



Central bank independence: Why? To what end?

(Recorded on 18 June 2026)

INTRODUCTION

Did you know that when it was founded in 1800, the Banque de France was a listed company owned by shareholders? A private central bank – well, those were different times.

In 1945, the Banque de France was nationalised. The Law of 4 August 1993 subsequently marked a major change in its relationship with the public authorities: whilst it remains state-owned, the Banque de France became independent of political influence for the purpose of conducting monetary policy. In practical terms, the fight against inflation was removed from the government's remit and became the sole responsibility of the Banque de France.

This is also the case in other countries such as the UK, New Zealand, the Czech Republic, Hungary, Chile and Brazil. The 1990s witnessed a wave of central bank independence.

But why did central banks become independent of political authority? Or, put another way, why was the fight against inflation entrusted to these institutions? And what does an independent central bank actually mean in practical terms?

My name is Lucile and I work at the Banque de France. In this new episode of our series on monetary policy, we will be going back to basics: the independence of central banks, an essential condition for monetary policy efficiency.

Welcome to L'Éco en court.

WHY INDEPENDENCE? – THE BASICS

To understand the origins of central bank independence, we need to go back to the 1970s and the first oil crisis of 1973. In developed countries, inflation spiralled out of control, however central banks, under pressure from governments, were slow to raise key interest rates so as not to hurt the economy. In France, as in other countries, one key measure to curb inflation was to save energy.

Let's listen to Georges Pompidou, President of the French Republic, speaking on the 8pm news on 20 December 1973.

George Pompidou: *"Let us save on petrol, electricity and heating; this alone will be enough to reduce our consumption and, in so doing, overcome certain import difficulties and mitigate the effects on rising prices and on our foreign trade."*

For several years, the US Federal Reserve [i.e. the US central bank] also prioritised employment over price stability.

By the time of the second oil crisis in 1979, when Paul Volcker took over as Chair of the US Federal Reserve, it was already very late in the game.

Paul Volcker, 17 August 2022: *"And there was always that conflict, which still exists today. 'Don't tighten monetary policy too much, or you'll end up with unemployment. So we continued on like that for a decade and ended up with higher inflation and higher unemployment. When I took over as Chair of the Federal Reserve at the end of the Carter administration, President Carter was utterly frustrated because it seemed impossible for him to take any initiative whatsoever, as all of this inflation was tying him up in knots. He couldn't do anything about the budget or about energy. Everything was gridlocked because of this fear of inflation, which was very real at the time. But I decided that we had to change our approach: we had to stop constantly fearing a rise in unemployment. We had to tackle this inflation, otherwise it was going to get worse as it was accelerating and had reached an annual rate of nearly 15%. And if we dithered any longer, it would reach 20%. People were genuinely concerned about the stability of the country so we tightened monetary policy."*

To stabilise prices, Paul Volcker had to raise key interest rates both significantly and sustainably. Although the remedy was effective, it was brutal: US gross domestic product fell and many countries entered recession.

Economists like Lucas, Barro, Kydland and Prescott drew a lesson from this episode.

Governments, under electoral pressure, are tempted to let inflation run its course by pressuring their central bank to keep key interest rates low in order to boost employment. If economic agents anticipate this bias, they adjust wages and prices accordingly: expansionary policies therefore lead to inflation without stimulating economic activity.

Conversely, an anti-inflationary policy pursued by a non-independent central bank will not be deemed credible and will prove ineffective, as economic agents are aware of governments' inflationary bias and anticipate that the central bank will soon be forced to lower its key interest rates.

The solution to maintaining price stability without resorting to measures as drastic as those forced upon Paul Volcker was to entrust monetary policy to central banks that are detached from the political sphere and are therefore credible when tackling inflation.

François Villeroy de Galhau, former Governor of the Banque de France: *“This is a very pragmatic observation, which originated in economic research and has since become widely accepted in political decision-making: an independent central bank achieves better results in the fight against inflation. This is because a central bank acts sooner and therefore tackles the problem of inflation on a timely basis.”*

WHAT INDEPENDENCE MEANS IN PRACTICE — THE FOUR PILLARS

An independent central bank is therefore an institution to which a government entrusts a specific mandate – like price stability – and the means to fulfil this. Independence is one of these means. It is not an end in itself and is based on several pillars.

