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Politicians constantly claim that the government must “live within its means”, just like any family. In this video, I explain why the household analogy is not only wrong — it is the foundation of austerity, underfunded services, infrastructure decay, suppressed wages and collapsing public trust.

Governments create money. Households use money.

Governments must manage real resources, not bank balances.

And when governments cut spending, their income falls — the exact opposite of what happens to you or me.

Understanding this difference is essential if we want a better economy, proper public services, fairer taxation and a stronger democracy.

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This is the transcript:

There is something called the household analogy. The household analogy is an idea put forward by right-wing economists and politicians who claim that there is no difference between the government and the way it must behave, and households and the way that they must behave, and it's wrong. It's absolutely wrong. It's based upon a mythical view of economics, which presumes that markets know best, and despite the fact that everything about this analogy is wrong, every single budget, including that which will be presented by Rachel Reeves next week, has been based upon this analogy for far too long.

In this video, I want to explain what the household analogy is, why it's wrong, what that means, and how we can do better, because if you are really going to understand how we can have a better economics that matters.

The argument within the household analogy is very simple, and you have heard it so many times that you will recognise it. The statement is that "Households must live within their means." If they borrow, the amount that they do borrow must be limited because their debt must be repaid, and ideally their spending should depend upon prior saving so that they don't go into overdraft because, it is claimed, overspending leads to bankruptcy, whether that is of the household or a business. And the economists who put forward this idea are universally microeconomists: in other words, they only think about the world through the lens of households and businesses, and very, very few of them at all think about the way in which government works, because basically they don't like government.

But the truth is, the government is nothing like a household. It is, in fact, in very many cases, the exact opposite of a household.

For example, households use the currency that is created by the state in which they're located. So in the UK, every household uses the pound. But the job of the government isn't to use the pound. The job of the government is to create the pound. It literally creates money every time it spends. When it has a valid budget approved by Parliament, all it does when it wishes to spend is tell the Bank of England to create new money on whatever it is that it wants to acquire, and the Bank of England will do so. Money is then injected into the economy.

No household can do that, because it hasn't got the power to create money, and nor does it own its own bank, but the government does. As a result, households can run out of money. That's entirely correct. To that extent, the household analogy is true; that's what households can do.

But the household analogy ignores the fact that governments can never run out of their own currency because they alone have the power to create more of it. So this creates fundamental consequences for the behaviour of households and governments, which means they are entirely different.

For example, a household can cut its spending, and the costs that it has cut out simply disappear; it has money left over as a consequence. If, for example, I stopped buying coffee, a situation I can't imagine, but suppose I did, then the coffee shop will not send me an invoice for the coffees I haven't bought. I will have simply eliminated the expense. It will have gone and I will have a saving. The household operates in isolation. Their cuts only affect their own budget, although I might have a material impact upon the well-being of one or two coffee shops in Ely as well, but that's not the point. The logic is that this does not scale to the economy as a whole.

When the government spends, it pays the wages of pensioners. It pays the wages of its employees. It pays its suppliers and contractors. And it feeds money throughout the economy. When the government stops spending, that income disappears, but there is a completely perverse outcome, which is quite unlike what happens in a household. When the government stops spending, it reduces its income because if people don't get the wages, pensions, and contractual payments that they are entitled to receive from the government, then they don't make payments of tax either.

Quite simply, the government, when it stops spending, stops money circulating through the economy.

And when the government spends, that money doesn't get used once. It gets used more than once. So the first person who gets money from the government, let's call it an old age pensioner, receiving their pension, spends it. Old age pensioners don't get their cash from the government to hoard it. They go out and pay their bills, they pay their rent if they've still got rent to pay, they pay their utility suppliers, they buy food, they buy clothes or whatever. But the point is that money then becomes somebody else's property. In the process, even if the pensioner doesn't pay tax on the income that they receive, the recipient at the second stage will. VAT will be paid. The person who receives the money will have a corporation tax liability if they make a profit as a result, and they will be paying their staff, and those staff will pay tax and National Insurance, and then they will have net income left over, and they'll spend, and the process goes on and on and on.

In other words, when the state spends, what it puts into the economy becomes somebody else's income, but that in turn then provides a second person with income, and on, and on, and every single time that happens, tax is paid. So if the government cuts its expenditure, it also cuts its income, and households don't do that. So governments and households are fundamentally different.

Quite literally, part of every pound the government spends returns to it as tax, but that is not true in households for one very good reason: households can't impose taxes, so again, we have a fundamental difference between households and governments, and to confuse the two, as most economists and politicians do, is just crazy because if you don't understand what you're trying to manage, you won't manage it well, and that's what's happened as a consequence of the household analogy.

Macroeconomics is, in this case, nothing like microeconomics. You can't add up every individual in the country and work out what the behaviour of the country as a whole will be because, in aggregate, we behave differently than we do in our personal circumstances. What is prudent for an individual can be destructive for a nation.

For example, in the face of an economic downturn, it's prudent for an individual to save to cover for the potential rainy day they might face. But if everybody saved, we would actually make any recession worse because there wouldn't be enough spending going on, and the result would be a depression rather than a recession. So in that situation, whilst it might be prudent for an individual to save, it's logical for a government to spend. Governments have to do, in a great many cases, the exact opposite of what households do. They act counter-cyclically, and that's why macro is not micro; they have to be different.

