Edexcel (B) Economics A-level

Theme 2: The Wider Economic Environment

2.3 Productive Efficiency

2.3.1 Productivity

Notes

Productivity

Productivity is defined as output per unit of input (e.g. worker) per period of time (e.g. hour).

Being more productive means the same input, such as the number of workers, produces more output, over the same period of time. This lowers the average cost per unit of output. Being less productive requires a larger input to produce the same quantity of output.

Productivity is most commonly measured with labour productivity. Labour productivity is a measure of output per worker per hour. It is equivalent to how much real GDP is produced per unit of labour per hour. This can be used as a measure to compare the efficiency of countries on an international level.

The impact of increases in productivity includes a lower average cost of production. This might result in lower prices for consumers, which in turn might increase demand in the economy and result in higher levels of employment. Moreover, the firm might become more internationally competitive, especially if they are more productive.

Higher profits that are earned as a result of high levels of productivity could be used for investment. This could mean the firm can support its growth in the long term as well as potentially become even more productive.

There could also be improvements in the standard of living if businesses can earn higher profits. This is because they are able to pay their workers higher wages. Higher levels of productivity also result in higher rates of economic growth, since the rate of production in the economy increases, and as a result, GDP increases.

○ Factors influencing productivity

Productivity can be increased by training workers or using more advanced capital machinery. Larger quantities of capital stock could lead to increases in productivity.

Human capital refers to the workers who are employed by a firm, and their productivity can be improved through investment in their education, training and health.

Changes in the level of investment can affect how productive a firm is. If a firm has easy access to credit, they are more able to make investments and therefore improve their long term productivity. Productivity can also be increased by innovation in the process of production, since there will be an increase in allocative efficiency. Moreover, when there is technological innovation, productivity often increases.

- **Link between productivity and competitiveness**

Since productivity influences the cost of producing each unit of output, it is directly linked to how competitive a business is. This is because if the average costs of production are high, the business will have to charge high prices in order to cover their costs. This makes them less competitive against other firms, which might be able to charge lower prices if they are more efficient.

Distinction between labour and capital intensive production

Production processes can combine either labour or capital. The intensity of each refers to the relative importance.

Production which is labour intensive relies mainly on labour. Likewise, capital intensive production relies on capital more. Services, such as hairdressing and hotels, and work similar to farming and mining are labour intensive. The transport and manufacturing industries are generally capital intensive, since production relies on machinery.

Generally, labour intensive production occurs when there is a large supply of skilled and relatively low cost (compared to capital) labour. The costs involved in labour intensive production tend to be more variable, so there is a lower breakeven point of output.

Capital intensive production occurs when firms can access relative cheap, long term finance and when capital is relatively cheap compared to labour. The costs involved in capital intensive production tend to be fixed, so the breakeven output is higher.