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INSTITUTIONAL FRAMEWORK LINKING CENTRAL BANK INDEPENDENCE TO PRICE STABILITY

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As a result of developments in academic thought and modern economic theory, central bank independence is widely regarded as one of the key institutional prerequisites for ensuring price stability. At the same time, the mechanisms through which central bank independence influences inflationary processes and the outcomes of monetary policy remain insufficiently studied and systematized. The purpose of this article is to synthesize current academic approaches and develop a comprehensive conceptual model that explains the relationship between central bank independence and price stability. The method of analysis and synthesis

was applied to summarize scientific approaches to identifying the key institutional elements of the regulator's autonomy and the channels through which it influences price stability. Using a systemic approach, central bank independence is examined as a holistic system of interrelated institutional and monetary elements functioning within a single mechanism for ensuring price stability. Using the method of conceptual modeling, the author has constructed an institutional mechanism that combines the elements of establishing central bank independence and the main channels through which it influences price stability. The framework proposed by the authors summarizes the main institutional and monetary transmission channels through which central bank independence contributes to price stability. The practical significance of these findings lies in their potential application to improving central bank governance, assessing the level of their institutional independence, and conducting further research.

Keywords: *CBI, central bank, central bank independence, price stability, monetary policy, market confidence, time inconsistency, money supply, inflation*

Introduction Given the geopolitical shifts that have taken place in recent years, the current global situation can be described as unstable, with serious negative economic consequences in both the short and long term. Military conflicts and their consequences have a direct impact on global trade and financial markets: they disrupt supply chains, reduce production capacity, reshape established processes, and cause volatility in financial markets. Furthermore, political decisions affect energy prices, which in turn puts pressure on price stability. Markets inevitably respond to such changes with price adjustments, posing a challenge to maintaining price stability. In this environment, financial regulators face new challenges in mitigating the

negative impact of numerous shocks while fulfilling the central banks' primary mandate—maintaining price stability.

The current global context requires central banks not only to maintain their traditional independence but also to adapt to new economic realities through flexible mechanisms and expanded mandates. Central banks must now address issues of financial stability, fintech regulation, climate risks, and innovative technologies, which increase their responsibilities and, at times, create conflicts with political demands. High levels of public debt may prompt governments to influence central bank policy in order to lower interest rates and thereby ease the fiscal burden. Shifts in political direction can lead to attempts to interfere with central bank operations, thereby undermining their ability to make independent decisions.

That is why it is important to emphasize the independence of the central bank, which helps avoid numerous problems arising from political interference in monetary policy. One such problem is “*time inconsistency*,” where the government, in an effort to stimulate the economy, attempts to implement short-term measures that lead to rising inflationary pressures. Ensuring the independence of regulators allows for the appointment of “conservative” bankers who prioritize maintaining price stability even at the cost of short-term increases in unemployment. To justify the role of the central bank, we consider it necessary to examine the mechanisms through which the central bank influences monetary policy and its outcomes.

In crises or recessionary episodes, independence can support credible commitments to low inflation, but fiscal dominance and policy coordination with fiscal authorities remain important disclaimer; the presence of independence interacts with inflation targeting and other policy tools to shape macroeconomic performance [1].

Alex Cukierman [2] noted in his study in 1994 that the last few years have witnessed a veritable wave of changes in central bank legislation that

are designed to increase the legal independence of the bank. Since the end of the 1980s, countries such as New Zealand, Chile, Mexico, Argentina, Spain, France, and the United Kingdom, as well as many former socialist states, have been considering changes in legislation that would make the central bank more autonomous from government. The changes in legislation usually give more authority to the central bank and also direct it to focus mainly on the objective of price stability even at the cost of disregarding other objectives such as high employment, growth, low interest rates or the financing of budget deficits. As examples of successful experiences in implementing the CBI (central bank independence) he cites Bundesbank and Swiss National Banks. The author also argues that independence allows the central bank to avoid political pressure to implement short-term stimulus measures, thereby reducing inflation without undermining public confidence [2].

Purpose of the article. In this article, we aim to examine current, scientifically substantiated views on the elements that ensure central bank independence and the ways in which policy impulses are transmitted within the system in the pursuit of price stability as the primary objective of the mandate. The author's vision is to formulate a single framework that functions as a coordinated mechanism by combining the individual elements of this system. Presenting an institutional framework linking central bank independence to price stability is both the objective and the result of this study.

