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Abstract: This paper testifies to the fact that the proclaimed independence of central banks, as conceived by its founders, is nothing more than a chimera. We demonstrate that the hypothesis 'inflation is a purely monetary phenomenon' does not substantiate the case for independence. Further, the portrayal of the conservative central banker, the imaginary principal-agent contract, the alleged financial autonomy, along with the ban on budgetary financing, amount to flawed logic in arguing for the independence of the central bank. We also highlight that the idea of independence is not convincing due to the absence of well-defined outlines in its operational toolbox and the system of rules it relies upon.

Keywords: inflation, conservative banker, principal-agent contract, financial autonomy, budgetary financing.

Introduction

We argue that Euclid's *reductio ad absurdum* suggests the veiled drivers encapsulated in the enormous effort lost while trying to motivate the independence of the Central Banks (CBI).

First, a brief survey of the area is likely to reveal a clear imbalance in the force ratio. On the one hand, we find those who set the tone, the note, and the method, namely the bankers. On the other side, there are economists within academia, overindulgently welcomed in the sphere of analyses, presenting interesting ideas that are yet to solidify into actual leads to follow. What needs to be done, the path, the normative part, all originate from the bank. It stands as the citadel of banking science, manifestly autonomous, closed to foreign interference.

Best (2022) observes that central banks' skill in managing 'unknown knowns', or what Rayner (2012) terms 'uncomfortable knowledge' – the effort to forget uncomfortable truths that institutions frequently engage in – is merely a means of promoting a push toward 'scientization'. The famous Maastricht Treaty (Article 107) and the Statute of the European System of Central Banks (ESCB) (Article 7), designed to shield bankers from external instructions and advice under the assertion of expert, yet notably confined knowledge, suit them perfectly. They can freely work on their science. In the name of science and under its cover, they can refuse unfriendly places and voices.

Second, discussions regarding the independence of central banks guide whoever is interested through all the important areas of the economy, i.e., inflation, employment, growth, money, credit, prices, budget, finance, value, interest, exchange rate, and so forth. As interesting as this journey may be, it lacks the same persuasive force when it comes to rationale supporting independence (refer, for instance, to Forder (2005) for a critical and interesting overview of the reasons that prompted the swift adoption of central bank independence). The idea conveyed is that Central Bank independence originates in weighty areas, specifically those with unquestioning roots.

Third, supporters of the idea of central bank independence link their discourse to the 'time inconsistency' of Kydland and Prescott (1977), which argues that policymakers should commit to a predetermined policy *rule* rather than exercise discretion that suffers from lack of credibility. At the normative level, this idea implies that certain institutions governing policymaking are better at making effective and credible decisions regarding monetary policy (Tabellini 2005). Consequently, attention shifted to the Central Bank, renowned for its stance against government tendencies toward inflation. Barro and Gordon (1983) explicitly considered the reputation and credibility of the Central Bank in the fight against inflation, effectively replacing the rule with the *credibility* of the organisation. Rogoff (1985) took a step further, proposing an alternative to the idea of reputation by suggesting entrusting monetary policy to a *conservative*, non-lax banker who demonstrates a clear commitment to price stability above that of most economic agents. A delegation of legitimacy, as outlined by Walsh (1995), concludes the anti-time inconsistency cycle, facilitated through an enticing *type of contract* in the form of the Principal-Agent. In this contract, the principal (government) empowers the Central Bank with monetary policy on efficiency grounds. As initiated by Walsh and notably from those who refined the idea, the contract includes rules governing the budgetary independence of the Central Banks, the prohibition of direct budgetary funding, the structure and duration of mandates, the governor's salary and grant conditions, and the overarching goal of price stability. The contract does not explicitly include the monopoly on monetary issuance and the status of lender of last resort; these are considered implicit.

With such roots, the central bank's position appears almost canonized. Is it conceivable for anyone to imagine that something might disrupt its tranquillity? This paper aims to prove that, grounded in conceptual and institutional laxity, central bank independence, as invoked today, is illusory. To address this problem, the problem is tackled in three directions. The first objective unveils the weaknesses of its theoretical construct, delving into the hypothesis that underpins the idea of independence: inflation as a purely monetary phenomenon. In this sense, we challenge the notion of a neutral currency and cast doubt on the efficacy of Central Bank independence in addressing inflation, suggesting a broader perspective that incorporates real-world dynamics. Based on the initial objective, the second goal involves deciphering the discrepancies among the key circumstances used to advocate independence, such as the conservative central banker, the imaginary Principal-Agent contract, the lender of last resort, the alleged financial autonomy on the money of other people and the dilemmatic ban on the Central Bank's budgetary funding. In a systematic manner, the analysis demonstrates that, relying on such assumptions, the founders' arguments fail to withstand scrutiny. Finally, we show why the independence of the Central Bank cannot be a realistic idea, considering the vague contours of its institutional support and conceptual toolbox, i.e., the rules intended to rigorously govern its behaviour. This section examines the pursuit of objectives, especially in ensuring price stability, emphasising the challenges of establishing credible targets. We closely examine the trilemma involving prices, inflation, and money supply, as well as the flexibility allowed under the umbrella of price stability. The discussion raises inquiries about the effectiveness of different rules and concepts, underscoring the foggy nature of the field and suggesting the likelihood of discretion prevailing over rules, thus questioning the very need for central bank independence.

Doubtful hypothesis in the plea for independence

Examining the argument in favour of independence, we intend to examine to what extent and in what manner the principle according to which the falsity of conjectures matters little if it does not affect the quality of the results. We allude to Friedman's famous dictum (1968, p. 39), 'Inflation is always and everywhere a monetary phenomenon', which was successfully exploited in the seminal arguments of CBI in the 1970s and 1980s. It is important to note that there are two hypostases of economic theory and practice: one that confirms Friedman's stance and the other that refutes his theory.

