The Quiet Narrowing of Britain's Productivity-Pay Gap

British wage growth pulls ahead of bleak productivity.

Light at the end of the tunnel PHOTOGRAPH: ANASTASIA ZOLOTUKHINA VIA UNSPLASH

FOR the typical British worker, wages still haven't returned to their 2009-peak. Apparently, the UK's flatlining labour productivity is to blame. The core theorem is that, without increasing what the average worker produces in an hour, there's no easy way to improve what they earn in an hour. The sentiment is certainly not uncommon, however there is one small problem: for the past decade, wages in the UK have grown faster than any other advanced industrial economy.

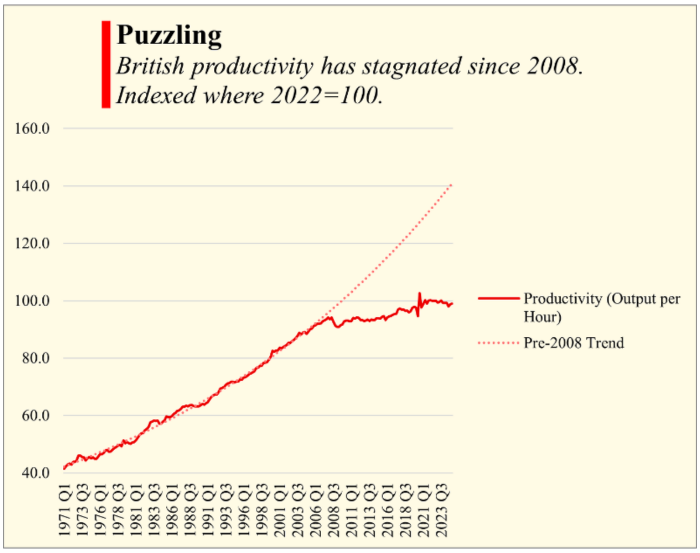

Chart 1 – Own illustration. Source: ONS.

The defining characteristic of the British economy following the 2008 Financial Crisis has been a conundrum called the '[productivity puzzle]()'. Productivity has remained persistently flat, bucking the 30-year long trend and confusing policymakers. If it had grown at the same pace, it would be roughly 40% higher than it is today.

For a long time, earnings growth and by extension living standards were intertwined with productivity growth. However, their disconnection after 2008 is impossible to miss.

Chart 2 – Own illustration. Source: ONS

Chart 2 graphs productivity and median earnings, which better represent the income of a typical employee compared to the average (i.e., mean), because they are not biased upwards by exceptionally high earners. The productivity-pay gap, a term coined by the Economic Policy Institute, an American worker-oriented, non-partisan think tank, is the rift that has opened up between the growth of the two metrics across much of the Western world. It's been widening in the US since the 1980s, but like many American phenomena it wasn't too long before it gained a foothold in the UK and Europe.

Researchers have tried to understand the causes of the discrepancy following the recession. Professor John van Reenen, who now acts as an economic advisor to the Chancellor of the Exchequer, Rachel Reeves, published a study with co-author Andreas Teichgraeber in 2021 suggesting that the two main reasons for decoupling were growing inequality and the rise of non-wage benefits.

Yet, even as inequality remains roughly stable and pension contributions grow, since 2014 Britain's wage growth has outpaced her peers. Combining median wages from employees on PAYE, US median wages, and mean wages from a broad basket of high-income countries, and controlling for inflation, the UK manages to edge out the US by 2 points, with British wages 13% higher than they were 10 years ago. Denmark, the next closest contender, finished 6 points lower with 7.5% growth.

