Schumpeter's theory of Innovation

The innovation theory of a trade cycle is propounded by J.A. Schumpeter.

- Schumpeter regards innovations as the originating cause of trade cycles.

It is innovations that are subject to cyclical fluctuations, not inventions.

- Innovations, thus in economics means the commercial application of inventions like new techniques of production, new methods of organization, novel product.
- Schumpeter regards trade cycles as the cause of economic progress in a capitalist society.
- Cyclical fluctuations are inherent in the economic process of industrial production.

When there are internal changes taking place on account of Innovation, the development process begins.

- Innovation, however does not arise spontaneously. It must be actively promoted by some agency in the economic system. Such an agent, according to Schumpeter, is an "entrepreneur", entrepreneurs are innovators.

To carry cut his innovative functions, the entrepreneur needs two things:-

1.He must have the technical knowledge to produce new products or new services.

2.Since the introduction of Innovation presupposes the diversion of the means of production from the existing to new channels.

Schumpeter classifies innovation into five categories as follows:-

1.Introduction of new type of goods

2.Introduction of new methods of production.

3.Opening of new markets.

4.Discovering of new sources of raw materials

5.Change in the organisation of an industry, like the creation of a monopoly, trust or cartel or breaking up of a monopoly, cartel, etc.

- The necessary command over the productive factor is provided by the monetary factor in the from of credit.

- The entrepreneur secures the funds for his project not from saving out of his own income but from the crediting bank system.

- Thus, money capital & bank credit play a significant role in the Schumpeterian theory.