

Governments aren't like households

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Politicians love to say the government must “live within its means” – just like a household. But this analogy is completely wrong. In this video, I explain why the household analogy is economic nonsense, how it misleads the public, and how it drives damaging austerity policies. Once you understand how government really works, you’ll never fall for this trick again.

<https://www.youtube.com/watch?v=sAKr5507qaU&si=MLNRsgroSi7LBahS>

This is the audio version:

https://www.podbean.com/player-v2/?i=96pff-1930688-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

Lots and lots of politicians make the mistake of using the household analogy to explain how the economy runs.

So let me be upfront, the household analogy is the pretence that the government operates in the same way as your household does, and it's wrong. And the purpose of this video is to explain why it's wrong and what you can say about that when you come across people, including politicians, who you might be shouting at on the television, who are claiming that we can go bankrupt in the way that the household can, or we've

got a maxed out credit card, like you and I are capable of having, and that is not possible for a government.

So let's talk about what the household analogy actually means.

It sounds horribly plausible that the country does, in fact, run like a household, because that's the thing we are all familiar with.

We aren't used to running countries because the vast majority of us, including most politicians, never do get to run a country.

And when they do, they don't seem able to understand that running a country is nothing like running a household, and they use phrases which are completely ridiculous.

One of the most common is that they say, "We must live within our means", without very clearly understanding what that might mean.

They also think that a country has to tax or borrow before it can spend, and that's not true.

And they make up things called fiscal rules, even though no such things have ever existed. They are simply things they make up for themselves and which they break whenever they want.

So let's talk about this myth, why it is persistent and why it is so damaging in UK economics.

The household analogy is dangerous because what it does is drive dangerous political and economic decisions. In particular, it creates the idea that the government is limited in what it can do in ways that are not true, and that has consequences for just about everything the government does.

So let me deal with those dangerous assumptions and what the consequences of them are.

First of all, it is entirely true that a household must earn before it spends. After all, where else is it going to get its money from? Okay, you could tell me it could live off the gifts from somebody else, and it could live off benefits, but that is income in this sense. The point is, there has to be something coming into a household before it can spend. It cannot create money. It cannot tax and nor can it set the interest rates that it is going to earn on the money it has saved. But the government can do all those things.

The government can create money, in particular because it has its own central bank. It literally owns it, and it can tell it to run an overdraft for it, which means that, of course, it can never max out its credit card because there is nobody who can tell it that it's run

out of credit.

So the government can create money.

It can also tax us. It has the legal power to do something which nobody else has got, which is to basically collect money with a certain degree of menace associated with it in the sense that if you don't pay the taxes that you owe, you can be prosecuted, and you don't have that right with somebody else. If you try to extract money from other people and apply threats, you could well find yourself in prison. The government doesn't.

This is fundamentally why it is so different from you and me, and yet our politicians don't recognise that.

We can also borrow, but the government can't do that. The government can't borrow because the government creates the money that it borrows. So the idea that the government borrows is meaningless. In fact, what the government does is offer a savings facility to the City of London, and therefore the government's a banker.

People don't come to you to say, "Would you like to hold my money for me?", but the government is in that situation.

So, the government is in a situation which is unimaginable for any household in the UK, however wealthy they might be.

The government simply is different. To pretend it's the same, it's therefore dangerous.

There's another myth that we need to tackle within this household analogy. The myth of the household analogy is that the state is dependent upon the economy for its income, and of course, I've just dealt with that. It isn't.

The reality is that, the economy depends on the state to create the money that it needs to function.

Quite literally, the UK private sector economy cannot exist without money, and the only agency that's got the right to actually create the currency in our economy is the government. It is the only organisation that can create pounds.

I entirely accept that banks can lend money in pounds, but that's different from creating the pounds themselves. Only the government can do that, and therefore, if we are talking about who is dependent upon whom, is the private sector dependent upon the state, or is the state sector dependent upon the private sector, the answer is that the private sector is the dependent one.

The government is not dependent upon the private sector. The private sector is dependent upon the government because it is the government that makes economic activity possible. They do that by setting the rules.

Households are rule-takers.

They take prices.

They take interest rates.

They accept the conditions as given, because, let's be blunt, you haven't got a choice and nor have I.

Whatever the prevailing rules are with regard to financial markets, they are what we have to take. We don't have another choice. The government has.

It can create money, it can set interest rates, it can set tax rates, it can decide how much money there will be floating in the economy, it can even decide the inflation rate and how it wishes to control it.

They shape the entire economy as a consequence. We as households are simply takers of the situation we're given. They are creators of the environment in which we exist. To pretend they are alike absolutely ignores this reality.

And let's talk about accounting.

Households have income and spending, and they are not related.

In other words, the spending of a household can be cut without having any consequence for the income of that household, and this is true, by the way, for any company as well.

