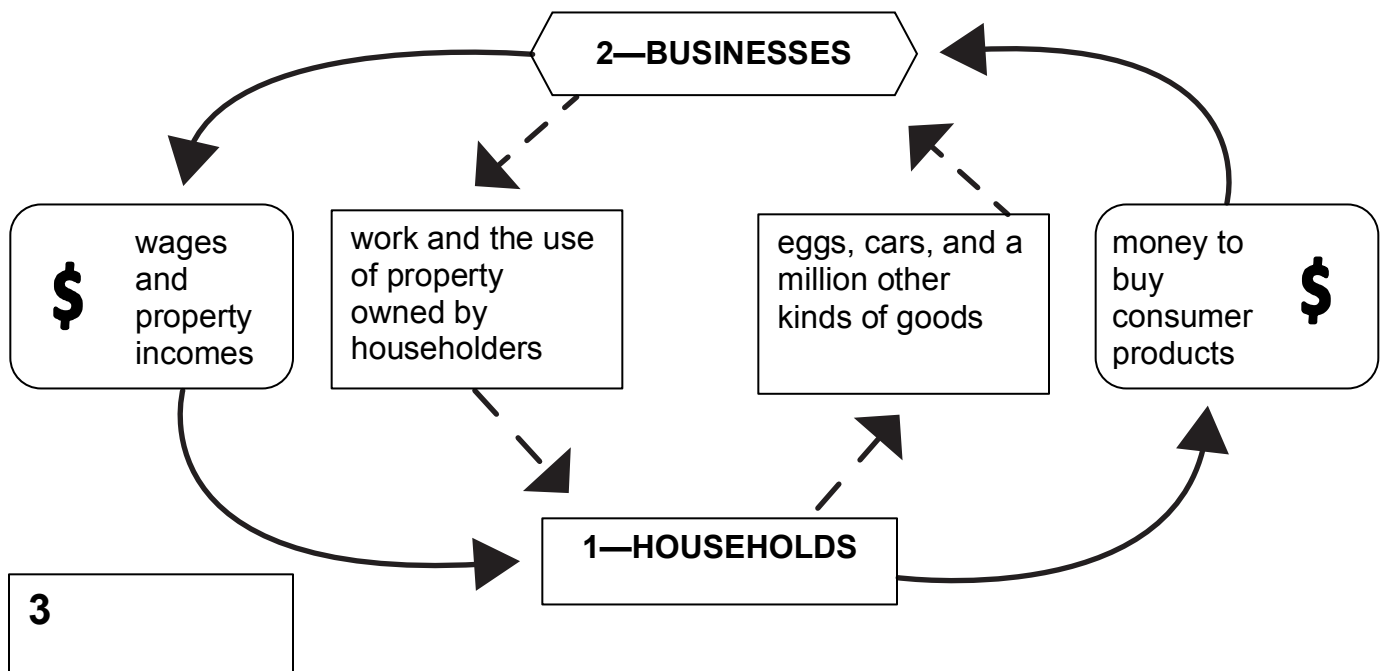


## WHAT IS INVISIBLE AND EVERYWHERE?



What is invisible and everywhere? The economy. It is part of every building, street, and streetlight. And it is part of every decision a government makes, including how to pay for those streetlights, government workers, and (when they happen) for wars. You can't see the economic parts of those things, but the economy is an important part of them—and much more.

Economists show the economy by using models. Here is a diagram that shows a very basic model for the economy.

### HOW THE MODEL WORKS

Households have two things businesses need: workers and resources (such as land someone owns). Households get money from businesses as wages and as incomes for property, such as rents. Households do two things with their money: they save some; they spend the rest to buy products from businesses.

There are two kinds of flows in this model: a flow of money, shown with solid lines, and a flow of real things shown with broken lines.

### MAKE CONNECTIONS

If businesses want to expand, they borrow money from banks and other financial institutions. Put banks in box 3. Then draw arrows to show money going into banks from savings and into business through the banks as loans. Label your arrows.

Here's a problem: economies don't always grow. What might stop them?