Inflation is, indeed, a monetary phenomenon as a form of manifestation. It is not noticeable through the explosion of supply or demand for goods or labour but manifests itself through the unbridled explosion of prices. Prices that are not expressions of production's long-lasting value but the result of monetary laxity originating in Menger's works and those who followed him in the line of thought of the Austrian School. Menger ([1871] 2007, pp. 273 and 279), preoccupied with the problem, wrote 'money as the "measure of the exchange value" of goods disintegrates into nothingness, since the basis of the theory is a fiction, an error' or 'the notion that attributes to money (…) the function of also transferring "values" from the present into the future must be designated as erroneous'. We consider that proponents of the idea of a neutral currency draw on the belief that money's only function is that of a general medium of exchange. It can be sent in any amount on the channels of money circulation without influencing the real economy. The standard of value appears to be an artefact, a point Hülsmann (2008, p. 61) seeks to emphasise when asserting that 'any quantity of goods and services can be exchanged with virtually any money supply'. However, Blaug (1990, pp. 153-154) cautions that 'in focusing exclusive attention on the medium-of-exchange function of money (...) it led to a neglect of the interdependence between commodity and money markets deriving from the function of money as a store of value' (consider also the counterargument in the debate on the function of money as a unit of account or a general medium of exchange in the chapter

Does Money Matter Anymore? by Salerno 2010). We consider this statement is pivotal in signalling the risks and losses incurred by neglecting the standard of value function of money. The rejection of the interdependence between the market for goods and that for money, resulting from the exclusive acceptance of the role of money as a medium of exchange and the downplay of its function as a standard of value, pave the way for 'relaxation', an endearment of today's damaging laxity.

Inflation is *not* a monetary phenomenon in terms of its origins and working mechanism. Prices are forms of expression of the forged values, which incur production costs, and which are subjectively dimensioned on the market under the rule of the demand-supply ratio. Here attention turns not to Friedman, but rather to Ricardo ([1817] 2001) and Marx ([1867] 1990), setting aside the ideology in which Marx encapsulated his thoughts, and Marshall ([1890] 2013). Their theories concerning cost, value, and price also refer to other origins of inflation beyond monetary ones. Within their theoretical frameworks, we discover insights into what inflation is and how it manifests, whether through demand-driven or supply-driven mechanisms. Global excess demand or a deficient supply that occurs when Say's law fails to function as an automatic machine – in the sense that any extra money translates into effective demand – can create inflationary tendencies. In other words, both excess demand and deficient supply can be rooted in causes associated with the physical intimacy of economic phenomena, which may not be directly related to money. Examining Hayek's (1967) work, we discover the close connection between price and production structures, where production, its architecture, and dynamics are responsible for how prices are formed. Additionally, the explanations provided by Sraffa (1960) and Huerta de Soto (2006), although articulated in different terms, shed light on the same phenomenon of cost inflation, noting that the prices of inputs are embedded in those of outputs. The theoretical framework they present precisely clarifies the rationale behind imported inflation. In essence, they did not overlook the role of money in the inflationary process. But in their explanation of inflation, they went beyond the perspectives of Fisher or Friedman, who exclusively focused on money and its movement as the sole source of inflation. A stance that is consonant with the rigour of science but unfriendly to the goals of some major economic actors.

Why is such a viewpoint unsuccessful and inapplicable? This is because it implies that the quantity of money is not neutral in the process of value creation and in the process of expressing it through money. In addition, it rejects the idea that inflation is the result of the movement of money. Rejecting this idea means defying reality; yet this disregard aligns with the concept of independence. If the currency is considered neutral, the Bank can conduct its monetary policy with no interference from the outside. In addition, in such circumstances, it is not burdened with responsibilities concerning the dynamics of the real world. In fact, the real world is misled through changes in relative prices and interest rates (Alonso-Neira et al. 2023b). The bank aims for inflation as a gateway to the real economy, but under its shell, the currency is neutral. A similar questionable philosophy extends to targeting prices, in which the quantity of money does not play a role. In this context, none of the supporters of independence has provided a compelling answer as to why we target inflation and not prices, or vice versa. The sandy ground on which this analysis rests gives room for distrust. How can one remain assured when the very material under scrutiny is deformed and often marginalised? How many of those enthusiastic about the idea of independence still wonder what money really is? What monetary aggregate are they thinking about, intending to move it, manipulating the interest rate – M1.M2, ... Mn or L?

The insistence on targeting inflation by a necessarily independent central bank on such shaky ground is illusory (see also the conventional wisdom linking lower inflation rates with central bank independence, as demonstrated in the works of Cukierman 2008; Carlstrom and Fuerst 2009; Arnone and Romelli 2013; Bodea and Hicks 2015; Garriga and Rodriguez 2020). Michel Aglietta also contends that building solidly on the idea of independence becomes impossible when it relies on an ambiguous notion detached from the classical discourse, such as the value of money. Furthermore, essentially, if the currency has no bearing on the real world, 'the Central Bank's independence would be an empty issue, devoid of significant content' (Aglietta 1992, p. 16).

Even when confined to its function as a means of exchange, money can be conceptualised in various ways, anything but neutral. However, the scenario changes when prices are expressed in an active currency. If inflation is linked to all its known and unknown determinants, encompassing factors such as costs, employment policy, implementation of investments, imports, exports, etc., the question arises: What is aimed at through the monetary policy interest rate and how accurately? Is inflation only the Central Bank's problem, or does it also concern the government? Or is it particularly the government's concern? Considering the two interconnected ideas, prices being expressed in an active currency and inflation not being a purely monetary phenomenon, yields two consequences: (a) the dynamics of prices do not exclusively belong to the nominal world, and (b) The explosion of prices, inflation, does not belong exclusively to this world either. It equally belongs to the real world, indicating that there must be room for other forces to enter this game. The independence of central banks alone does not solve the problem of inflation (see, e.g., Klomp and de Haan 2010; Hayo and Hefeker 2002). The independence of central banks is neither absolutely necessary nor sufficient for monetary stability (to reduce inflation). In this context, Fullwiler and Allen (2007) cast doubt on the very ability of the Fed to target inflation.

