

a) ***Clarify and strengthen FSOC's systemic-risk mandate, and the incentives of its members.*** Several member agencies still lack a systemic-risk mandate of their own; unless incentives are aligned, coordination will always be fragile (Kohn 2014, Brookings 2021).

b) ***Institutionalize coordination:*** create formal, auditable mechanisms for data-sharing, joint scenario exercises, and macroprudential reporting.

c) ***Strengthen independence where forbearance risk is highest***: protect examiner autonomy, model-validation teams, and stress-testing design across agencies, subject to periodic external review.

Independence serves citizens, not technocrats

- Credibility erodes slowly through concerns about political pressures, blurred boundaries and weak accountability.
- The best defense is practice, not posture: stay within clear mandates, deliver results, and strengthen the framework through transparency, governance, and accountability.

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