

## What Should Be Taught and Learned in Economics Classes (and Is It?)

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### Abstract

This paper highlights five major deficiencies of the introductory economics courses typically taught in the United States: (1) inattention to the key role of private ownership, (2) neglect of the competitive process, (3) lack of coverage of entrepreneurship, (4) neglect of the insights of public choice economics, and (5) inaccurate portrayal of economic central planning. The paper shows how these deficiencies could be remedied with a greater emphasis on economic freedom in introductory courses. The paper also reports on an innovative new course design intended to improve the content and enliven the presentation of basic economics.

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### I. Introduction

Introductory college level courses in economics generally consist of a two-semester sequence in microeconomics and macroeconomics. These courses are designed to provide both economics and business students with the foundation for further study in these fields. In addition, many schools offer a one-semester course for students that provides an overview of the subject. It is often the only course in economics these students will take. Many high schools also offer a one-term course similar to the college-level survey.

These basic courses cover key economic concepts such as: scarcity; incentives—how changes in personal benefits and costs influence choices in a predictable manner; opportunity cost—the concept that the way to measure costs is through what one gives up; gains from trade; how division of labor and specialization enhance output; and supply and demand and their determination of price.

Introductory economics courses generally do a pretty good job of covering these basic concepts in a sensible and understandable manner, usually at the start of the course. The better courses also cover the “invisible hand” principle—the tendency of markets to bring the interests of individuals into harmony with economic progress by directing entrepreneurs to undertake productive projects rather than unproductive ones. Some also explore the secondary effects of political intervention into the market—the “unintended consequences” that often stem from a lack of understanding of economics.

However, the application of these basic tools is often ignored as the typical course moves forward. Economic reasoning is de-emphasized and greater emphasis placed on mechanics that are of questionable value to beginning economics students. Moreover, mathematical formulas and relationships are central to the content of many introductory courses, leaving students with the impression that economics is about the development and understanding of engineering-like linkages among variables. This approach undermines the power of economic reasoning and its application to an understanding of how alternative forms of economic organization work.

Introductory courses also suffer from key omissions that undermine student understanding of economic growth and the institutional framework for prosperity. Section II of this paper will highlight five major deficiencies of introductory economics courses as they are typically taught in the United States. Section III will consider the treatment of economic freedom and its potential importance in introductory courses. Finally, Section IV will briefly describe an innovative new course designed to both improve the content and enliven the presentation of basic economics principles.

## **II. Five Omissions That Retard the Effectiveness of Economic Education**

The effectiveness of economic education is substantially reduced because five key topics are either omitted or handled in a misleading manner in most principles courses. In several cases, these deficiencies leave students with an incorrect view of how economies operate and why some prosper while others stagnate. We now turn to the examination of each of these five factors.

### *A. Private Ownership*

Aristotle wrote that “what is common to many is taken least care of, for all men have greater regard for what is their own than for what they possess in common with others” (Aristotle, quoted in Durant, 1939, p. 536). Students need to understand the incentive structure that emanates from private ownership.

Fundamentally, private ownership rewards good stewardship through an increase in value and punishes poor stewardship with loss of a value. The natural incentive to maintain a property’s value provides an incentive to develop resources in ways that are highly valued by others. This leads to conservation of resources for the future and provides an incentive to take the preferences of others into account.

In spite of the central importance of property rights to the understanding of how alternative forms of economic organization operate, this topic is almost universally excluded from principles courses. A recent review of the outline and examination from the high school Advanced Placement course in economics illustrates this point. The AP course purports to mirror the college-level principles classes. But although the AP course outline includes a line entry on property rights, there has not been even a single question on the topic on any of the exams available back to 1990 (Ferrarini, Gwartney, and Morton, 2011). Furthermore, for a generation of students who claim to be concerned about “sustainability” and environmental protection, the fact that many environmental problems stem from an absence of private property is an important insight that would help them immensely as they look for ways to protect the environment. But most principles courses fail to introduce students to the critically important role played by private ownership in the maintenance, conservation, and availability of resources across time.

### *B. Competition and the Competitive Process*

In principles courses, the topic of competition is almost always introduced within the framework of the pure competition model. Students are informed that competition is pure (or ideal) only when there are numerous sellers all offering the identical product in a market with no entry barriers. Moreover, a mechanical graphic analysis is used to illustrate that the conditions of this model result in the ideal allocation of resources.

The lesson from such analyses is that other forms of competition (that is, different structures of markets) are inferior. Moreover, only a few markets can approximate the conditions of the purely competitive model. Thus, the real world is characterized by the absence of competition in varying degrees. This approach leaves students with the impression that markets are inferior and work poorly.

Of course, the ideal conditions of the purely competitive model are relevant only in a static world. The real world is dynamic, and the implications of dynamic competition are far different, and substantially more important, than those of the static model. Dynamic competition is about discovering and acting on opportunities to increase the value of resources and create wealth. When markets are open—when governments have not erected various restrictions limiting entry—the pursuit of profit provides sellers with a strong incentive to engage in wealth-creating activities. This dynamic competition weeds out inefficiency and poor quality, rewarding the best with more customers and thus greater revenues. It is the lifeblood of human progress.

Just think about how dynamic competition works and how it improves the products and opportunities available to each of us. Sears was once a powerhouse of the economy. After World War II, it expanded into newly built shopping centers, providing young families with quality appliances and tools at prices they could afford. But then upstarts like Walmart and Home Depot figured out how to provide these and other goods at more economical prices, and Sears shrank to relative market insignificance. Now Amazon is challenging Walmart by selling goods inexpensively online—without having to bear the costs of providing retail stores.