One can turn a blind eye to the fact that M is hard to define, and that L escapes the Central Bank's analysis; that the line between monetary and non-monetary assets is difficult to draw; that the potential increase in money supply could be due to public spending policies; that inflation can be imported, etc., and then declare and legislate the independence of central banks. But what is this independence based on? On a monetary policy that operates with a neutral currency and targets a purely monetary phenomenon. Not even Milton Friedman would align with such logic because the frequently cited idea was taken out of context. It was extracted to demonstrate something even he might not explicitly agree with. Friedman invokes Poincaré's famous remark that 'money is too important to be left to central bankers', suggesting that the design of a rule could, in fact, achieve a fair degree of monetary stability – precisely what an independent central bank is designed to achieve but falls short of accomplishing (Friedman [1962] 2013).

The faintness of some arguments supporting the independence of Central Banks

The conservative central banker. A Prince Charming of the banking science

One of the contemporary rationales supporting central bank independence is the hypothesis of 'credible commitment'. This theory posits that an independent central bank can more credibly commit to the long-term goal of price stability, as it is less inclined to shock markets and agents by unexpectedly adjusting the money supply to exploit potential short-term advantages from these unexpected changes. Barro and Gordon (1983) argued that a central bank endowed with the kind of credibility and reputation needed to influence the inflation expectations of economic agents could counteract the inherent inflationary bias of policymakers (see, e.g., Duffy and Heinemann (2021) doubts about the existence of a real-world central banker who can effectively manage the trade-off between credibility and flexibility). However, the omniscient, incorruptible governor with Robin Hood-like qualities in the fierce fight against inflation is the creation of Rogoff (1985). Essentially, the Conservative banker is designed to substitute for a rule. His aversion to inflation is enough for this. He is a law onto himself, the final authority, the head of an institution, which is, in itself, of last resort.

Here is a portrayal of the conservative central banker beyond economic good and evil: 'In my view, a central banker cannot afford to isolate himself in an ivory tower; on the contrary, it is necessary to pay constant attention to the developments and trends in the economy and financial system, as well as to the coordinates of government policies, especially fiscal policy. This approach should not be assimilated to the promotion of discretionary conduct but should be associated with a solid anchoring in everyday realities, whose complexity often exceeds the imagination of those who design economic rules or models' (Isărescu 2019, p. XXI) [1]. We have a sketch drawn by a central banker. Endowed with universal vision, imaginative enough to look beyond rules and models, capable, by himself, of solving any trilemma, endowed with monopoly. Fischer (1995) is seized by the idea of entrusting the monetary policy to a personality or institution. At the same time, there may also be an element of dodge here, one also attempted by Berger et al. (2001) in aligning Central Bank conservatism with that of an organisation. However, behaviour attitudes target individuals, not the walls of an organisation.

It is hard to believe that the modern literature on central bank independence relies on such arguments. Claiming scientific validity by placing a human character as a source of objectivity in the financial world's reality seems difficult to accept. In his famous treatise on economics, *Human Action*, Mises ([1940] 1998) warned, by the very title, that the objectivity of economics lies in its subjectivity, a perspective rejected by Rogoff's impartial governor. This governor operates within his own paradigm, where his aversion to inflation is econometrically related to his own compensation (Persson and Tabellini 1993; Walsh 1993). In conclusion, under the guise of the Conservative governor, the idea of CBI turns into a Prince Charming fantasy.

The prophetic Principal-Agent contract

It is convenient, it blends perfectly, for both the government and the Central Bank, that the relations between them be included in a contract resembling the framework outlined by Walsh (1995). Such a contract grants rigour, with clearly delineated rights, obligations, and sanctions that govern the behaviour of both parties. This represents the idyllic part intended for public presentation.

Walsh's idea supports the hypothesis that the state and the Central Bank, as two public institutions, are related according to the rules established by the private environment. This suggests that they are subject to the unforgiving influence of the free market, gratifying successes, and sanctioning failures. Buchanan and Tollison (1972) demonstrated the existence of a political market where governments wear out their opportunisms and selfish interests. In other words, there is no trace of the real market (Herrendorf 1998). History shows that banks were created to evacuate usurious behaviour and sanitise the free market. However, proponents of independence present a different perspective, asserting that a more independent Central Bank aligns closely with the interests of citizens. The more it is a state within a state, the better equipped it is to shield citizens from the endemic inflationary inclination of a usurping Principal.

Could we consider plausible the idea that two monopolistic entities, one acting as a creditor and the other as a saviour – as a last resort – engage in a game specific to private players? That they enter an Agency Contract, and the moral contingencies and agency costs are the known ones? We believe this to be an illusion for the following reasons.

First, no one has witnessed such a contract. We learn about its existence in the works of Walsh (1995) or Persson and Tabellini (1993). But the promoters of the idea of independence do not reveal the contract. The Maastricht Treaty, while hinted at tentatively, remains shrouded in fog regarding the definition of the Principal and the Agent. Otherwise, it remains invisible, presumably because visibility is not convenient.

Accepted merely as an idea, the contract in question is doomed to be nonexplicit, diffuse, and directly non-binding. In this context, Herrendorf (1998) identified a flaw in the incompleteness of Walsh's contract. The challenge is that such a contract is inherently incomplete, specifying only general clauses, with 'the exact details being left until a later date' (Coase 1937, p. 392). The main issue is that these two pillars running the economy, the state, and the Central Bank – while occasionally admitting behaviours specific to the free market during moments of public tenderness – become 'islands of conscious power in this ocean of unconscious co-operation' (Robertson 1923, p. 85) of the market. An incomplete contract takes the form of an abnormal relation with the New Institutional Economics paradigm. Why does this happen? Operating with other people's money, the Central Bank operates as an Agent to replace property with possession. Thus, it becomes not an absolute master but a very strong player as the holder of the right to control. By conceding indefinite rights in residual form, the State faces an incomplete contract that the Central Bank can complete at will, identifying power with property. Thus, unwittingly, it validates Grossman and Hart's idea (1986, p. 693): 'we do not distinguish between ownership and control and virtually define ownership as the power to exercise control'. The Central Bank does not make this distinction either, playing both sides by being both Agent and Principal simultaneously.