Results In this study, we proceed from the premise that sound decisions and targeted actions by an independent regulator are directly and closely linked to ensuring price stability in the country. Some scholars have counterarguments to this premise; these are discussed separately in the "Discussion" section. In addressing this task, the authors propose dividing the framework into two clusters of elements:

- Components that ensure the regulator's independence (CBI);
- Elements that ensure the independent regulator achieves its mandate.

With this in mind, the authors have identified the following key elements that ensure the regulator's independence: the procedure for appointing an independent Governing Board and Central Bank Governor; the procedure for dismissing the Central Bank Governor and changing the composition of the Governing Board; the procedure for forming the Governing Board and its rules of procedure (if any); the procedure and scope of authority of the Governing Board and the Federal Open Market Committee (FOMC) in the monetary policy decision-making process.

International experience shows that the independence of a regulator depends on the quality and transparency of the procedural aspects of the regulatory body's formation, the organization of the monetary decision-making process, and the legally established procedure for dismissing the central bank governor and members of the Governing Board. The more clearly this issue is defined in the law, the greater the regulator's independence. The well-balanced system, protected by law, can withstand external pressures and make decisions that prioritize the fulfillment of its mandate, maintain price stability over the long term, and contribute to the country's financial stability and economic growth. A transparent process for appointing and dismissing the central bank governor—one that is independent of the current government—and the establishment of an independent board help ensure a high level of professionalism and the selection of conservative leaders. The appointment of central bankers with strong professional qualifications facilitates the implementation of conservative monetary policies that prioritize the fight against inflation.

Obviously, the legislative barrier to pressure is effective only in societies with a strong institutional foundation and the rule of law.

Therefore, while the presence of these elements does not guarantee the regulator's independence, it is essential for achieving it.

Next, we will examine the mechanism by which an independent regulator achieves its monetary objective through its key components and transmission channels. Drawing on previous research, we need to describe the role of regulatory independence in ensuring price stability. We propose that the following be included among the main transmission channels:

- *Market confidence.* Independence helps build investor and market participant confidence in monetary policy, as decisions are made based on economic rather than political considerations.
- *Time-inconsistency problem solving.* The absence of political pressure helps avoid short-term impulses, that often lead to excessive economic stimulation and rising inflation.

- *Control of the money supply.* Countries with highly independent central banks exhibit more stable price levels due to the regulator's effective control over the money supply in the economy.

Market confidence is generally considered a key factor influencing inflation expectations. Crowe, C., & Meade, E. (2008) pointed out that over the past two decades, the pace of central bank reforms in terms of institutional independence and transparency has been particularly brisk. The paper examines the current level of central bank independence (CBI) and transparency in a broad sample of countries using newly constructed measures, and looks at the evolution in both measures from an earlier time period. They have demonstrated that the regulator's independence, combined with transparency in its actions, enhances the effectiveness of monetary policy through the expectations channel. They find that enhanced transparency practices are associated with the private sector, making greater use of information provided by the central bank [3].

A clear policy framework from an independent regulator, coupled with transparent and understandable communication with the public, helps improve inflation expectations among the general public and investors, thereby reducing inflationary risks. Interaction with fiscal policy: independence carries greater weight when fiscal policy aligns with the goal of fostering confidence. Fiscal dominance can undermine the effectiveness of independence by limiting the scope for monetary policy or forcing the adoption of balancing measures; thus, combining robust independence with prudent fiscal policy generally yields better results in terms of price stability than independence alone [4].

In all cases, the most sustainable changes are observed when measures are embedded in a robust framework that includes clear macroeconomic objectives and predictable policy-making rules. Regulatory authorities must have sufficient autonomy to take urgent action. Researchers emphasize a set of measures (sterilization, reserve management, capital controls if necessary, liquidity requirements, LTV/LTI limits) coordinated with fiscal and structural reforms [5,6,7].

Clearly communicated independence, including inflation targets and forecasts regarding future policy, reduces the information gap between policymakers and private agents, aligning expectations and mitigating inflation surprises.

Control of the money supply. The concept of autonomy allows for more effective regulation of money supply growth, which is the primary driver of inflation. This framework is inextricably linked to the level of trust in the regulator, as changes in the money supply are also influenced by the behavior of economic agents, which is shaped by inflation expectations.