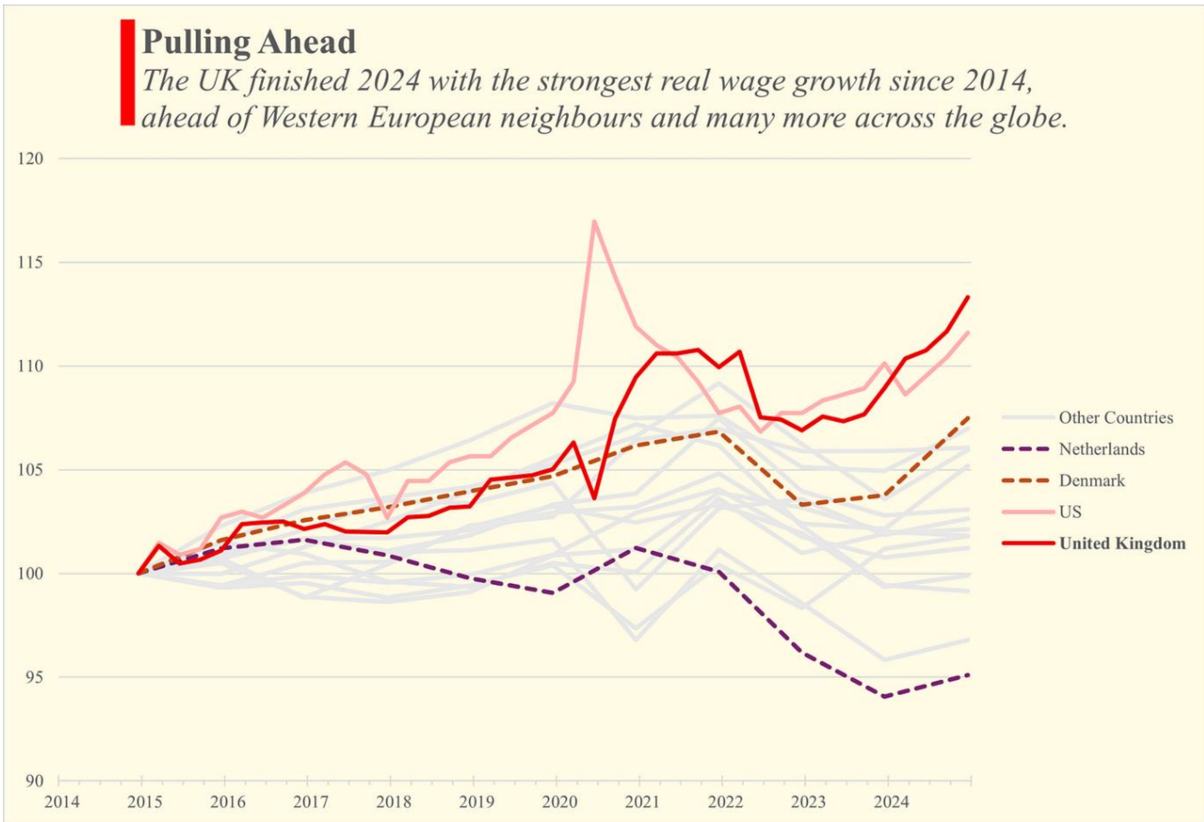

Chart 3 – Own illustration. Source: OECD, ONS, FRED. 'Other Countries' refers to Germany, France, Ireland, Italy, Spain, Finland, Norway, Sweden, Australia, Austria, Belgium, Canada, and Japan.

Unlike the UK, many of these countries did not see a large fall in real incomes following the 2008 crisis. As such, more work needs to be done if pay is to fully catch back up to the accumulated productivity growth since 2008. Nevertheless, it is undeniable that this growth represents the manifest success of Britain's policymakers and her labour institutions. Minimum wage increases – rather than leading to unemployment or inflation – have meant that the bottom 15% of employees have seen their purchasing power grow the fastest, at up to 23%.