Central Banks emerged to provide support for public debt, having missions of general interest. However, these agents have never been elected, but only appointed through normative means. Establishing price stability as a starting point provided an exploitable opportunity for power abuse (Jaillet 2019). Targeting prices was deemed satisfactory because it gave access to the core structures of the economy, although the goal proved unattainable. Evolving from *government children*, Central Banks became undemocratically appointed masters in areas where other political forces were democratically appointed. By managing sub-objectives, the Central Bank came to deal with everything: money issuance, inflation targeting, security of the banking system, lender of last resort, economic growth, exchange rate, etc. Little of what is happening in the economy escapes the care and concern of the Central Bank. The Central Bank, functioning as a Principal in disguise, dictates its operational rules in all these areas, diminishing the state's illusory role as the Principal. Douglass North posits that upon gaining control of others' money, the Central Bank, like any organisation, can indulge in deforming its intentions. He argues that 'institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules' (North 1990, p. 16). However, when this bargaining power is divorced from the market and lacks democratic oversight, the consequences of central bank independence become evident, a diluted responsibility difficult to encapsulate in a tangible contract. When reduced to an unwritten agreement between the government and an omniscient and inflation-averse governor, the Principal-Agent contract becomes a mere speculative representation of the central bank, framed in terms defined by the Central Bank to display something that does not exist.

Second, a real agency contract is recognised to involve 'agency costs' (Jensen and Meckling 1976). In our analysis, we specifically consider the 'residual loss' that the Principal, the government in this case, bears as a minus of prosperity caused by the Agent's opportunistic behaviour. Is there any consideration for such consequences? None. It is claimed that there is no residual loss for either the state or the population. However, the existence of such a loss becomes evident when one observes the manoeuvre to abandon an awkward goal, shifting from price targeting to inflation targeting. The Central Bank knows a priori that once prices rise, they do not revert. Instead, they become the 'new normal' and the population pays the price with a measurable loss of prosperity.

Overall, the alleged Principal-Agent contract is dilemmatic in practice but comfortable as an idea that floats in the air, not just anyhow, but endowed with the status of rule, an institution. Under its shield, the benefits are twofold. First, a contract lends credibility. Secondly, a non-existent contract exempts from ungrateful responsibilities. Is this what Friedman had in mind when stating, 'I suspect that by far and away the two most important variables in their loss function are avoiding accountability on the one hand and achieving public prestige on the other' (as quoted in Fischer 1990, p. 1181)? In the quest for prestige, even an imaginary principal-agent contract turns out to be a useful prop. Anyway, it is better than a rule. A rule obstructs the path to independence. When the influence extends to the edges of the economy, a single rule is insufficient. The best rule would then be the 'no rule'. In fact, the objective expression, the monetary-financial-fiscal mix, makes it difficult, if not impossible, to 'sign' a Principal-Agent contract solely between the government and the Central Bank. Many other agents would need to participate, diminishing the stature of the Conservative governor.

Lender of last resort

It has become a common assertion that such a function is implicitly part of the structure of a principal-agent contract. Typically, the common phrase reads as follows: 'The Central Bank assumes responsibility of' this position'.

The initial step is to demonstrate that the Central Bank occupies a central role; that it serves as the supervisor, the monetary, if not the financial guardian. The prevention of endemic banking panics, deflation, and recession is framed in these terms (refer, for instance, to Freixas et al. 2000; Bernanke 2013) and this is also the source of a large share of its prestige. Salerno (2010, p. 119) cautions that, in its role as the 'lender of last resort', the Central Bank is 'empowered to create base money ad libitum', always ready to avert a banking panic by simply printing and lending the necessary quantities of notes to banks or thrifts facing challenges in meeting their demand liabilities.

To assume the role of a lender of last resort, prior independence is imperative. A conventional Principal-Agent contract does not inherently encompass independence; it only delineates the agent's autonomy in resource management for the Principal's benefit, utilising clearly defined means. However, autonomy alone does not align with the aspirations of the Central Bank. Only by operating as a highly independent institution can it effectively supervise the entire banking system, produce macro-effects through successive iterations of interest rates, and, as a last resort, intervene to rescue others too big and too important to let them go bankrupt.

The third step involves formally omitting this function, exemplified by The Maastricht Treaty, which argues that the 'natural' phase has been achieved. The lender of last resort function seamlessly aligns with the issuing function, constituting intrinsic components of the central bank's framework. These functions serve as criteria for defining a 'full-fledged' central bank (Isărescu 2019, p. XXXII). A central bank matures not upon some external request; instead, as stated by Goodhart et al. (2019, p. 82), 'it is the intellectual basis, and the reasoning, of central bankers for providing such support, rather than the individual act of rescue itself, that determines whether the central bank had become a LOLR in fact'. This task is assumed with enthusiasm and emphasis, as it bestows prestige and conclusively closes the circle of proving the imperative for independence. Are there any concerns with such a self-assigned role?

First, wielding the role of a lender of last resort is an affront to the spirit of the free market. The essence of a free competitive market concerns all economic players. However, interventions to address insolvency issues or temporary liquidity shortages exclusively benefit those in the nominal market, those engaged in handling money and similar values. Those in the real economy, the direct producers of goods and services, receive no rescue, relying instead on the corrective mechanisms of the free market and the consequences of failures. By discriminating, the bankruptcy of the institution of bankruptcy on the nominal side is encouraged. Unlike their counterparts, those in the real economy lack the political assurance of a one-to-one payoff for their debt claims, a safeguard offered by central bank deposit insurance and privileged access to the lender of last resort (Salerno 2010).

The second concern revolves around the mechanics of the rescue process itself. When one knows beforehand that they will be rescued, even if this assurance is not formalised, their behaviour may deviate from the principles of fair competition. Then, there is a questionable issue regarding the source of the aid. If the Central Bank saves with the money of others and fails to sanction irregularities, it is no longer a matter of moral contingency, but of serious immorality. This is particularly problematic when rescue efforts are selectively directed only toward the 'chosen ones' in the nominal area. If central banks had not implicitly assumed the role of the lender of last resort, commercial banks would have been compelled to handle the hot money influx cautiously (Mises [1940] 1998).