The first is institutional. In Europe, independence is enshrined in Article 130 of The Treaty on the Functioning of the European Union: *neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.*

François Villeroy de Galhau: *“Under various different governments and presidents, I have never received a call – not even from the Finance Minister – prior to a meeting of the Governing Council. Moreover, if I had ever received such a call, my duty would have been to hang up, politely but immediately.”*

Second pillar: functional independence. The central bank has all the tools it needs to fulfil its mandate. In previous episodes, we discussed key interest rates, asset purchase programmes and forward guidance.

Third pillar: Personal independence. Central bank governors serve for long terms and can only be removed from office for serious misconduct.

Jerome Powel, Chair of the US Federal Reserve, 1 June 2026: *“The legal safeguards ensuring that monetary policy is conducted in a non-political manner are clear. Federal Reserve governors and the presidents of reserve banks enjoy legal protection against dismissal. Our terms of office are long and decoupled from the presidential election cycle.”*

Lastly, financial independence. Central banks have their own financial resources – in good years, they build up reserves to tide them over leaner years. A central bank that has to seek government assistance to cover its expenditure could have its independence undermined.

THE EVIDENCE: 2022-2025

The 2021–23 inflationary surge served as a full-scale test of the effectiveness of central bank independence.

François Villeroy de Galhau: *“It is very interesting to compare the most recent bout of inflation experienced following Russia’s invasion of Ukraine in 2022–2023. We emerged from*

this much more quickly thanks to the independence and credibility of central banks. To achieve this, we raised interest rates in the euro area to 4%. Banque de France research findings demonstrate that if we had not had that credibility – if we'd been operating under the 1970s model – we would probably have had to raise interest rates to twice that level, to 8%. So independence actually works.”

THE FLIP-SIDE: ACCOUNTABILITY

Stepping outside the governmental sphere does not mean stepping outside the democratic sphere.

In France, independence stems from democracy: the European Treaty, transposed into French law on 4 August 1993, was adopted by referendum in September 1992. Furthermore, the nomination of the Governor of the Banque de France is proposed by the President of the Republic. This proposal is subsequently subject to a vote by the Finance Committees of the National Assembly and the Senate.

François Villeroy de Galhau: *“Independence stems from democracy, is born of democracy and must return to democracy. Independence is not the freedom to do whatever one pleases on one’s own terms. On the contrary, the more independent we are, the greater our duty of accountability to our fellow citizens.”*

Indeed, independence goes hand in hand with accountability for the effectiveness of our actions before national and European representative bodies. This accountability is not merely a democratic requirement, it is also an economic tool.

Another safeguard is that decisions within the Governing Council of the European Central Bank are taken collectively, following genuine debates whose minutes are made public.

WHY INDEPENDENCE IS CURRENTLY BEING CRITICISED

VOICE-OVER: Nevertheless, for some time now, leading politicians have been challenging this standard of independence, which has been taken for granted for over thirty years in developed countries.

Donald Trump, President of the United States, in December 2025: *“And I will soon be announcing our next Chair of the Federal Reserve – someone who believes in much lower interest rates.”*

So why is the independence of central banks back in the spotlight?

François Villeroy de Galhau: *“It is a misconception that a non-independent central bank would enable interest rates to remain lower in the long term. I believe that, in practice, the opposite would be true.”*

Whilst economic theory has established that central bank independence promotes macroeconomic stability, this does not of course preclude democratic criticism or debate over the nature and scope of this independence.

François Villeroy de Galhau: *“Independence, like any virtue, needs to be nurtured. We should never rest on our laurels.”*

CONCLUSION

A big thank you to everyone for following our series on monetary policy. I'd also like to thank Guillaume Horny for his help. If you enjoyed this episode, please do leave us your comments and stars. Till next time!