Monetary policy independence and confidence: The mechanisms linking a country's central bank to price stability often rely on building confidence and stabilizing expectations, which reduces the need for a

significant acceleration in money supply growth to control inflation. This is complemented by evidence that clearly formulated, rule-based frameworks (including inflation targets) strengthen the confidence channel, even when money supply growth is not explicitly a policy instrument [8].

The main transmission channel is a firm commitment to price stability, which reduces the need for sharp adjustments to the money supply to achieve target levels. When economic agents are convinced that the central bank will not allow runaway inflation, money supply growth can stabilize at a lower, more predictable level, ensuring stable inflation without significant interventions in the base money supply. Long-term inflation expectations adjust in line with credible benchmarks, even if money supply growth is not the sole or primary policy tool in the short term [8].

Evidence on inflation targeting's role in anchoring long-horizon inflation expectations supports the view that independent, well-communicating institutions are more effective when they pursue explicit targets. Hoffmann and others in 2023 year show that central bank communication and treatment information interact with trust to shape households' inflation expectations; long-run anchoring appears stronger when targets are credible and well communicated [9]. In inflation-targeting regimes, central banks typically anchor policy primarily through interest rate decisions, with money supply growth no longer the sole or primary nominal anchor. Several works trace this transition and discuss the historical shift from money-growth or monetary-aggregate targeting to IT, while acknowledging that money supply regulation can still play a role as an intermediate or auxiliary instrument or as a historical anchor in certain regimes.

Mukherjee, B., & Singer, D. A. (2008) describe inflation targeting as a modern system in which it serves as a public commitment to ensuring price stability, while acknowledging that some central banks still consider money

supply growth rates as additional or secondary factors in the formulation of monetary policy [10].

Dow (Central banking in the twenty-first century) emphasizes a framework where inflation targets and interest-rate policy are central, while acknowledging the interdependencies among monetary stability, financial stability, and broader macroeconomic outcomes; money aggregates recede as the primary instrument, but their role is contextual in crises and unconventional policy episodes [11].

Beyers et al. (South Africa) use a CGE model to examine monetary-policy implications for financial stability and inflation targeting, confirming that policy-rate changes influence inflation outcomes but that financial stability considerations can modulate the inflation-targeting process. This supports the view that money supply is regulated through policy rates and balance-sheet tools within an IT framework, with implications for inflation targeting and financial stability [12].

The literature converges on a transitional pattern: money supply regulation remains relevant conceptually (as a potential instrument or benchmark) but IT regimes largely rely on interest-rate rules and transparent communication to meet the inflation target. The evidence suggests that strict money-growth rules tend to be deemphasized once IT is adopted, but under certain regimes (e.g., early inflation targeting, emerging markets, or crisis periods) money aggregates can re-enter policy considerations as auxiliary targets or liquidity provision tools.

Money supply regulation remains a relevant policy instrument in the sense that it can influence inflation dynamics through transmission channels, but under inflation-targeting regimes its role is generally secondary to policy-rate rules, communication, and expectations management. In crisis periods or when unconventional policy tools dominate, central banks may directly or indirectly regulate money supply

(via balance sheets, asset purchases, liquidity facilities) to support inflation-targeting credibility and macro stability, even if these actions do not map neatly onto a traditional money-growth rule.

Let's take a look at the third component of the transmission in our framework, *Time-discrepancy*. Institutional mechanisms of macroprudential regulation—such as clearly defined independence, powers, and requirements regarding reserve funds—are closely linked to the ability to address time lags between market pressures and regulatory responses. Messono et al. suggest that central bank independence can reduce economic vulnerability by ensuring a timely response to imbalances—particularly exchange rate imbalances and balance of payments pressures—thereby enhancing the responsiveness and credibility of policy measures [13].

Thanks to the regulator's independence, policy is formulated with a long-term perspective, which helps avoid politically motivated measures to stimulate the economy. This eliminates the problem of time inconsistency. Central bank independence (CBI) helps solve time inconsistency problems by insulating monetary policy from political pressures, thereby delivering lower and more stable inflation in the long run. This insight is supported by models where the inflation outcome is a weighted average of government's and independent central bank's preferences, with the weight given to independence shaping inflation dynamics [14].