Third, exerting this function perverts the essence of the alleged Principal-Agent contract of which it is meant to be a part. The lender of last resort belongs to the macroprudential policy, prioritizing prevention over sanctions. The 'conservative governor' may not be fierce enough to deal with large-scale conflict situations where state presence is imperative. In this hybrid aid formula, the government may incur political costs, while the central bank earns all the glory (Müller 2019). The Central Bank expends its professionalism in attempting to cover incompetent resource managers from bankruptcy. It curbs the use of discount window operations and sends the liquidity truck to the entire banking system. The amount dispatched is deemed 'adequate', evaluated based on the intricacies of quantitative-econometric philosophy. The government comes out somewhat battered, and the Central Bank emerges triumphant, a perfectly convoluted illustration of an alleged Principal-Agent contract. Finally, what can be said about the brand-new role assigned to central banks, serving as the 'dealer of last resort' (Mehrling 2010) or 'market maker of first resort' (Cukierman 2013) for all assets in financial markets, injecting a substantial amount of liquidity into the banking system at substantial cost to taxpayers? Initially presented as temporary post-crisis measures, it has turned out to be the new normal.

Financial autonomy on someone else's money

The instrumental and technical independence, referred to as the 'dentist' by Keynes (1963, p. 373), is undeniable and can be easily established in a causal relationship aimed at inflation; establishing a connection between this objective and the financial autonomy of the Central Bank is not as straightforward.

Admittedly, financial independence is construed as a barrier to the potential predisposition to corruption of those who run a central bank. Financial independence appears as a price to maintain behavioural verticality. This idea, coupled with the one derived from Article 107 of the Maastricht Treaty, gives rise to a compelling logic: the ability to reject advice or instructions is contingent on financial independence. However, the challenge lies in the fact that it is not the Central Bank's money. Even if it serves as the bank of the banks, the central bank is duty-bound to remain the bank of the state. Further, if that is the case, the management of the funds it was endowed with must be subject to the same philosophy as in the case of public money. In essence, while Central Bank specialists may receive large amounts of money from the state budget to prevent corruption, the Central Bank, in defiance of basic democratic principles, proclaims its own financial independence (either individually or in a consortium) in accordance with its own principles and regulations.

According to African tradition, anything beyond a seven-year look-back period becomes history. The Central Bank finds it convenient to overlook the fact that at the beginning it received a dowry, portrayed in the literature as a 'bride' endowed by the state (Rothbard 1994; Pohoață et al. 2021). Unlike typical businesses that start with their own funds or borrowed funds, a state bank has a generous 'groom'. Delving into the sources used to pay its first salaries, initial expenses, and contributions to the development fund would be intriguing. Because, afterwards, the Central Bank claims to pay them from its own resources obtained through profit accumulations, but the facade tends to overshadow the substance. When the Central Bank declares that most of the seigniorage and profit go to the state budget, it creates an impression of selfless patriotic service. It is not profit that defines its objectives; its calling is more civic and societal. A closer analysis of the profit acquisition and distribution process reveals a different story: its financial independence is forever safe. Article 46 of Law no. 101 of May 26, 1998, on the Statute of the National Bank of Romania, specifically addresses the Distribution of net losses. It states that 'if the net loss is not offset by the reserve fund, equity, and credit available in the special revaluation account, the Ministry of Finance will transfer securities to the National Bank of Romania to cover the remaining amount.' This arrangement illustrates that the state, represented by the Ministry of Finance – often viewed as the source of monetary evils – does not abandon its 'bride'. Instead, it extends support because the bride, the Central Bank, proves to be equally beneficial in return.

If those who have signed a payroll at a Central Bank remain attracted to the allure of a generous salary, what can be said about the governor's remuneration? As we have seen (Walsh 1993), a governor's salary is adjusted in accordance with inflation dynamics. What good are the models that prove the reverse proportionality between the two parameters when a recognised financially independent Central Bank sets its own salaries? Has there been any mention of pecuniary punishment imposed on Central Bank Boards of Directors or governors during the 2008 crisis? None that we are aware of. What is evident is that the apparently 'free lunch' prohibited for others is not forbidden to those vested with its management (Fischer 1995).

Ultimately, this is the problem. The alleged financial independence does not align with the equivalent responsibility. There are no sanctions. Fischer (2019, p. 331) disarmingly explains: 'The most difficult issue is the sanctions that should be imposed on the Bank for failing to meet its targets … and there is no explicit sanction in most countries. Public reprimand and loss of reputation is probably a sufficient sanction'. If the distress caused by the so-called humiliation had been so great, we might have witnessed widespread resignations of central bank governors in 2008. The fact that this did not occur is, first, evidence that asserting financial independence and attaining it has little to do with the salaries paid by banks. Was monetary policy completely innocent in the economic and financial turmoil of the mentioned crisis? Second, the Central Bank defies. No other state entity claims such a status. The Central Bank is granted this privilege. How can one handle money and expect others to foot the bill?

The dilemmatic prohibition of budgetary financing

The ban on budget funding has been linked to 'temporal inconsistency' and the need to discipline governments. Essentially, a democratically elected political authority is relegated under the guidance of an *a priori* uncorrupted entity specialised in the movement and rehabilitation of the world of money, with the *spell of political influence* capable of inducing unfortunate situations.

What came out of this project? Conceived as a pro-independence mechanism to detach the state from its direct sources of funding, the result has become perverted. The strong twinning between monetary and financial aspects flips the mechanism, prompting it to seek cooperation and placing the ban on budgetary funding between inverted commas. Considering the realities tangential to the project, it raises questions such as: Does the 'temporal inconsistency' still convincingly and adequately support the independence and opposition to direct funding? Does the Central Bank adhere to the prescribed behaviour within these frameworks? Does the government, in turn, uphold its commitment to self-discipline and refrain from brushing the independence of the Central Bank? Does the Central Bank remain an entity with a distinct game in the gear of an economy that demands systemic functionality?