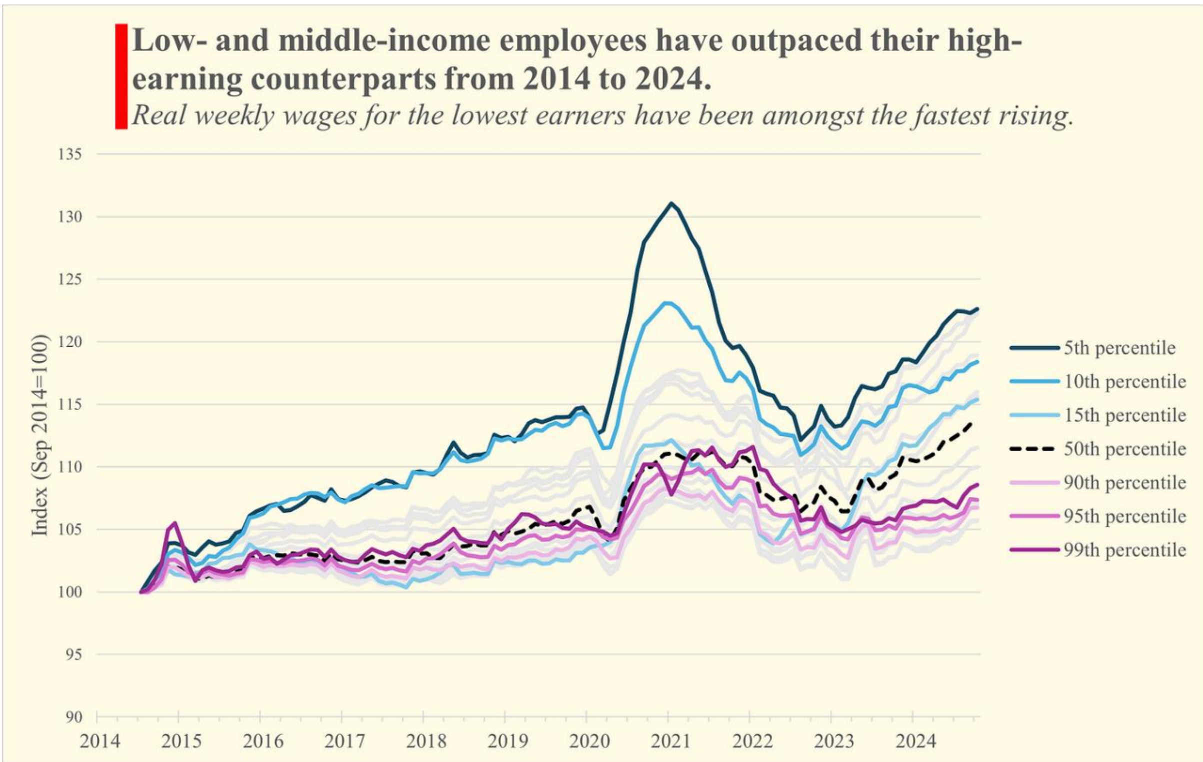

Chart 4 – Own illustration. Source: ONS

Rising wages coupled with anaemic productivity growth means the gap between the two has shrunk. As it stands, only a small proportion of this shrinking is due to the shift towards the middle and short end of the income distribution. Chart 5 shows that from 2014 to the early months of 2025, the median rose 14% whereas the average rose only 11%. That 3 point difference captures the transfer of income from high wage to low wage employees.

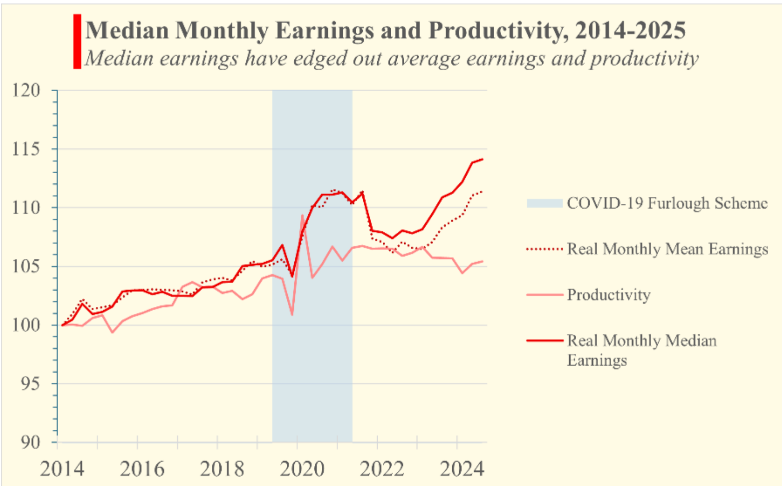

Chart 5 – Own illustration. Source: ONS

The other 11 points come from a transfer *to* workers, *from* employers. ONS data shows that the proportion of GDP directed towards labour income, rather than profit, has been rising over the same time period.

For the UK, signs are promising and wage growth is strong, especially for those who need it. However, policymakers and critics alike are watching with bated breath. When it's working in reverse, perhaps the productivity-pay gap isn't such a bad thing after all.

Chart 6 – Own illustration. Source: ONS