Mind the productivity gap

The public sector potential

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Public sector productivity is one of the defining issues of our time.

Slow growth in public sector productivity is costing the UK economy £80bn a year

The UK economy has experienced nearly 20 years of salary stagnation, largely as a consequence of flat-lining productivity. Over the same period, the level of public expenditure has doubled.

With public sector spending now accounting for approximately 44% of GDP, a more productive public sector is vital to achieving better productivity and a stronger UK economy overall.

However, public sector productivity growth has underperformed the wider economy in recent years. Our analysis has found that if UK public sector productivity growth had kept pace with the private sector since 2019, UK GDP would have been 3% larger by the end of 2024. This means weak growth in public sector productivity is costing the economy around £80bn a year in lost output. If this relative weakness continues, the shortfall will widen to 5% of GDP by 2030, meaning around £170bn of lost output each year.[1]

Only when we truly understand where the issues lie, will we be in a position to target the right solutions. And solutions do exist. Not all areas of the public sector have been affected in the same way. There is an opportunity to look forward, rather than back. Broader, cross-sector collaboration offers the chance to share learning and embed solutions that could have a meaningful impact on productivity and the wider health of the UK economy now.

About our discussion

In this paper, we discuss the nature of the productivity challenge across public services, including how different services have been affected, and where we might look for opportunities to improve public sector productivity and its contribution to UK economic growth. We offer a structured analysis informed by a review of existing studies and research on productivity, GDP and spend within the public sector.

[1] Calculated using ONS sectoral productivity and output data. Shortfall calculation compares actual public sector output in 2024 with an alternative scenario where public sector productivity had grown in line with the market sector since 2019. Projection to 2030 assumes continuation of trends observed since 2019 and uses OBR March 2025 GDP forecast.

Context

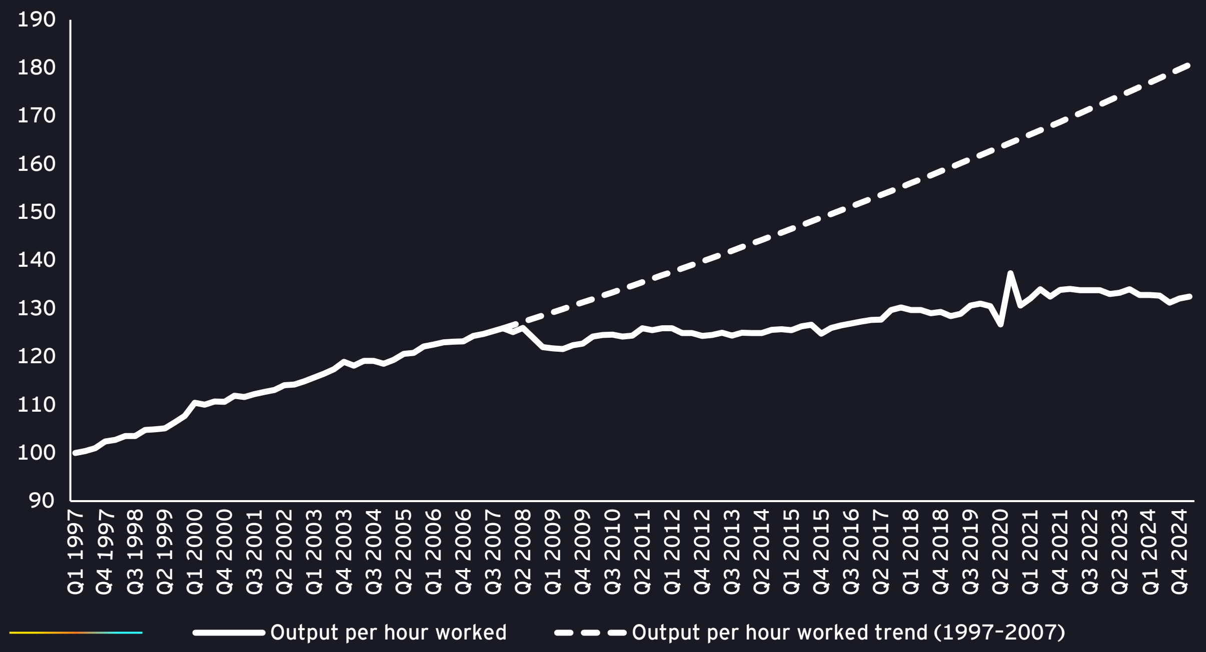
The UK has a long-standing productivity challenge

Since the 2008 global financial crisis, successive UK governments have faced a multitude of different economic challenges and have implemented a wide range of different economic policies to tackle them. However, they have consistently agreed on one thing: over the long term, the fundamental economic challenge facing the country has been low rates of productivity growth.

