Monetary Sovereignty and Central Bank Institutional Design: Implications for Fiscal Policy Autonomy and Economic Stability

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As the paper is currently a work-in-progress, this presentation will focus on its summary, conceptual framework, and most significant preliminary findings. I will outline the central argument, discuss the spectrum of monetary sovereignty and central bank institutional models developed in the paper, and highlight how these different frameworks concretely impact fiscal policy autonomy, taxation roles, and public spending constraints. Special emphasis will be placed on comparative analysis drawn from selected global economies. The presentation will conclude with initial policy implications and directions for further research.

Paper summary:

This paper provides a systematic analysis of how central bank institutional design—and consequently the degree of monetary sovereignty—determines the real scope of fiscal policy autonomy available to governments. Theoretically, a fully monetarily sovereign state, as the sole issuer of its currency, faces no intrinsic financial constraints other than inflationary pressure and currency stability concerns. In such an idealized scenario, taxation primarily serves monetary policy objectives, such as managing currency demand, reallocating economic resources, and stabilizing business cycles, rather than financing governmental expenditures.

However, real-world applications diverge significantly from this theoretical framework due to varying institutional structures and political-economy constraints. To explore these differences, the paper introduces a conceptual spectrum of monetary sovereignty based on central bank institutional arrangements. Three distinct models are delineated:

1) Integrated Model: The central bank is operationally integrated with the treasury, enabling direct monetary financing of public spending. Taxation primarily supports monetary policy functions—regulating aggregate demand, generating currency demand, and providing automatic economic stabilization. Fiscal policy in this model faces minimal constraints, limited chiefly by inflationary considerations.

(2 Intermediate Model: Partial independence exists between the central bank and treasury, characterized by close cooperation but excluding direct monetary financing of government deficits. Here taxation serves dual purposes—monetary stabilization and revenue generation—while government spending is disciplined by market constraints, albeit softened by indirect central bank interventions.

3) Independent Model: Defined by complete central bank autonomy, explicit prohibitions on direct monetary financing, and distinct separation between monetary and fiscal authorities. Taxation serves predominantly to finance public spending, substantially constraining fiscal autonomy via institutional regulations and market-imposed limitations.

Empirical analyses of major global economies—including the United States, China, Japan, and selected European countries—illustrate how each model concretely shapes the nature and limitations of governmental fiscal policy. The findings highlight that even monetarily sovereign states voluntarily impose institutional constraints on fiscal autonomy to mitigate political risks (such as deficit bias) and maintain currency credibility. The paper ultimately provides policy-relevant insights into the complex interplay between central bank institutional designs, taxation roles, and the practical scope of fiscal policy discretion in contemporary economies.