

We need a debate on Central Bank Independence based on .

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Andrew Baker of Queen's University Belfast posted a couple of comments over the weekend that I held back and, with his permission, post now as a blog.

Andrew started by saying in response to the suggestions by Andy Haldane on increasing inflation rate targets that:

IMF staff [have been floating the idea](#) of moving inflation targets to 4% for the last 18 months or more, mainly with a view to the Eurozone, so as to give the ECB more room for easing (18 months ago) and so as to reduce the value of debt in some euro zone countries.

He then added:

I have four questions:

1. Going to 4% in the UK would seem to me to be ineffective, because there is consistent undershooting of a 2% target. Consequently how would this deal with immobilised monetary policy? It seems to me it doesn't, but going to 4% maybe something you want to do in the medium term, but it does not immediately increase the policy armoury? Can anyone explain Haldane's thinking, it looks to me like a fairly desperate attempt to defend inflation targeting over the medium term, which doesn't really get to the root of the problem?

2. This raises the question of how 2% became more or less the norm around the world. It always struck me this was a very loose and intuitive figure. And once it became established it was about signalling credibility by conforming to the norm. I am not aware of research showing how this was an optimum level for society as a whole in terms of its distributional effects. If we accept the basic premise that high inflation hits those at the bottom of the income stream, with least disposable income most, can anyone point me to research that shows that 2% was optimum for low income groups? I'm not aware of any, and I suggest no such research was conducted, because the justifications for CBI were all about symbolic credibility and not optimum distribution

and collective societal welfare. Happy to be shown to be wrong if anyone can point to research showing the distributional benefits of 2%? I suspect 2% was like the 3% of GDP for fiscal deficits in the Maastricht criteria, — it was a back of the envelope calculation that was literally plucked out of the air — and became the norm, and therefore ‘credible’ and the definition of ‘credibility’.

3. Surely the analysis has to begin with diagnosis — what is the primary macroeconomic problem and then you ask — what monetary policy can do to tackle that — for example if you define this as a short fall of demand together with depleted infrastructure (broadly defined) that is neglected by private sector funds, then you ask how monetary policy can be adjusted and experimented with to help — in relation to those problems. Haldane seems to be suggesting deflation/ disinflation is the problem. The question surely is whether this is a symptom of something more fundamental? If you moved to full on long term deflation that would be a problem no doubt, but it is not cause, — you need to identify the cause. He seems to be hinting at prolonged stagnation — so you surely ask what is the root cause of that?

4. Haldane’s main concern seems to be to defend CBI. Fair enough I accept a central bank should have a price stability mandate and latitude to deliver that through interest rates. But why is it a problem to acknowledge reality and say you having one mandate/ target/ policy rule that applies all of the time is unrealistic? The nature of capitalism over the long run is that strange things happen that confound conventional expectations every 40 years, or so. Surely if you are going to do institutional design for central banks you need to distinguish between normal and non-normal times (when inflation is very low and unemployment quite high), and in those circumstance you need to build in experimental and contingent clauses, — that ask the central bank (to do extra stuff QE of different forms) — we’ve already been doing it informally. Is the suggestion that this destroys anti-inflationary ‘credibility’? This seems to me to be nonsense. The greater danger is informal instruction. Having contingencies were the central bank accepts treasury instructions under specified circumstances while still retaining some autonomy, actually seems to me to be a way of maintaining a more nuanced, and sophisticated modified form of CBI. If your position is CBI in its current terms is a sacred cow and a box that must not be opened, it seems to be to a completely untenable position in the current circumstances. So what am I missing here, from those so reluctant to put this issue of CBI on the table?

Before concluding:

The purpose of all of the above was to say when you begin to analyse CBI it starts to look like a social construction, based on certain accepted ‘norms’, where following the ‘norms’ signals ‘credibility’.

But ‘norms’ cannot stay the same forever, because circumstances and context can and do change. If the norms and the policy rules they give rise to become redundant and cease to act as a reliable guide for policy (for nearly a decade), — where is the

'credibility'? At that point you have to redesign them and come up with a more sophisticated and contingent institutional design. This seems too big a mental block/hurdle for some to jump over. I'm trying to work out why. And the best I can come up with is the fear that if you start to change and tamper with central bank institutional design you will lose everything and anti-inflationary credibility will suddenly evaporate. I don't think that is a fully thought through tenable or entirely rational position. There is a mental block based on fear, out there on the subject of central bank institutional design. Very damaging — because we really need a sensible debate about this.

I think this conclusion is likely to be correct.

Call it clinging to straws.

And yes, we do need that debate on this.