

Funding the Future

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As I have written many times before, one of the most persistent and damaging myths in economics is the so-called household analogy. This is the idea that the government's finances are like those of a household, meaning that it must "live within its means", balance its books, and cannot spend more than it can tax or borrow, with that borrowing itself being constrained by a so-called "fiscal rule", of which there are no such things.

This idea sounds plausible. It is also completely wrong. And it matters enormously that people understand why, because its consequences are dangerous for most people in a country like the UK. There are a number of reasons for saying so.

First, a household and a government do not operate in the same financial environment. A household must earn before it can spend. Its income comes from participating in the economy and is limited by what others will pay it. It cannot create new money. It cannot impose taxes. It cannot set interest rates.

A government, or at least one like we have in the UK, that can issue its own currency, can do all those things. As [I have recently explained](#), it spends before it raises taxes, creating money in the process. It taxes later, partly to withdraw money from circulation to control inflation, and partly to influence economic behaviour. This is the process of using tax as an economic steering wheel, as I have described its role to be. Such a government does not borrow despite the appearance of doing so because it never needs to borrow the funds it has already created. Instead, what looks like borrowing is actually the making available of a safe savings facility for institutions in the City of London and international financial markets.

Second, the household analogy assumes the state is dependent on the rest of the economy for its income. The reality is the reverse: the rest of the economy is dependent on the state to create the money that makes economic activity possible. Without the money generated by government spending, there could be no private sector economy.

Third, households do not set the macroeconomic rules within which they operate. They are price-takers, interest-rate-takers, and subject to the economy's ups and downs.

Governments are price-setters for the currency they issue, interest-rate-setters if they choose to be, and the ultimate shapers of demand in the economy. Pretending they are the same as households ignores that critical difference in power.

Fourth, the household analogy is almost always used to justify austerity. The story goes: “We’ve maxed out the credit card, so we must tighten our belts.” Even John McDonnell once said that on behalf of the Labour left when Jeremy Corbyn was Labour leader. In reality, the UK government’s “credit card” provider is an institution it owns and controls, the Bank of England, which will always make any payment that the UK government asks it to do so long as Parliament has approved a budget for the payment to be made. In that case, the only limits on what the government can do economically are not financial, but are instead created by the availability of resources in the economy and the risk of inflation, and not some mythical overdraft limit.

The consequences of getting this understanding wrong are significant:

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Believing the household analogy locks us into a politics of artificial scarcity, where essential public investment is abandoned because “we can’t afford it” – even when the resources exist.

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It encourages the public to see government spending as a zero-sum game: that more for the NHS must mean less for education, or more for green investment must mean less for defence, when the real question is whether the economy has the capacity to do all these things, which it might do.

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It entrenches the false belief that taxes fund spending in a mechanical sense. This obscures the real role of taxation as a tool for redistribution, inflation control, and shaping the economy’s direction.

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It hands power to the financial markets by making it seem as if the government must borrow from them to survive, when in reality it chooses to issue bonds merely because the City wants to use them as savings mechanisms.

Breaking free from the household analogy would, then, change a great deal of economic understanding and so economic policy. In particular, if we accept that spending comes before taxation in a currency-issuing state, then we can ask different questions. We can debate what we want the government to spend on to meet our needs and ambitions as a society. We can design taxation to manage inflation, redistribute wealth, and discourage harmful activity, and not to supposedly pay for public services.

And crucially, discussion can focus on real limits, such as those in skills, technology,

material resources and the environment, rather than on artificial ones invented by economists.

The household analogy is not a harmless simplification. That would be to completely misunderstand it. What it actually is can be best understood as a rhetorical weapon used by those whose intention is to shrink the state, weaken public services, and privatise public services. It turns the government into a supplicant to the markets, and most especially the City of London, and the public into passive consumers rather than active citizens capable of shaping our collective futures.

This is why the household analogy needs to be rejected. The UK government is not like a household. It is the creator of the money we use, the setter of the rules, and the only institution capable of mobilising resources on the scale needed to tackle the crises we face, from climate change to crumbling public infrastructure.

The choice is stark: either we keep pretending the state must balance its books, like a family in a soap opera debt-crisis scene, or we face up to the truth that it has far greater responsibilities and capacities than most of our economic and political establishment will acknowledge and start using them for the common good.

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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