Monetary Independence and the Separation of Powers: A Principle in Constitutionalism

PAUL TUCKER

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Paul Tucker is research fellow of the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. He was the deputy governor of the Bank of England (2009–2013) and is the author of *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* (2018).

Central banks are shaped by law. It was for reasons of legitimacy that after the 2007–09 global financial crisis, the Bank of England urged the new coalition government and parliament not to give us certain powers and to add extra constraints around some of the new stability-related powers that were coming our way. We largely prevailed. I mention that because I have not seen that kind of "do not make us too powerful" culture at the Federal Reserve over the many years I have been able to observe it.

This conference is about the Fed, particularly in the light of the cases that will be heard by the US Supreme Court. But it should be said that in some ways these issues are about the legitimacy of the Supreme Court itself. In that context, I'd like to recommend the late Richard Fallon's book on the legitimacy of the Supreme Court, which came out at around the same time as my own *Unelected Power*.

To substance: I want to offer an argument, a rather simple argument, for why monetary independence is distinguishable from the independence of other delegated functions, such as securities regulation and so on. The argument rests on a fundamental pillar of republican and liberal governance (I use "liberal" in its old European sense).

Many granular arguments are being advanced for why the Fed should be distinguished. Whatever their merits, those arguments, and more important, whatever the justices decide, are going to have to rest on some big principles. I say "have to" because the decision needs to make sense to people, both experts and interested members of the public. I think there is such a principle: the separation of powers.

Typically, when people talk about the separation of powers, what they instinctively think about is the independence of the judiciary from the elected people in the legislature and executive government. But there is another elemental part of the separation of powers, which is not only in the US Constitution but is vital to the history of constitutionalism. In my country, the United Kingdom, going back to the mid-medieval period, there developed a norm that the king—or, more abstractly, the ruler—shall not be able to tax the people without consent.

This matters a lot because—the second step in the argument—the monetary levers are always latently an instrument of taxation. Most obviously by surprise inflation or deflation, but actually in more subtle ways, even without massive surprises. What follows from that is a negative proposition: The last officer of the state who should hold the monetary levers in a constitutional republic, or what I would call a liberal democracy, is the head of the executive branch. The monetary levers belong ultimately with the elected assembly.

For much of our history—not just since the US was founded, but the modern era more generally—assemblies essentially solved this via the gold standard. In Britain, decisions to come off gold during the Napoleonic Wars, and to go back onto gold afterwards, were taken by the parliament. Formally, those were decisions not taken in Threadneedle Street, nor in Downing Street. The gold standard belonged, as it were, to parliament which, on the recommendation of the executive, passed an act authorizing the central bank to suspend conversion of notes into gold.

We discovered in the 1930s, however, that the gold standard was not sustainable under full-franchise democracy. The United States discovered the same for itself in the early 1970s when it came off gold, bringing an end to the Bretton Woods system. The violence, if you like, of the swings in real economic activity—in real demand, output, and jobs—entailed by sticking to the gold standard could not be maintained when those suffering had the vote. In the gold standard's 19th century heyday, the UK had a property-owning, property-franchise-based democracy, as did some US states until the middle of the 19th century.

If something like that is correct, then the question is what other choices does the legislature have for its monetary regime. There are not many. In theory, one choice would be to have a committee of the legislature meet to set interest rates, routinely and in emergencies. I hope you agree that is for the birds. So, if it cannot properly be handed to the elected executive, delegation to a central bank emerges as a solution to a problem of reconciling price stability with the separation of powers under full-franchise democracy.

That poses the question, a vital question, of what constraints should be placed on that institution so that the delegation does not create some kind of unelected monetary king. My answers, which include plenty of preconditions and constraints, were set out in *Unelected Power*, and I am not going to repeat them here. I mention them because the constitutionalist case for an independent monetary authority does not remotely entail untrammeled powers.

Summing up so far, I have argued that when the high-level question comes up as to whether the court (here or in any other constitutional democracy) should accept laws that give the monetary levers to the executive branch, the answer is no, they should not. The reason lies in a very basic principle that is not only enshrined in the Constitution but helps to motivate the Constitution itself.

That is the main thing I want to say. Let me add two other points, one concerning central banking and one concerning the administrative state.

On central banking, since the Fed's role in supervision and regulation has come up, I might briefly say something about its warrant. It is this. In a monetary economy, only the central bank can act as a lender of last resort (LOLR), since only it can create the most basic safe asset—its own money—at lightning speed;

waiting for hours for a finance ministry to issue treasury bills will not cut it. Any LOLR will naturally—organically—have some supervisory role since it will want to ensure it is repaid, and so will want to know about the banks it is lending to and about the collateral it is lending against. It will also naturally want some kind of say in the regulatory requirements, because if they are too lax, it will be more active as LOLR. If the Fed's functions in this area were taken away, the United States would find itself with more fiscal (equity) bailouts. Beware of what you wish for.

Finally, let me just say something briefly about the agencies known here as commissions. Partly for the reasons already given and partly perhaps for some other reasons, one can distinguish between, say, the current Federal Trade Commission (FTC) case and cases concerning the Fed.

First, everybody here knows that if after a general election there is a change of administration, then under what has become an established norm the chairs of the regulatory commissions—the Federal Communications Commission (FCC), Commodity Futures Trading Commission (CFTC), Securities and Exchange Commission (SEC), Federal Deposit Insurance Corporation (FDIC), Federal Trade Commission (FTC), and so on—submit their resignations. This enables the president to fill the vacancy on the five-member panel. This has the effect of maintaining the 3–2 balance of party representation on the commissions—three for the president's party, two for the other party, giving the majority to the incoming administration. That does not happen at the Fed. There is no such norm that it should happen. That is tremendously important in terms of social norms. To equate the independence of the FCC with the independence of the Federal Reserve is to make a category mistake in terms of US practices.

The distinction alerts us to the importance of what counts as independence. If thought of as independence from quotidian politics, there are three things. One is that the president (or in other countries the prime minister) cannot get out of bed and say, "I'm sick of this person, you're sacked."

Second is that the treasury secretary cannot casually issue a directive that says, "This is what you should do." There should be no law that gives them a directive power in normal circumstances. If there is any such law, it should be restricted to carefully specified, emergency-type situations, with a clear carve-out in the primary legislation. Such a thing exists for the Bank of England.

And the third thing is that an independent agency, as defined, should not have to go and get its funding from the elected assembly every year. Because if it does, the assembly—the congress, the parliament—is undoing or undermining its intention to delegate something in a way that puts it at arm's length from day-to-day politics. Here, the commissions are subject to annual appropriations. They are not independent as I am defining it. Whether, normatively, the FTC, FCC, etc. should be independent is another matter. I do not think they should all be independent. I'm going to address the criteria for degrees of independence appropriate for other agencies in the book I am working on.

But, to reiterate, the monetary authority is different. If the Supreme Court decides that the president can control the monetary levers, your country will have given up one of the most basic principles of constitutionalism, the separation of powers. It would be ironic, and tragic, if that holds up in an old parliamentary democracy but not here.