Prior to 2008, productivity as measured by output per hour was growing at over 2% a year. In the years since, that has dropped to an annual average rate of just 0.5%. The impact of this weaker trend over time has been stark. If productivity growth had continued at the pre-crisis trend, output per hour would now be over 36% higher than the latest official estimate.

The shortfall sits behind much of the UK's long-term economic and fiscal challenges and, as a result, a great deal of time and effort has gone into attempting to understand the drivers of this weaker growth — what economists have dubbed "the productivity puzzle." A wide range of plausible causes have been proposed; however, since the COVID-19 pandemic, the data has been highlighting a new source of weak productivity growth — the public sector.

UK output per hour, 1997 = 100*



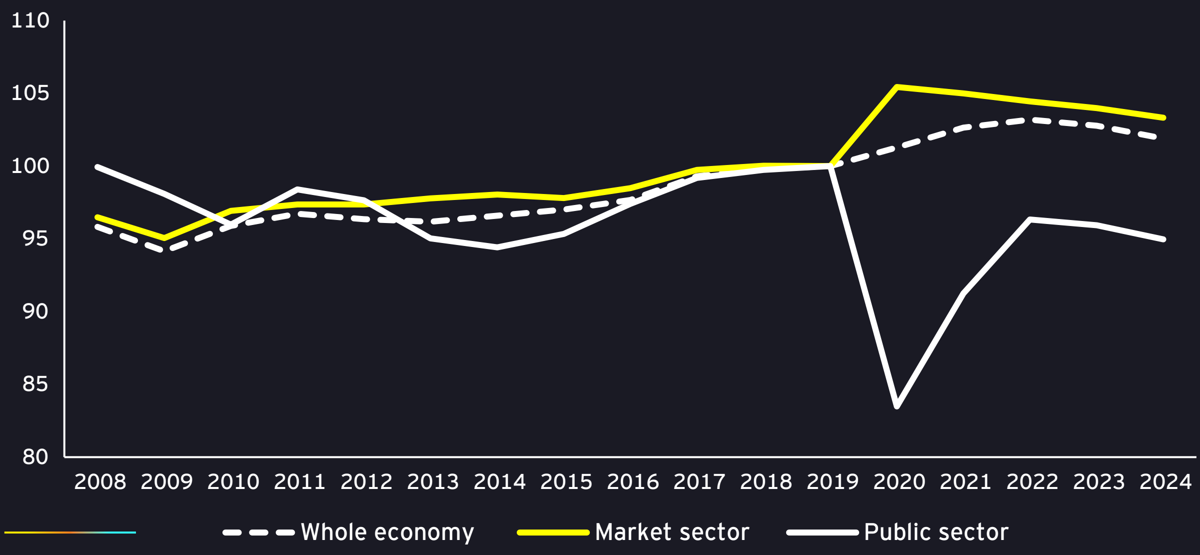
*Source: ONS

Recently, productivity in the public sector has lagged behind the wider economy

The output of the public sector makes up around 44% of UK GDP, so is an important driver of total productivity. However, since the COVID-19 pandemic, the public sector has seen its productivity lag significantly behind that of the private sector. As such, it is increasingly acting as a drag on total UK productivity. As spending plans continue to be tight, and demand continues to grow, improving public service productivity is a key way of improving or maintaining the performance of public services without having to spend more.

While productivity in the wider economy is over 3% higher than 2019, the public sector is nearly 5% below.

Output per hour, 2019 = 100*



*Source: ONS

Falling public sector productivity worsens an already challenging fiscal situation

Falling productivity means the public sector is delivering less for the resources that the government and tax payers are putting in. At a time when departmental budgets are stretched, and the fiscal situation means further savings need to be made, the causes for this need to be better understood.

Additionally, long-term projections by the Office for Budget Responsibility (OBR) show that increased demands on public services from an aging population, spending on climate change and rising geopolitical tensions mean that, without action, the public finances are on an unsustainable path.[2]

Based on these projections, the Treasury has estimated that public sector productivity growth would need to be 0.5 percentage points higher each year, as a share of GDP, just to maintain the size of the state at current levels and still be able to meet the increased demands on the public sector.[3]

[2] CP 1142 – Office for Budget Responsibility Fiscal risks and sustainability
[3] Chancellor Jeremy Hunt's speech at the Centre for Policy Studies - GOV.UK

What are the drivers of recent trends?