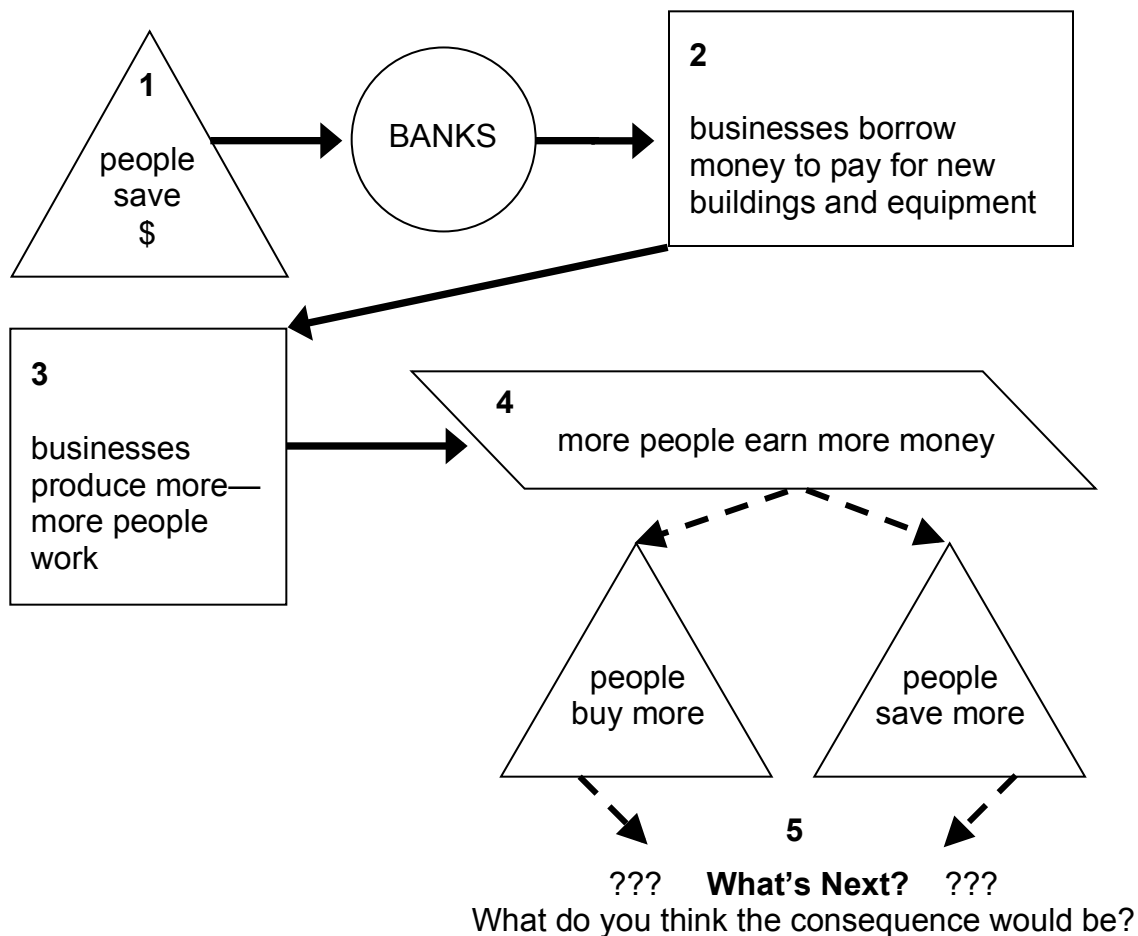
### BUILD A BIGGER MODEL

Models usually leave some things out as they try to make ideas clear. On another page, you could make a more complete model, showing business purchases from other businesses and a very big missing part: government. But the important idea here is that there are connections among all the parts of the economy. A change in one part affects all the others. So be sure your model keeps that idea clear.

## CHANGE: ONE VIEW

An economy doesn't stay the same. It changes all the time. An economy may shrink at times, such as major depression. At other times, it may grow.

Here is a flow chart showing how an economy might change.



Something important is missing from this chart: reasons.

At each step, people make choices. But there is no one reason for those choices. The economist Adam Smith said that people act from self-interest. That means that they make choices that will benefit them. He also said, though, that an “invisible hand” leads people to make choices that not only help them but help the economy to grow. Adam Smith wrote about economics in 1776, and this chart is based on his ideas, which have influenced people greatly since he wrote about them.

What is your view of these ideas? Before you decide, figure out what kinds of reasons you think that people in businesses, banks, and households would have for the choices at steps 1-5. Would they make those choices automatically? What other choices might they make?

Make your own model. Start over at step 1. This time, change what happens. People don't save. Or people save, but businesses don't want to expand. Show what changes take place when people make different choices.

## CITY CENTERS AND ECONOMIC DEVELOPMENT

Here is a way to look at economic development past, present and future. It is a model of how the economy changes. This model combines the ideas of Joseph Schumpeter, an economist who did not agree with Adam Smith, and the ideas of business historian, N.S.B. Gras.

Is this model better than Adam Smith's idea? Of course, we think so, but the answer to that question is up to you. See if this model works before you decide. To show how it works, we have set up several examples on the following pages. They are studies of development beginning early in American history and ending with today.

This model is new—it is an innovation. So some people (maybe including you) will resist it. Others (we hope including you) will find it useful.

To introduce our model, here are some of its important ideas and questions about them.

1. Idea: Cities are centers of the economy.

The headquarters of major firms usually locate in cities, as do major banks and other funding sources. So successful changes—innovations—usually take place in cities.

For example, Cyrus McCormick may have had the idea of introducing the reaper to farms while visiting a small farming community. But he went to the city of Chicago to get the funding, the workers, and the factory equipment to manufacture those machines.

Question: Name one change that took place in your city or another American city and figure out why it was based in that city and not in a small town.

2. Idea: An innovation is a new way to do things.

Here are five different kinds of innovation—changes in production.

a new product      a new way to produce      a new market

a new source of supply      a new way to organize a business or public project

All of those are kinds of changes—kinds of innovation. So an innovation is an idea that is introduced into the economy. It is an idea that becomes real.

Question: Choose one innovation that you think is important today. It could be the computer, the shopping center, or anything else that has brought major change. Which of the five innovations is it?

There is much more to the model, and you'll find out how it works as you look at American economic development in the following case studies. Each one shows how we built the model—and how you can apply it.