

THE SCHUMPETER/GRAS MODEL

This model of economic development was originally introduced to the study of the American city in “Choices and Changes: the Building in Chicago,” a project sponsored by the National Endowment for the Humanities. William R. Waters, Professor of Economics, DePaul University, developed the model and has clarified it in the following section for this project. The model incorporates ideas of Joseph Schumpeter and N.S.B. Gras. This more complete explanation can be used in discussion in conjunction with the case studies in this unit.

STARTING POINT—What is important in the economy?

Why people act:

There are some few people who want to make changes. The majority either doesn't care or resists the changes. The motives for change are many: profits, glory, the good of the city, nation, or mankind.

The role of the government:

The economy does not develop independently of government. Government sometimes limits or sometimes encourages change in the economy through laws and law enforcement as well as the financial decisions it makes. This role is critical and must be recognized by someone who wants to bring about economic development.

Business Cycles:

Innovational investment is sporadic. A clustering of investments, due at times to high and low “animal spirits” of businessmen brings ebbs and flows of business activity. These business cycles include the regular cycles of 8-10 years and longer ones, called Kondratieff waves, which are about 50 years long.

THE CHANGE—What is necessary for development?

An Urban Center

Major innovations in economic development take place in an urban community that is an economic center for a region. This city dominates the commerce, industry, transport, and finance of the region. This center has the leadership resources of the region to support the development as well as the financial assets of institutions to pay for it.

SCHUMPETER/GRAS MODEL (continued)

What is necessary for development? (continued)

Entrepreneurship and Innovation

Development takes place when a creative organizer has a vision to do something differently. An innovating entrepreneur introduces this vision, coordinating the factors of production needed for the innovation. This action disturbs and destabilizes society. Such innovators are private businesspeople, public officials, or communal activists such as Jane Addams or Samuel Gompers.

Credit Creation

The innovation requires funding, and the banking system's job is to supply it. Banks make savings available to business. They also create credit, making use of savings as the base for lending more money than they actually have on account. Without funding, innovation will not take place. Funding is not automatic.

Resistance

Innovations hurt some members of society because they introduce competing products or structures. This negative effect is called "creative destruction." People who think they will hurt by an innovation resist the change. Consequently, producers work to create demand for their innovation in order to break the resistance.

Political Support

Government is often a partner in the process of development. On the other hand, government can restrain development by passing unfavorable laws, deciding court cases in a non-supportive way, or by creating a stormy business climate that discourages investment. Political integration and stability are crucial to the development process.

Progress and/or Problems

By increasing consumers' options, improving producers' productivity, and introducing new forms of organization, innovations bring improvement in material welfare. Or, at other times, they diminish welfare. In either case, there has been change: this is the economically dynamic or developmental process.

SCHUMPETER/GRAS MODEL (continued)

KEY IDEAS TO FOCUS ON IN THIS MODEL:

1. Economic development results from private and/or public innovation. In public innovation, what we call the entrepreneur is an innovative public official.
2. Development won't occur without funding, so the banking system (or some substitute such as corporate profits or public tax revenues) is crucial. Historically, in the private enterprise economy, funds have been created.
3. Cities are usually the location of the funding and the decision making because that is where important banks are. Banks make the households' saving available to business, but they are more than that. They create credit, a procedure so important that Schumpeter calls credit creation "the monetary complement of innovation."
4. The government is almost always involved to either support or resist the innovation.
5. Resistance is always present because, after all, there are people who are harmed. That harm is called creative destruction, and it is a source of conflict.
6. The standard of living rises due to creative economic activity. Schumpeter calls this process a creative response to changing economic conditions. There are also times when the standard is lowered.
7. While Adam Smith believed that an "invisible hand" (the market process) promotes the improvement of wealth of the nation, Joseph Schumpeter believed that entrepreneurial activity would bring about that development. There are several important differences between the views of Adam Smith and Joseph Schumpeter, and most of them relate to Smith's general view that the economy would manage itself and develop automatically if given the freedom to do so. In contrast, Joseph Schumpeter believed that people had to bring about changes that would result in economic development and that this process was not automatic.