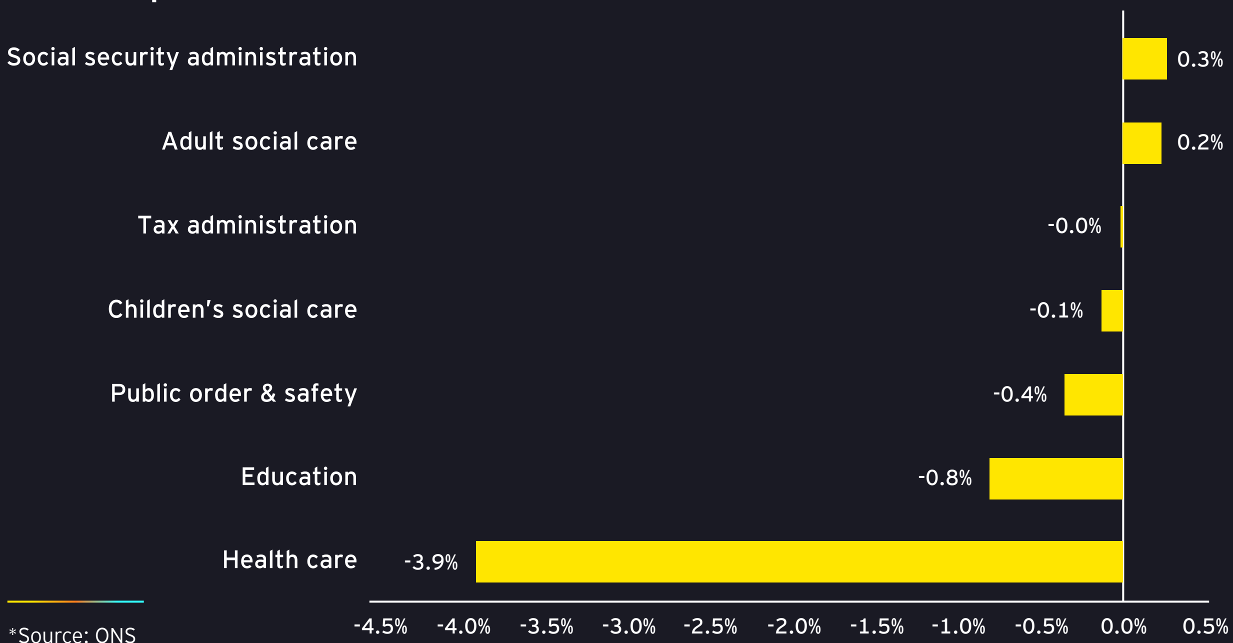
The official data shows that the health service is the biggest single driver of recent weakness

The methodology used by the ONS meant that, during the pandemic, UK public sector output saw steep falls, as many non-urgent appointments and procedures were cancelled, schools were closed, and delivery of other public services was suspended.

Since the pandemic, output in the public sector has largely recovered, however the level of inputs has also grown significantly, meaning that productivity has not recovered to pre-pandemic levels.

Looking at the drivers by public service area, only social security administration and adult social care have higher productivity than in 2019. Public order and safety (largely the courts system) has seen the largest decline (-12%), however healthcare and education – as the two largest areas of the public sector at 40% and 16% respectively – have made the largest contributions to the overall fall, with healthcare by far the largest contributor.

Change in productivity since 2019, by public service area weighted by share of total public service expenditure*



*Source: ONS

Public sector productivity is measured differently to the wider economy

To understand why estimates of public sector productivity growth have been weak since 2019, we first need to understand how it is measured. Productivity is an estimate of how much output can be produced for a given quantity of inputs. Inputs are typically measured through the amount of labour required in hours and the output produced is measured using the market price of the good or service produced, which is taken to reflect both the quantity and quality of output produced.