First, it is worth noting how a significant number of respected economists point out several key points: that the two main entities, the Central Bank and the government, trespass each other's territories, especially and conspicuously evident after recent global crises, where the central bank far exceeds its mandates, adopting an inappropriate position belonging to the quasi-fiscal field (Coombs and Thiemann 2022; Blinder et al., 2017); that the monetary-financial mix is obvious; that the extension of the Central Bank's job description is mostly fuelled by the financial; that a dual responsibility of the Central Bank over the monetary and financial spheres warrants a more thorough analysis; that the 'temporal inconsistency' dilutes its explanatory force as the Central Bank extends toward the financial, etc. Despite these observations, the consensus remains neutral, advocating for the Central Bank's independence.

In this context, Goodhart et al. (2019, p. 71) reference a 1959 episode, emphasising that 'more than that, monetary policy, as we have conceived it, cannot be envisaged as a form of economic strategy that pursues its own independent objectives. It is a part of a country's economic policy as a whole and must be planned as such'. Since 1959, the financial crises and the complexity of all complexities have called for a different arithmetic for the monetary-financial relationship. Aglietta (1992) suggested viewing independence as an 'institutional arrangement', inviting the Central Bank to interact with both the government and the markets. Trichet (2019), the governor of the Bank of France, highlights that the function of bank of banks must be tailored to ensure the stability of the monetary-financial system as a whole. As a case in point, in his country, France, it is not inflation or prices that are aimed at, but a financial aggregate. Despite acknowledging that the Treasury could serve as a last resort, the central banker sees independence as both possible and necessary, even in the context of a ubiquitous bank operating throughout the entire area of the money movement.

Noticing the monetary-financial conjunction, Fischer (2019, p. 300) asserts that 'the most important source of institutional non-neutrality to inflation is the tax system; within the tax system it is the taxation of capital that is most distorted by inflation'. The author notices the interference of the two sectors but does not seem impressed by the prospect of a CBI extending its reach to taxation. As early as 1994, Lamfalussy (2019) foresaw that financial innovation would have a pervasive impact on monetary policy, asserting that the prevailing global phenomenon was financialization rather than monetization of the economy. Consequently, cooperation between the Central Bank and the Ministry of Finance becomes imperative. Volcker (2019) states that regardless of the degree of formal CBI, what matters is a mix of policies, 'ideally a suitable co-ordination of policy'. The question arises: who bears the responsibility for such coordination, not only concerning monetary policy, but also encompassing fiscal policy, the labour market, social policies, and other complex issues? Is it the government or the Central Bank? The underlying idea is that the monetary-financial system is an inseparable whole. In relation to this, what a central bank can aim at has nothing to do with any lesson of good practices to be delivered to the government. Instead, within a 'institutional arrangement' jointly adopted, it must interact with the government in the market. No chance of cutting it short when it is in need and asking for money.

Second, as the argument of 'temporal inconsistency' loses its power in advocating for independence amid an increasingly obvious financial-monetary mix, alternative territories warrant exploration. Or, other territories can be taken from the Ministry of Finance, which lacks the expertise of the Central Bank. The Central Bank possesses unique access to credibility, the ability to fine-tune sophisticated models (why should they be sophisticated?), the clarification of excessively intricate tasks, a broad and extended perspective, and more – all favouring the Central Bank, not the Ministry of Finance. This is underscored by

Bernanke (2019). It remains to be seen how many long-term models coming from the Central Bank's research labs are also sustainable.

Within the same philosophy, Debelle and Fischer (1994) argued that dynamic inconsistency is not the sole rationale for independence. They contend that the Central Bank should not be left alone to face political pressure. Exploiting the 'population's aversion' to inflation could be a viable approach. The government by no means, should be the one to inspire this sentiment. The Central Bank is much more qualified in this area as well. Professor Charles Goodhart offers an intriguing perspective. A completely politicised bank appears implausible. The government's reluctance to completely relinquish control of such a profitable player leads to a twisted outcome: 'An "independent" Central Bank will inevitably become much more politicized than a "dependent" Central Bank' (Goodhart 1992, p. 33). Mugur Isărescu (2019, p. XL), the governor of the National Bank of Romania, also notices the wire dance of a bank that does not thrive in total independence, in a complete detachment 'from the political consensus on appropriate actions'. In the end, a protective umbrella may be necessary – a rescuing or 'mending' one. This allows the bank to retreat to safety during turbulent economic times, leaving the government at gunpoint.

Recently, such 'unconventional' situations have occurred, with examples including 2008, 2012 and post-Covid 19 episodes. It is impossible to ignore the fact that budget deficits have become very 'unconventional'. Article 104 of the Maastricht Treaty went up in smoke, especially during the eminently banking / credit crisis that triggered the economic recession (Lastra and Wood 2010). Although central banks did not engage in direct financing, as banks of banks, they did settle in the 'logical' chain indirectly leading to budgetary financing. Consider the last global recession. It is no longer a secret that, leading up to 2008, central banks pursued an expansionary monetary policy, detached from the logic of the natural interest rate, creating an imbalance between saving and investment. Alonso-Neira and Sánchez-Bayón (2023) demonstrate that artificially maintaining interest rates 'too low for too long' (below natural rates) resulted in substantial microeconomic distortion, that is, an accumulation of long-term failed investments that markets could not assume. The business cycle closely followed the pattern outlined by the Austrian School: optimistic expectations about future returns and easy credit conditions (Hoffmann and