Time lags in central bank regulation arise when regulatory actions, interventions, and supervisory measures lag behind, run ahead of, or accumulate over time relative to the dynamics of financial markets. Understanding how these time lags are addressed—through policy adjustments, institutional reforms, and macroprudential tools—is crucial for maintaining financial stability and effective regulation. In examining the impact of time lags on the achievement of price stability, we will focus on

the timing of intervention and its link to market imbalances, the role of macroprudential and regulatory tools in correcting time lags, and the dynamic interaction between central banks' regulatory measures and processes related to exchange rates and discrepancies.

Researchers (Beine et al., 2007) emphasize that official interventions are typically identified with a delay, and the decision-making process often exhibits “inconsistency” or a lack of alignment with fundamental indicators, requiring further corrective measures [15].

Data on trading rules and market reactions suggest that signals of intervention often encounter resistance from market participants, indicating that interventions do not always lead to the creation of profitable trading rules in a structural sense, but rather reflect a strategy to counter prevailing short-term trends or delays in adjusting the exchange rate trajectory [16]. This dynamic involves a corrective mechanism that operates with a certain time lag: interventions can give the regulator time to implement adjustments with a longer-term perspective (such as boosting confidence in policy, sterilization, or macroprudential measures), rather than immediately correcting imbalances.

Ireland's experience serves as a concrete example of how expanding the powers of supervisory authorities enables the implementation of macroprudential measures (such as setting limits on loan-to-value ratios and applying other macroprudential tools) within the broader European framework. It highlights how the regulatory framework—legislation, information-gathering powers, and cross-border supervisory mechanisms—influences the pace and effectiveness of corrective measures in response to emerging imbalances [5].

Several works emphasize the role of misalignment as a leading indicator of currency crises, with empirical results showing episodes where misalignment preceded policy responses. The correction of misalignment,

therefore, depends on timely recognition of mispricing and a suite of coordinated tools (sterilization, reserves management, capital controls, and macroprudential safeguards) deployed over successive periods [7,17].

In summary, we have a solid foundation for incorporating factors such as the mitigation of time inconsistency, monetary policy, and market confidence into the framework by which an independent central bank ensures price stability. A study of current academic approaches to identifying the factors that influence an independent regulator's ability to achieve price stability has enabled the authors to propose their own view of the framework by which the National Central Bank influences price stability, as illustrated in Figure 1.

The framework proposed by the authors summarizes the main institutional and monetary transmission channels through which central bank independence contributes to price stability. Institutional safeguards, including independent Board and Governor and transparent appointment and removal procedures, strengthen central bank autonomy. This autonomy mitigates the time-inconsistency problem, enhances market confidence, anchors inflation expectations, and improves control over the money supply, thereby supporting the effectiveness of monetary policy and ensuring price stability.

This conceptual framework is consistent with the time-inconsistency framework of Kydland and Prescott, the conservative central banker model of Rogoff, and the credibility-expectations channel emphasized in modern monetary policy literature. At the same time, the author's approach synthesizes existing elements of the framework and expands upon it by introducing a set of interrelated and necessary conditions to ensure the regulator's independence, thereby forming a comprehensive framework aimed at developing the scientific and theoretical foundation.