So what is the real constraint on government spending, because it isn't its ability to get hold of money? Households have to get hold of either money or a way of borrowing before they can spend, but governments don't; they can create their own money. But there has to be a constraint, and, of course, there is.

The constraints are the real resources within the economy. Those resources are people and the skills that they have, the materials that are available for them to use, and, of course, the environment in which we live, which we wish to sustain. So the real question is, "How do we put these resources to best use?" Not, "Have we got any money to spend?" That's what the decision-making of government should be about. Households have to worry about money flows. Governments have to worry about, "Have we got people, skills, material and can we live within environmental constraints?"

So we have to properly understand tax and borrowing. That's true because the way in which they're seen by households is nothing like their behaviour when it comes to government.

For example, taxes are a cost to households; let's not pretend otherwise, that's what they're meant to be. They are meant to reduce the capacity of a household to spend because the government requires that, because it has provided all households with services, and that's the purpose of taxing.

But when that income arrives with the government, it doesn't fund the provision of those services because those services have already been paid for with money created by the government. And so in that case, at a macro level, tax is not a mechanism for funding, even though it's a cost to households. Instead, tax creates the space in the economy in which those services can be supplied.

Quite deliberately, by imposing taxes, the government reduces the scale of private sector activity in the economy so that resources are available for it to buy to deliver the public sector services that we are dependent upon, whether that be schools or hospitals or whatever else you care to think of, and that's important.

But secondly, tax also controls inflation. If the market sector economy is going too fast or something happens in the world outside and we get a hike in inflation, then extra tax can take demand out of the economy, rebalance the situation for the time being, and control inflation as a consequence. That is the role of taxation.

So these things exist for a different purpose in government accounting than they do in household accounting, and we can't see them as the flip side of each other, quite simply because they're not.

And the same is true of what is called government borrowing. If we borrow from a bank, we have to repay, but that's not what is the case with the government. A government creates money, and since 1694, when the National Debt was created in the UK, it hasn't usually taxed all that money back out of the economy into which it injected it. Instead, it's left some there to fuel growth, to allow for population growth, and to simply encourage a low rate of inflation because, by and large, that does tend to encourage economic activity.

But that money goes somewhere. It normally ends up in the hands of the wealthy. When that process of spending and spending and spending out of government activity, which I described earlier in this video, eventually reaches a person who doesn't need to spend again because they've already got enough, they will save. And they've got to put that money somewhere. And even if they put it in a bank, the bank has got to put it somewhere safe as well, and they give it to the Bank of England. That's what the National Debt is. It's money redeposited with the government because people like banks, and life insurance companies, and pension companies, and foreign governments who hold Sterling all know that there is only one agency in this country which can guarantee to repay them, and that is the government, because it actually makes money.

So government borrowing isn't like household borrowing. It's the exact opposite, in fact. Nobody would want to inherit their parents' debts, but the fortunate young people of the UK will inherit the debt of the UK government because the government's debt represents private savings, and the people who inherit those private savings will be better off as a consequence.

It is yet again the exact opposite, but the failure to understand this polar opposite situation between government and household has led to really bad policy.

Austerity has been one of those policies because we have underutilised the resources within the country to try to make the government, when seen as a household, balance its books when it never needed to.

We've underfunded public services as a result. We've got infrastructure decay as a consequence because we haven't been willing to spend on it.

And wages have been suppressed because it has been feared that this will lead to inflation, when that need never have been the case, and the fear was misplaced.

In fact, fear is the operative word. Fear has become the narrative of politics when opportunity has been lost as a consequence.

And so has democracy. The analogy depoliticises real political choices; it pretends that we have no option. There was a reason why Margaret Thatcher used to use the phrase 'TINA', which stood for 'There is no alternative', and to what was she referring? The household analogy, of course, but there was an alternative. There always was another option, and she just chose to deny it. She encouraged fatalism, and she destroyed trust in government as a consequence.

There is a better story.

People have to understand that the government is a currency issuer and households are currency users.

Governments choose outcomes, and budgeting is about real resources and not money.

And if governments understand that, we will have a better economy.

We'll have properly funded public services.

We'll have investment-led economic renewal.

We'll have fairer taxation and a stronger democracy, and more confidence and less fear.

And so we need to end the household analogy. It is wrong. It's always been wrong. It will always be wrong. It is a falsehood. We need instead to talk about how we manage the real resources of the country, including you and me and everyone else.

And we need to fund services properly, and we can, and as a consequence, we could rebuild democratic confidence, and that would push the far-right off the edge of the political field forever.

That's what's at stake here. That's why the household analogy is so important. That's why you have to understand it. Please do, please get your head around this. The government and households are nothing like each other, and more often than not, whatever is good for households is bad for the country as a whole, and it's time we said it.

AI: How to use it as a campaigner

We have produced a guide on how to use AI as a campaigner, for which we're already getting good feedback. It's available **as a free download here. Take a look. We think you'll find it useful.**

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