A company can, for example, shed employees and reduce its costs, and as a consequence, it will save money.

The same is true of a household. The children could be thrown out to go and get on with their lives on their own, and the household would save money.

But for the country, that's not true.

One person's spending within the country is another person's income.

In the country, we're talking around 68 million people in the UK right now, and the vast majority of what we do is actually with each other. Of course, there are imports and exports; let's not pretend otherwise, but most of our interactions are within the UK. So, one person's spend is another person's income.

The government can't therefore cut its spending like a household does and presume that there will be no consequence for its income, because in fact, there is.

If the government stops spending on benefits, for example, the amount of income in

the national economy goes down.

If it stops spending on civil servants, the government's tax revenue goes down because people aren't paying tax as a result.

And this matters because austerity by a government - it trying to cut its costs to balance its books - has a totally different consequence to a household.

A household can do that, and it's entirely rational and sensible because if it's facing a financial crisis, it can, as the saying goes, cut its cloth to suit the circumstances.

But for the government, the absolute inverse is true. If the government is facing a financial crisis, the best thing it can do is spend more money, because more money being spent by the government will create more income in the economy, and more income in the economy will create more tax revenue, and that will create the virtuous cycle that will actually solve its crisis for it in exactly the opposite way to what will happen in a household.

So the household analogy is, in other words, total rubbish in this situation. And what we come down to is the fact that almost everything that is said by politicians about economics when they are using the household analogy is a representation of their complete failure to understand macroeconomics.

They say we're going to max out the credit card. Even John McDonnell did that when he was Shadow Chancellor for Labour, and the government can't because they own their own bank.

They say they've got to impose austerity, and they can, but it is totally counterproductive because it cuts their income and their tax revenues and therefore creates a worsening financial situation.

And they say that they are takers of interest rates and markets set them, when that is not true because we can see that what central bankers do with regard to interest rates almost and absolutely directly always influences the rates that apply in markets.

So this idea that the government is somehow a rule-taker and not a rule-maker is completely absurd.

The government is a rule-maker, households are rule-takers, and they're fundamentally different.

But the problem is that believing the household analogy locks us into ideas about artificial scarcity because we talk about money not being available, and therefore, there are things that we cannot do.

This is not a constraint on government.

Governments can do whatever they wish so long as resources are available to do them, and they can do so because they can create money.

Now, I stress the point incredibly strongly that there have to be resources available to do the things that they want. In other words, there have to be people to employ, there have to be resources available, there have to be buildings, and whatever else; let's not pretend otherwise. The government isn't completely free to decide to spend however it wants, because if it does and there are no resources to buy, it will generate inflation, and nobody wants excess inflation.

So I am not talking about government spending willy-nilly without constraint; I do not wish to suggest that any government can ever do that, because it's not true, because the availability of real resources is the constraint.

But when the government pretends that money is the constraint, they give financial markets needless power over governments, which is totally unnecessary.

So, if we reject the household analogy, we can ask different questions.

What do we want the government to spend on?

How is the government going to design tax to control inflation and simultaneously redistribute wealth? Because tax, just like money, can do more than one thing at once.

And how are we going to focus on creating the skills, the tech, the materials, and the environment in which we can grow the economy?

Because those are real questions that we can ask once we give up the household analogy and realise that there are things the government can do if only it understands its power to literally create wealth.

There are no artificial constraints on ambition if you are the government.

So the government has to drop the rhetoric of the household analogy.

It isn't an essential simplification to explain how the economy works because it totally misrepresents the truth.

The household analogy is like saying it's just safe to walk across the road, whatever happens, when we know that's not the case. Nor is it safe to run the national economy like a household; that's also not safe. In both cases, people get hurt because of a false and simplified story being told.

But even worse than that, the household analogy isn't even a simplification.

It's a deliberate political tool.

It's about deliberately trying to shrink the state and to weaken public services.

It's about benefiting the City of London through privatisation.

And it's about turning us, the public, into passive consumers rather than into active participants in the state, where we realise that we have a right to demand action.

The household analogy is fundamentally about undermining the role of government.

So we have a choice. We can keep the soap opera of balancing the books, or we can recognise the state's real capacity and responsibility, which is to balance the economy, and we can recognise that the state can do that for the common good.

That's what having a government is all about: delivering for the common good, and abandoning the household analogy would let it do it.

So what do you think?

Do you think the household analogy is a con-trick created by those who want small government?

Or do you think that it's something that works for you and helps you understand how government works?

Or are you just believing that all of this is very complicated and that you really don't want to get your head around it?

Let us know. There's a poll down below, and I'll be interested to see what you think.

Poll [poll id="179"]

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, [here](#).

One word of warning, though: please ensure you have the correct MP. ChatGPT can get it wrong.

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