Aadya Bahl November 24th, 2025

Explainer: What is economic productivity?

*Productivity powers economic growth and raises living standards. But the UK has witnessed a prolonged period of stagnation, marked by weak economic productivity growth. While the reasons behind this slowdown are often described as a "puzzle", **Aadya Bahl** decodes the key factors that have led to this decline.*

Productivity is central to how economies grow. It measures how efficiently resources such as capital and labour are used to produce goods and services within a firm, a sector, or a country. A common measure is labour productivity, which captures the amount of output per worker (or output per hour worked). It is intrinsically linked to living standards, as noted by the economist Paul Krugman: "A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker."

Why is productivity in the UK so low?

Higher productivity allows firms to grow, pay higher wages, and invest in innovation, creating a virtuous cycle of growth and prosperity. Higher incomes and revenues translate into greater tax receipts for the government, enabling better public services such as healthcare and education, and raising the standard of living for all residents.

This cycle has stalled in the UK. Since the 2008 financial crisis, the country has experienced weak productivity growth with stagnant real wages. By 2023, pay in real terms was broadly the same as it had been in 2007.

The UK saw the sharpest contraction in labour productivity when compared to the United States, France, and Germany. Between 2010 and 2023, average annual productivity growth was just 0.5 per cent, compared to 1.6 per cent between 1997 and 2010. Estimates suggest that productivity is 26 per cent lower than it would have been had pre-crisis growth continued.

Low investment, combined with slow skills growth, has been a central factor behind the UK's "productivity puzzle." The slowdown in capital accumulation post 2008 was far more pronounced in the UK than in other major economies – twice as large as the US and Germany, and seven times as large as France. Despite relatively high profit rates, many UK firms choose not to reinvest their earnings.

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This trend has persisted through recent economic shocks like Brexit and the pandemic. Heightened trade tensions, depressed consumer confidence and elevated uncertainty surrounding the business environment in recent times are weighing heavily on growth. As a result, in its most recent world economic outlook, the IMF projects that economic output in the UK will grow by 1.3 per cent per year in 2025 and 2026 in real terms, which is slower than the period between the financial crisis and the pandemic.

What are the productivity gaps across the UK?

The UK's productivity issues are also spatial, with major cities outside London underperforming. Manchester and Birmingham, for instance, are 31 per cent and 37 per cent less productive than London. In contrast, France's second cities, Lyon and Toulouse, have narrower gaps with Paris. If Manchester and Birmingham close their gaps to match those shared by Lyon and Toulouse with Paris, economic output in the UK would increase by nearly £20 billion every year.

Regional differences reflect variations in capital and skills, with capital intensity sharing a strong positive relationship with productivity. This can be seen in the example of Greater Manchester, where research shows that the city-region would need to increase its capital per job by 15 per cent and add 180,000 high-skilled workers to its labour market to reduce its productivity gaps with London. Yet investment in skills has declined nationwide.

Workplace training participation, measured as a proportion of those in employment receiving work-related training in the past three months, fell from 29 per cent in 2002 to 20 per cent in 2020. In 2024, an average of only 11 per cent of employees aged 16 to 64 reported receiving job-related training in the previous four weeks. This trend is particularly concerning, as workplace training boosts productivity, and helps workers adapt to technological changes and upskill to meet the demands of an evolving labour market.

Has the UK become less dynamic?

The underperformance of key sectors, such as manufacturing and the information and communication sector, has also weighed on the national productivity slowdown. These are high value-added sectors that rely heavily on both skilled workers and capital investment and should be driving growth.

At the same time, the UK economy has become less dynamic. Fewer new firms are being created, workers are moving less often between jobs, and job reallocation between sectors has slowed. This matters as dynamism fuels the process of ‘creative destruction’, where new and more productive ideas, technologies and businesses replace older, less efficient ones.

As the work of two of the three 2025 Nobel Prize in Economic Sciences recipients, Philippe Aghion and Peter Howitt, has shown, creative destruction empowers long-term growth. When dynamism slows, innovation slows with it, and productivity gains stall.

How does investment affect economic growth?

The UK has many strengths, particularly given its specialisation in services. Key sectors such as financial and business services, life sciences, and digital and information services all hold strong competitive positions globally. The net zero sector is another area of advantage, with clean energy technologies emerging as a comparative strength. This sector grew by 10.1 per cent since 2023 — three times faster than the wider UK economy.

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But productivity challenges risk acting as a drag on this potential. Weak investment, slow skills growth, regional disparities and declining economic dynamism continue to hold back economic performance. Addressing it requires coordinated action and a long-term commitment to investment in people, places, and infrastructure.

Public investment in housing and transport can make it easier for workers to access good jobs and for firms to attract the talent they need. Private investment must be encouraged by providing clear incentives for investment and a stable policy environment.

A more productive Britain would mean higher wages, better jobs, and stronger public services. It would mean an economy that works not just for firms, but also for its people. After years of stagnation, the case for investing in growth, and in the people who power it, has never been clearer.

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About the author

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Aadya Bahl is a Policy Officer at the Centre for Economic Performance at the London School of Economics. Her work aims to use data-driven and research-backed insights to inform policy decisions. Prior to joining CEP, she worked with Metro Dynamics across multiple projects aimed at driving inclusive growth across places, and the GM Chamber of Commerce on the Local Skills Improvement Plans. She has a Master's in Development Economics and Policy from the University of Manchester.

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