Cachanosky 2018; Alonso-Neira et al. 2023a). Caught off guard, central banks were compelled to relinquish their primary instrument of maintaining price stability over the medium term, interest rates – and transition to purchasing financial assets from both the public and private sectors. This shift in strategy led to an expansion of the Central Bank's toolkit, extending beyond conventional instruments to encompass long-term refinancing operations, outright monetary transactions, and asset purchase programmes. Notably, the European Central Bank (ECB) introduced the Quantitative Easing policy in 2014, initially planned to conclude by the end of 2018, resulting in a doubling of the size of the Euro system balance sheet. The story did not end in 2018, as net asset purchases resumed in late 2019 amid a slowdown in both euro area inflation and the global economy. Furthermore, in response to the COVID-19 crisis, the ECB introduced a new asset purchase initiative called the Pandemic Emergency Purchase Programme. As a result, the balance sheet expanded to nearly EUR 9 trillion in 2022, representing approximately 70% of the GDP of the euro area GDP (Claeys 2023). Therefore, the 'cut-off' caused by the Covid 19 pandemic once again made the Stability Pact into a great epsilon. Meanwhile, banks were forced to raise funds, with inflation control lagging. Moreover, the Central Bank found itself assisting states in accumulating debt, padding up their balance sheets with state securities. Tucker (2020, p. 1) admits that during the last global crises, the Central Bank took back the 'roles they used to have in the 1930s and 1980s, that is, simple tools in the service of the Ministries of Finance' (see also Mudge and Vauchez 2022). Essentially, they turned exactly into what the Treaty required them not to do.

In fact, central banks detach from the institutionalized background and influence state debts through something that is not visible at first glance. By manipulating interest rates, they influence the value ratios for foreign exchange. A higher rate can make domestic goods more expensive relative to foreign ones. Consequently, in an open economy, exports fall, and imports rise. The trade balance records the phenomenon and sends it to the balance of payments. It should also be noted that the dynamics of the interest rate is no stranger to the dynamics of the tax base (of turnover). The alleged financial neutrality of the central bank is merely superficial.

Loose environment, blurry outlines

A concept as assaulted as independence should come to the fore through the establishment of benchmarks, including a working definition, a universally accepted taxonomy, clear objectives, intelligible mechanisms, etc. Unfortunately, for the rigour required by acceptable knowledge, the ground on which it moves is slippery.

The exercise begins by not identifying a working *definition* of independence. It becomes apparent that independence cannot exist in its pure state; it can assume various manifestations, such as political, economic, real, or legal; institutional-strategic or tactical; formal or informal; within or against the state; neither too big nor too small, and the list goes on. How many of these invoked forms of manifestation are directly related to the underlying motivation, that of 'temporal inconsistency'?

The exercise continues with the search for the *goal*. Theoretically, the central bank is granted independence to deal freely with ensuring and maintaining price stability in the medium term. From theory to practice, the path is sprinkled with subobjectives, targets, goals, functions, and purposes, most of which the Central Bank takes on.

However, the place where the CBI appears to seek credible contours but fails to convince is that of the shifting sands on which *targets* are set. Prices, inflation, money supply, or all in one place? Due to 'temporal inconsistencies', the Central Bank is delegated the task of ensuring price stability. However, the Central Bank knows how to give a favourable interpretation of the context to facilitate its mission and dissipate its responsibility. By origin, there should be no goal other than price stability. In fact, despite not appearing to breach the principal-agent contract, inflation targeting seems more appealing. Does Parliament or the citizens know why the switch is changed? As previously emphasised, price targeting involves coordinating economic processes whose articulation and chaining cannot be the sole responsibility of the Central Bank. All economic players related to the supply-demand mechanism participate in this process. Rectifying an already high price level back to its initial state requires more than mere mastery in manipulating the interest rate. Other influences and determinants may exert a more significant force in influencing the supply-demand tension so that the end flows toward restoring prices to the starting point. Aspects such as the structure and size of supply or demand, their civilian or non-civilian nature, the intensity of agency in a global economy, investment promotion and commissioning policy, the length of production periods, and the state of trade balance or policy payroll are all tied to price dynamics. Importantly, these are areas regulated by governments, not central banks. Undertaking such a complicated task, while imperative for economic health, poses a considerable risk of damaging the Central Bank's status. Opting for inflation targeting is less risky and more convenient. If inflation goes beyond the target and prices rise accordingly, the central bank simply adjusts its instruments. The die is cast, and it could happen again; prices remain where they were driven by exceeding the target. There is no need for sophisticated calculations to restart the process. If calculations are performed, it is to induce the idea that the interest rate is not fixed, it results from calculations. After all, the very conservative governor wears the coat of the well-known *comissaire-priseur* from the Walrasian general equilibrium model, which, through successive iterations, tests the market and reaches an equilibrium price. The nuance is that the governor is interested in the equilibrium price of money. This interpretation aligns with what Goodhart et al. (2019, p. 51) convey when they write that 'central bankers need to vary interest rates in response to deviations of the uncertain future rate of inflation (from the desired, say, 0 to 2 per cent rate), rather than react to current data'. The 'current data' consists of prices, production, and employment, which remain unchanged.

What takes the issue into derision is the way in which this dilemma, or trilemma, is bathed in all waters: prices-inflation-money supply. According to Goodhart et al. (2019, p. 99), price stability 'leaves open a great deal of flexibility about the choice of immediate, specific, short-term objectives'. Under the guise of price stability, the Central Bank can adopt various subobjectives as it pleases. Alan Greenspan (2019, p. 263), the chairman of the Fed, upholds the 'guiding principle' of the Central Bank as 'stability of all prices, including assets and financial stability'. French banker Trichet (2019, p. 269) disagrees, stating that 'prices, interest rates and exchange rates cannot take the place of a money supply growth target' and adds, 'tracking the ultimate goal of price stability alone raises the danger that the central bank will not be able to anticipate trouble'. However, the unshakeable belief in price stability remains the leitmotif of Japanese banker Yasushi Mieno (2019). Furthermore, Fischer (2019, p. 311) concludes that 'my present view is that the inflation target with its greater short-term inflation rate certainty is preferable, despite its greater long-term price level uncertainty'. Of course, especially in the long-term, price targeting can bring clouds to the clear sky of the Central Bank. Alexandre Lamfalussy (2019, p. 365) suggests another approach: 'Money supply targeting relieves central banks of some of the pressure which might be exerted on them by governments or parliaments'. German banker Karl Otto Pöhl (2019, p. 381) states that focusing solely on price stability, without addressing the stability of the financial system 'whether we can declare victory, remains to be seen' (see also Svensson 1999; Guender and Oh 2006). In this regard, Fullwiler and Wray (2013) argue that 'beguiled' by the low levels of inflation over the past two decades, the Fed believed that its policies were effective until the fatal outcome: the financial crisis of 2008.

