AQA Economics A-level

Microeconomics

Topic 4: Production Costs and Revenue

4.2 Specialisation, division of labour and exchange

Notes

- Specialisation occurs when each worker is completes a specific task in a production process. The concept was famously stated by Adam Smith, who showed how, through the division of labour, worker productivity can increase. Firms can then take advantage of increased efficiency and lower average costs of production.

- An extract from *The Wealth of Nations,* Adam Smith:

- "To take an example, therefore, from a very trifling manufacture; but one in which the division of labour has been very often taken notice of, the trade of the pin-maker; a workman not educated to this business … could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But in the way, in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on, is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some manufactories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them… But though they were very poor, and therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. Those ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day."

- Smith essentially said that by dividing the production of pins into 18 different tasks, the output of pins could increase significantly. Each worker specialises and output increases.

- Specialisation can be achieved by individuals, businesses, regions of countries or countries themselves.

- **Advantages:**
  - Higher output and potentially higher quality, since production focusses on what people and businesses are best at.
  - There could be a greater variety of goods and services produced.
  - There are more opportunities for economies of scale, so the size of the market increases.
  - There is more competition and this gives an incentive for firms to lower their costs, which helps to keep prices down.
- **Disadvantages:**

- Work becomes repetitive, which could lower the motivation of workers, potentially affecting quality and productivity. Workers could become dissatisfied.
- There could be more structural unemployment, since skills might not be transferable, especially because workers have focussed on one task for so long.
- By producing a lot of one type of good through specialisation, variety could in fact decrease for consumers.
- There could be higher worker turnover for firms, which means employees become dissatisfied with their jobs and leave regularly.

Specialisation in the production of goods and services to trade:

Countries can specialise in the production of certain goods. For example, Norway is one of the world's largest oil exporters. Countries trade to get the goods and services they are unable to produce.

Countries can exploit their **comparative advantage** in a good, which means they can produce a good at a lower opportunity cost to another.

Absolute advantage occurs when a country can produce more of a good with the same factor inputs.

Advantages:

- Greater world output, so there is a gain in economic welfare.
- Lower average costs, since the market becomes more competitive.
- There is an increased supply of goods to choose from.
- There is an outward shift in the PPF curve.

Disadvantages:

- Less developed countries might use up their non-renewable resources too quickly, so they might run out.
- Countries could become over-dependent on the export of one commodity, such as wheat. If there are poor weather conditions, or the price falls, then the economy would suffer.

The functions of money:

- **A medium of exchange:** without money, transactions were conducted through bartering. Goods and services were traded with other goods and services, but people did not always get exactly what they wanted or needed. The goods and services exchanged were not always of the same value, which

also posed a problem. Exchange could only take place if there was a **double coincidence of wants,** i.e. both parties have to want the good the other party offer. Using money eliminates this problem.

- **A measure of value (unit of account):** Money provides a means to measure the relative values of different goods and services. For example, a piece of jewellery might be considered more valuable than a table because of the relative price, measured by money. Money also puts a value on labour.

- **A store of value:** Money has to hold its value to be used for payment. It can be kept for a long time without expiring. However, the quantity of goods and services that can be bought with money fluctuates slightly with the forces of supply and demand.

- **A method of deferred payment:** Money can allow for debts to be created. People can therefore pay for things without having money in the present, and can pay for it later. This relies on money storing its value.