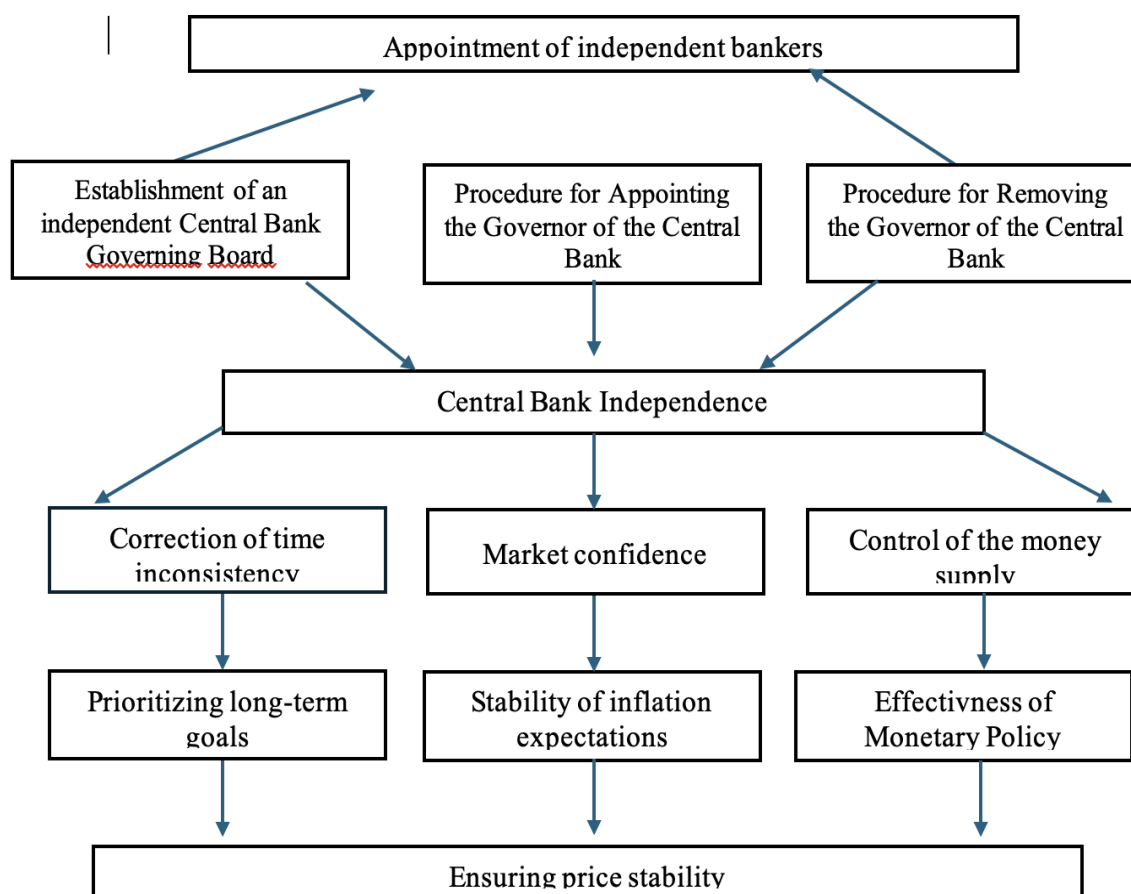


Fig. 1 Institutional Frameworks Linking Central Bank Independence to Price Stability

Source: created by the authors

Conclusions The independence of the regulator is critical to ensuring price stability, as it helps reduce inflation, strengthen control over the money supply, and build market confidence. Central bank autonomy helps avoid policy misalignment, ensures the appointment of conservative leaders, and promotes effective monetary policy, as confirmed by empirical studies. The legal framework and institutional safeguards are fundamental to ensuring the regulator's independence. Legislative enshrinement of independence, separate funding, clear procedures for appointing leaders, and tools for assessing institutional autonomy are necessary conditions for the effective functioning of a central bank. The combination of all these

elements of formation and transmission frameworks allowed the authors to present their own vision institutional frameworks linking central bank independence to price stability, which aims to develop the scientific and theoretical foundation and practical approaches for achieving price stability.

Discussion There is some disagreement or nuance regarding the immediacy and sufficiency of interventions. Some studies argue that intervention signals often come after trends have already moved, and that traders may trade against interventions, implying that time-correction requires sustained policy reform beyond the initial intervention [16].

Empirical consensus and nuances: a large strand of cross-country empirical work finds a negative association between CBI and inflation, and often a reduction in inflation variability, though magnitudes depend on measurement, sample period, and potential endogeneity; several studies emphasize that the strength of the inflation benefit increases when accompanied by credible frameworks (e.g., inflation targeting) and robust communication [9,18, 19].

Schnabl analyzes the shift from a focus on money supply indicators to inflation targeting, noting that in many developed countries, money supply growth figures have lost their stability or ceased to play a key role following the introduction of inflation targets, and central banks began using balance sheet tools and communication to manage inflation expectations instead of directly regulating money supply growth [20].

A substantial literature finds a negative correlation between CBI and average inflation, and reductions in inflation variability in more independent regimes. The classic line (Bade-Parkin lineage) shows a robust inverse relation between independence and inflation across many countries, though recent work emphasizes measurement issues and potential endogeneity as caveats [18,19].

Further research: Further research on this topic will aim to refine and improve the methodology for assessing the degree of regulatory independence. This methodology will be supported by empirical data collected from a broad sample of countries and covering a sufficiently long time period. This will allow for the use of the latest independence indices, which cover not only traditional aspects but also new dimensions, such as financial autonomy and transparency of communications. Such research will help to more objectively assess the state of institutional autonomy and will have practical applications.

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