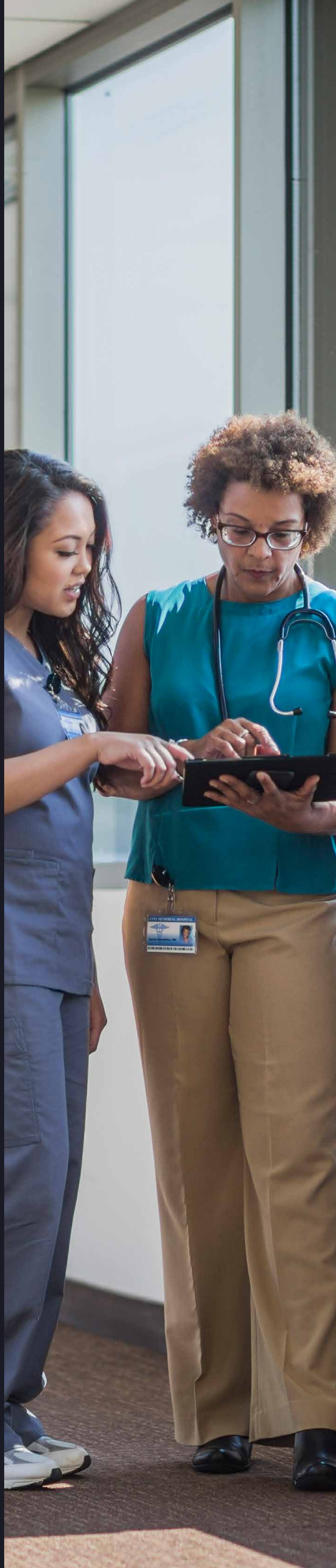
Data on inputs into the public sector (largely staffing costs) is readily available. However, most of the outputs, such as medical services or education, are provided for free - so there is no market price. This makes estimating output (and therefore productivity) challenging. Traditionally, national statistics agencies across the world have assumed that the output of the public sector equals its inputs, i.e., if spending on education goes up 5%, education sector output goes up 5%. This approach, while simple, has the significant limitation of always assuming 0% productivity growth.

To address this limitation, the UK's Office for National Statistics (ONS) has, since 2005, been developing methods to more accurately estimate productivity growth in the public sector. The approach now taken by the ONS is known as "direct volume measurement" and involves counting the actual outputs of the public sector directly and then making an adjustment for quality.

For example, for the health service, output is measured using data on activities actually carried out, such as the number of GP appointments or outpatient procedures, weighted by an estimate of the costs of that activity. An adjustment is then made for the quality of that activity using a range of data, including survival rates, clinical outcomes, waiting times and patient surveys.

This then allows for an estimate of health sector output that better reflects productivity — i.e. if the NHS was able to deliver more or higher quality care, for the same level of inputs, then the ONS estimate of output and productivity would increase.

This is a superior methodology to the simple input = output approach; however, it is limited by data availability and conceptual challenges. For example, data on outputs is most readily available for health and education, so these sectors have the most comprehensive measurement. In other areas, such as justice and public administration, data on outputs is more limited. Additionally, some areas of the public sector produce outputs that are challenging to define conceptually. This is most pronounced for defence, where there is no agreed definition of the "output" of defence spending. For these areas, the ONS continues to use the input = output methodology, so productivity is still not measured across the entire public sector. In fact, productivity is currently measured for around 60% of public sector services.



The obstacles to productive working

Whilst there are no "quick fixes," research suggests that there are key barriers to more productive working in the public sector, including:

- Targeting capital investment in buildings, equipment and technology to help staff operate more efficiently.
- Focussing on good management practices, particularly in large organisations like public service providers, to help them operate effectively.
- Retaining experienced staff and leaders, and relating this to workforce planning. It tends to take newer staff longer to carry out their roles more efficiently than more experienced staff. Recognising this in workforce plans, and ensuring public services keep hold of the experienced staff they need, supports better public service productivity in the medium term.

What are the potential solutions?

The key themes that emerge to close the productivity gap include:

Driving collaboration: Public sector productivity varies considerably across government departments and public service areas. This suggests that there are opportunities to share experiences and drive cross-government solutions to lift productivity overall (e.g. through the rollout of integrated tech-enabled platform solutions already operating in one area of the public service and expanding their use to others).

Adapting to changing expectations: Service delivery models will continue to change, as the public's expectations of public services increase and as technology, digital and artificial intelligence (AI) shape how we live. Interoperable data will empower the public to act as consumers. The public will increasingly decide how, when and why they will interact with the public sector. How does the public sector anticipate and embrace public-centric service models, accelerate their adoption and price in the productivity benefits of technology investment and adoption more clearly?

Investing in modern infrastructure: As Professor Lord Darzi has reported in his national review of the NHS, the quality of public sector assets and infrastructure matters. An ageing public sector estate costs more to maintain and impacts on the operational efficiency of key public services such as health care.

Harnessing technology and upskilling teams: The impact of technology and digital solutions needs to be better understood. Tech-enabled, AI, intelligent and triaging tools will deal with more straightforward queries. But experience still matters. The public's interaction with specialist professionals will become more focussed on highly complex tasks and activities requiring multidisciplinary expertise and approaches.

Planning: Aligning an analysis of the underlying productivity drivers in organisations with the savings and transformation activities designed to improve them provides an opportunity to free up capacity and unlock financial headroom for reinvestment while more agile operating models are created.

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