Whom to believe? The problem is that in such a field, foggy, and devoid of clearly emphasised rules and concepts, one does whatever wants of independence. In fact, as argued by Pöhl (2019), price stability alone does not bring victory; the territory must be expanded. Despite efforts to unravel the remnants of the Philips curve via Samuelson and Solow, Friedman, Phelps, and Lucas, the quest remains elusive. In vain did Lucas solve the problem. Other exploitable surroundings must be revived or identified. The 'average' rigidity of wage contracts – the dispute Fischer (1977) *versus* Sargent and Wallace (1975) – poses challenges until it is understood that these contracts are not signed or terminated at once, and monetary expansion in this way is problematic, lacking the expected tidal effect. However, proof must be provided that every fraction of the interest rate is meticulously calculated, leaving nothing to chance. The solution resides in the Dynamic Stochastic General Equilibrium models (see, e.g., the COMPASS model of the Bank of England – Burgess et al. 2013; the FRB/US model of the Fed – Brayton et al. 2014, etc.).

Institutional laxity, the absence of clear rules, or the existence of questionable rules can inevitably contribute to a dubious notion of independence. What guidelines should be selected from the set of rules stored in the drawer? Friedman's rule on the dynamics of the money supply in relation to the dynamics of GDP? The long-term currency neutrality rule? Walsh's rule on a Principal-

Agent contract? Rogoff's rule, emphasising that a conservative central banker is the key to combating inflation? Keynes' rule, portraying the CBI as that of the dentist? The Maastricht rule, asserting that the Central Bank does not receive instructions or advice from anyone?

Under such circumstances, the likelihood of discretion prevailing over rules is ensured. Expressing concern about the rapid changes in free market structures, Goodhart et al. (2019, p. 103) contend that 'central banks will rightly aim to retain their discretionary flexibility' to adapt to circumstances. Similarly, Greenspan (2019, pp. 266-267) argues that a 'predetermined path', a rule, is an illusion. He states that 'there are no simple models that can be inferred from some complex set of econometric techniques that can provide a definitive guide for monetary policy or, for that matter economic policy in general' (idem). The conclusion is that 'there is clearly no rigid distinction between model-based "discretionary policy" and those policies that are in automatic pilot with a specific target in mind. The latter is a version of the former'. This exposes the futility of scholarly econometric exercises summoned, apparently, to objectify the decisions of the Central Bank. The outcome resembles discretionary policy, as discretionary as the one envisioned by the conservative governor. Does it take independence to reach such a conclusion?

Conclusion

To defend a territory naturally recognised as one's own, there is no need for theories extending beyond the natural edges of the perimeter. However, a theoretical outpouring of such proportions implies something else.

First, in the theoretical-doctrinal game it engages, the Central Bank defies. Requesting the disjunction from the economic whole, but especially from the financial-budgetary sector to which it remains attached and, furthermore, achieving this represents the maximum deviance. Within this context, it is charged with the obvious touches of its undemocratic behaviour. Defiance is also the tendency to become autonomous, including in 'its own science'. If the banking science allows itself to draw its own methodological perimeter, a Robinsonade, then the Conservative governor can prove useful in its attempt to resort to deceptive arguments on behalf of the CBI.

Second, the Central Bank's great battle is against the Ministry of Finance. In fact, it is not the break from the Ministry of Finance that concerns it but subordinating and disciplining it. Or the attempt of these entities to discipline one another – since at least at instrumental level they are deemed to cooperate, is an improbable idea and an impossible practice. The illusion that one entity disciplines the other through interest rates and non-financing, while the other compliantly minds its own budgetary optimum with no connection to the monetary optimum, is deceptive. When the Central Bank appropriates subsequent targets for employment and growth, can it be expected not to interfere, at least on an instrumental level, with the budgetary and fiscal sectors?

Third, the econometric exercise it resorts to provide rigour to the analysis gives it the upper hand, but that is all. As Alan Greenspan (2019) argues, the laborious mathematical process does not rule out the possibility of the interest rate being fixed in the governor's office. Furthermore, if independence in the long run lacks a connection to the real dynamics of the economy, as suggested by validation attempts, the mathematical exercise occurs in a vacuum. The qualified refusal to expose the decision-making process to the public is explicable. Such an action would carry inherent risks. As a rule, diffuse accountability to Parliament remains in force.

Fourth, another noteworthy aspect of the problem derives from the fact that very often, the CBI stems from an unfriendly relationship with democracy. In such a country, only the citizen enjoys freedom, with all efforts directed toward the citizen, be it in Parliament, the Government, the Presidency, or even the Central Bank. The budgetary and monetary optimum is designed for the benefit of the citizen. A full national treasury serves little purpose if the citizen is not well. It is absurd to think that the central bank should thrive when the citizen is in distress.

Fifth, the issue of independence is also a matter of ownership. The central bank's money is actually someone else's money; to an overwhelming extent, it is the state's money. The imaginary Principal-Agent contract does not entail a transfer of ownership. Consequently, if it manages a collective pocket, the Central Bank must be professionally accountable to Parliament. Liability involves the existence of brake pads and rules. Or, in this case, the central bank proves very tenacious in convincing that circumstantial, institutional laxity, defines normality. The exception resides in the infatuated rule: the permission to refuse any advice or instruction from political power.

Finally, the refusal of the free-market philosophy stands as a great insult that the CBI makes to an open society. No one denies the normative character of the Central Bank; only not the way it perceives itself. The economy it is called upon to engage with is more natural and rejects its epic tales, as well as the speculations rooted in the imaginary of pure economies. By denying the free market its episodes of spontaneity and directing the way it should behave, saving its failed products to make good use of their money, the Central Bank, despite its independence, places itself in the imaginary, becoming independent and master of an improbable world.

Endnotes

[1] All citations from Isarescu (2019) have been translated from Romanian to English by the authors.

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Conflict of Interest Statement

The authors declare no conflicting interests.

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