What is the difference between a rich economy and a poor economy? In a rich economy, each worker has a relatively good standard of living; that is, a lot of goods and services produced with a relatively small amount of effort. In a poor economy, you work very, very hard and get very little. The difference between the two outcomes is productivity. And economist defines productivity as the amount of output that is produced from a given amount of labor input. Or, if you take an hour of labor input, productivity is the amount of output that that labor produces.

The question then is "What makes the difference between and economy where labor is highly productive and an economy where labor is less productive". In the highly productive labor situation, this worker winds up, at the end of the day, with lots of goods and services, a rich economy. But if productivity is low, the same amount of labor yields a low output, a relatively poor economy.

So let's review the factors that influence productivity. What is that allows a worker to produce a lot with a relatively small amount of time? The first thing that makes a big difference in productivity is the availability of good tools, what we call capital. The higher the capital labor ratio in an economy, the more workers are able to transform a given amount of time into a large quantity of output. So the higher the capital labor ratio, the higher the ratio of output per worker.

A second factor influencing productivity is natural resources. The more natural resources that are available to each worker, the easier it is to transform a given amount of time into a large amount of output. So the higher the ratio of natural resources to labor, the more productive the worker is, the more output produced per hour.

Another factor influencing the productivity of labor is human capital. The more skills the worker has, the more the worker is able to transform a small amount of time into a larger amount of output, doing it by smarts. The higher the ratio of human capital to labor, the more output per worker is likely to be produced.

Finally, there's the matter of technology. The better the overall level of know-how in the economy, the better the skill, the accumulated knowledge about how to transform inputs into output, the higher will be the productivity.

So all of these factors influence the worker's ability to transform a given amount of labor time into a larger amount; that is, more capital per worker, more natural resources per worker, more human capital or skills per worker and better technology or overall know-how. Productivity is very, very important to the economy, because it's closely correlated with the standard of living. The higher the productivity of a worker, the higher the price a company can afford to pay that worker to get that worker to work for them. Remember the company sells its goods for a given price, a price that's fixed by the market. So if your worker can produce a lot of goods in a small amount of time, you can afford to pay him or her a high wage. Labor productivity is correlated with wages. The higher labor productivity is, the higher the wages companies can afford to pay their workers without sparking inflation; that is, without pushing up the prices of goods and services. The more output you get from a given amount of labor, the higher the wage you can afford to pay your worker in an environment with stable prices.

So, productivity is correlated with the standard of living. Higher productivity means higher wages for workers, more output per worker and a higher standard of living in the economy. One of the things that characterizes economic growth is an increase in the productivity of labor. When technology advances, when capital accumulates, when skills are being acquired by the labor force and when new natural resources become available, the productivity of labor rises and this one of the hallmarks of economic growth.