Aadya Bahl   August 19th, 2025

Britain is falling behind the US and productivity is largely to blame

The gap in living standards between the UK and US has widened sharply in recent years. ***Aadya Bahl*** *argues that reversing this trend means confronting the UK's deep-rooted productivity and investment challenges.*

Americans enjoy a much higher standard of living compared to the British. When considering real GDP per capita, a key measure of living standards, the gap between the UK and the US has not only persisted but widened significantly in recent years.

Real GDP adjusts for inflation to reflect the purchasing power of income more accurately. In 2004, the real GDP per capita in the US was approximately $58,000, compared to about $47,000 in the UK—a gap of around $11,000. By 2024, that gap had more than doubled to around $23,000. The American real GDP per capita reached $75,500, while the UK lagged behind at roughly $52,500.

But GDP per capita, as an average, can mask inequality – and the US has substantially higher income inequality than the UK. Yet it remains a useful indicator of relative prosperity across countries. Academic research shows that correcting for this bias by excluding the income of the top 1 per cent of earners does not eliminate the gap between the two countries. This persistent divergence carries serious implications for Britain and its residents.

The productivity puzzle that stalled Britain's growth

Productivity measures how efficiently resources are used to produce goods and services in an economy. For instance, labour productivity typically measures the amount of output produced per worker (or hour worked).

When compared to the United States, France, and Germany, the UK had the worst contraction in labour productivity after the financial crisis. Between 2011 and 2019 productivity grew by 0.5 per cent per annum in the UK compared to 0.8 per cent annually in the US.

The root of Britain's economic stagnation lies in what economists and policymakers have dubbed the "productivity puzzle" – the fall in productivity growth after the financial crisis and the subsequent flatlining of productivity since 2010. Had pre-2007 productivity trends continued, British workers would be 16 per cent more productive today than they actually are, translating directly into higher wages and improved living standards.

The flatline in the UK was primarily driven by weak investment across both tangible capital like machinery and intangible capital like software and R&D, though underinvestment in human capital was also a contributing factor. Investment contributed 1.1 per cent to average annual productivity growth before the financial crisis and 0.7 per cent after. Over 11 years, this 0.4 percentage point annual shortfall cumulated to a potential 4.4 per cent loss in GDP.

By 2019, the US was 28 per cent more productive than the UK but is 11 per cent more productive if we adjust for capital and skills. This means that roughly 60 per cent of the UK's productivity gap with the US could be attributed to lower levels of investment.

Declining dynamism and sectoral decomposition

Britain's economy has also become less dynamic, with fewer new firms starting up, slower job reallocation between sectors, and reduced movement of workers to more productive companies. This matters enormously because dynamic economies generate substantial productivity gains through shifting resources from less to more productive uses. Despite high value-added, intangible-intensive sectors being the UK's strengths, much of the productivity slowdown stems from sectors like pharmaceuticals, transport equipment, and computer software and telecommunications.

This suggests the challenge is not about changing what Britain does but doing it more effectively through greater investment and innovation. Reallocation of workers between firms fell after the financial crisis. If we could help half of the worst-performing companies improve from the bottom third to average performance, the UK could be 4.5 per cent more productive and wages could increase by an average of £1,500 annually.

The geography of economic decline

The UK also exhibits large spatial disparities in productivity. In 2019, London produced £76,000 of gross value added per job, more than twice that of regions like Powys and Torbay. This meant that London was 50 per cent more productive than the UK average.

> *The productivity gap between Greater Manchester and London is 35 per cent, far larger than the 20 per cent difference between Paris and Lyon.*

When London is excluded from national productivity estimates, average living standards in the UK fall by 14 per cent, and rank below Mississippi, America's poorest performer. In comparison, removing San Francisco, the most productive city in the US, from the American average reduces living standards by just 4 per cent. Similarly, removing Munich reduces Germany's average by 1 per cent.

This difference is due to the poor performance of big cities outside of the national capital in the UK. For instance, the productivity gap between Greater Manchester and London is 35 per cent, far larger than the 20 per cent difference between Paris and Lyon. At current growth rates, it would take nearly a century to close this gap to French levels.

Not only does this highlight London's outsized role in UK economic growth, but it also raises concerns that the focus on the capital has come at the expense of productive capacity elsewhere. While the UK is one of the world's most service-driven economies, core cities outside the capital which could be producing high value service output are not.

The finish line has moved further away

The post-pandemic period has crystallised the divergence between American and British economic performance in striking ways. While Britain has seen productivity decline across 13 of its 19 major economic sectors since the crisis, the United States has experienced broad-based growth driven by the services sector.

Crucially, America's advantage has been supported by a boom in oil and gas extraction, and a growth in services. And while America is known for its tech-producing companies, the tech-using services have driven its productivity performance relative to Britain. For instance, American businesses increased their software spending by 42 per cent between 2017-19 and 2021-23, compared to just 17 per cent in Britain.

> *Without decisive action, the UK risks further widening this great divergence — not only with America, but also with its own economic potential.*

The path forward for Britain requires confronting these fundamental challenges head on. The current government's Industrial Strategy recognises many of the right issues, with planned investments in planning reform, enhanced local capacity and improved access to finance.

But the scale of the challenge suggests that reversing decades of underinvestment and declining dynamism will require sustained effort on multiple fronts. That includes fostering a more supportive tax environment and expanding full expensing to cover all types of business investment.

Getting businesses to invest in both physical and human capital, improving innovation and restoring economic dynamism will be key to closing the productivity gap with the US. Without decisive action, the UK risks further widening this great divergence — not only with America, but also with its own economic potential.

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About the author

Aadya Bahl

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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