Recovering from the Global Financial Crisis: achieving financial stability in times of uncertainty

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Introduction

> "Experience has shown that political institutions often do not maintain stable prices. They have several powerful incentives to expand the money supply beyond the rate of real growth in the economy. In non-democratic societies, the control of the money supply is an important instrument of economic policy that can address various political needs, most notoriously the financing of government needs. It is against this background that independent central banks find their contemporary justification: central bank independence is conceived as a means to achieve the goal of price stability. Central bank independence has been the preferred institutional arrangement to promote monetary stability since the end of the 1980s and beginning of the 1990s. A number of factors have contributed to this development."[1]
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> —Rosa Maria Lastra, *Legal Foundations of International Financial Stability*, 2006

How Independent Are Highly Independent Central Banks?

Theories that appear to suggest that absolute independence exists (i.e., "the theory that recognizes no limits on central bank independence, so long as the bank itself is reliably pre-committed to achieving price stability"[2]), indeed, cannot be sustainable.

A sufficient and appropriate degree of central bank independence is definitely necessary for the goal of achieving price stability. However, despite the levels of independence claimed to be enjoyed by several central banks, recent events indicate shifts in focus of monetary policy objectives by various central banks, notably, that of the Fed Reserve.

The impact of political and government influences on central banks' monetary policies has been evidenced from the recent financial crisis and in several jurisdictions. Many central banks have adjusted monetary policies having been influenced by political pressures that have built up