Examples of the dynamic competitive process changing our lives abound. Facebook created a new market for social networking, and now Google is challenging Facebook, trying to get more people to use its multiple online services. The iPod altered the way we listen to music and read books. Cell phones continue to evolve into sources of news events and multi-communications services. This process—finding new ways to satisfy customers—is ongoing in free economies and it is constantly expanding our opportunities and improving our living standards.

But dynamic competition is largely ignored in mainstream principles courses. Instead, students are informed that only a few

markets are competitive and therefore, resources are misallocated because the ideal conditions implied by the purely competitive model are absent. “Misleading” is a charitable description of the treatment of competition in the typical principles course.

### *C. Entrepreneurship*

Mainstream economics tends to ignore both the role of the entrepreneur and the entrepreneur’s significance as a source of economic growth. Entrepreneurs are the innovators willing to undertake risk in an effort to discover and produce improved products and lower-cost methods of production. They do not necessarily come up with entirely new inventions; they may discover how to modify the inventions of others and expand their availability to a larger number of consumers. Entrepreneurs often fail, sometimes several times, before they discover a successful innovation that may transform the lives of millions.

Entrepreneurs are risk-takers who act on opportunities that are often overlooked by others. Steve Jobs and Steve Wozniak saw that the personal computer had a future when most experts thought computers would always be gigantic machines that filled entire rooms. Jobs and Wozniak came up with the Apple II, which launched the revolution of the personal computer.

Even though entrepreneurial innovations are a key ingredient of the growth process, traditional economics courses rarely mention them. Students in high school and college are surrounded by innovations they “can’t live without”—their iPhones and Droids and GPS systems, not to mention services such as eBay and Groupon—yet their economics classes teach them nothing about how these products and services appeared. The dynamic competition that students see all around them is merely “monopolistic competition,” not much distant from the sinful states of oligopoly and monopoly. Similarly, mainstream economics generally fails to inform students that monopoly and oligopoly are usually the result of political decision-makers working hand-in-hand with well-organized business and labor interests.

### *D. Public Choice*

Although the omissions of private property rights, dynamic competition, and entrepreneurship are highly important, the most grievous omission of mainstream economics is that of public choice.

Launched by the 1962 book *The Calculus of Consent* by James Buchanan and Gordon Tullock, public choice applies the tools of economics to the operation of the political process. The public choice literature grew rapidly during the 1960s and 1970s, and in 1986 Buchanan was awarded the Nobel Prize in Economics for his path-breaking work in this area. Public choice makes it possible to use the tools of economics to analyze how both the market and political decision-making processes work. Without knowledge of the operation of both processes, one is in a poor position to make choices among those two general forms of economic organization.

It seemed reasonable that, with the passage of time, the insights of public choice would be integrated into mainstream economics, including introductory courses. However, this has not happened. The typical mainstream course does three things: (a) analyzes how markets work using the tools of demand and supply; (b) explains why they will sometimes fail to achieve efficient allocation of resources under certain conditions, resulting in market failure; and (c) derives ideal government solutions for the correction of market failure. Thus, the tools of economics are applied to the operation of real-world markets and used to explain why they will sometimes work poorly. But no such analysis is applied to the political process. Instead, the mainstream approach models government as a corrective device, like a pinch hitter who will always deliver the game-winning hit.

Greg Mankiw's widely used introductory principles text illustrates this point. Mankiw, a professor at Harvard, is no left-winger; he was chairman of George W. Bush's Council of Economic Advisers. During the fall of 2011, he was the target of a student protest for his perceived support of market economies and his failure to provide sufficient attention to Marxist and other interventionist theories in his principles class.

Yet, in his text Mankiw introduces his discussion of the role of government in the following manner:

To evaluate market outcomes, we introduce into our analysis a new, hypothetical character called the benevolent social planner. The benevolent social planner is an all-knowing, all-powerful, well-intentioned dictator. The planner wants to maximize the economic well-being of everyone in society (Mankiw, 2012, p. 145).

Mankiw's language is more colorful than in most other texts, but his approach reflects the mainstream perspective. Government is modeled as if it is an entity available for the imposition of ideal solutions through the political process.

Clearly, the mainstream approach treats the market and political processes asymmetrically. The tools of economics are used to analyze how markets really work and to identify categories of economic activity where there is good reason to expect that Adam Smith's invisible hand will fail to achieve efficient allocation of resources. A balanced, symmetric analysis would do the same for political allocation. But this is not the approach in today's economics courses.

Instead of analyzing the operation of the political process, today's courses focus on what idealized government action would look like, under assumptions that are often highly restrictive. In the words of Mankiw, government and the political process that directs it are modeled as an omniscient benevolent social planner. Public choice analysis indicates that, like markets, the political process will fail to allocate resources efficiently when certain specified conditions are present. Just as there is "market failure," there is also "government failure."

There are several categories of government failure. First, there is the special interest effect: the tendency of politicians to spend funds on projects favored by well-organized interest groups. Second, there is the shortsightedness effect: the incentive for political decision-makers to favor projects yielding highly visible benefits prior to the next election at the expense of future costs that are difficult to identify. Excessive use of debt financing and unfunded promised benefits provide examples. Third, there is rent seeking: political decision-makers will find it attractive to favor some firms, sectors, and interest groups in exchange for financial contributions and other forms of political support. As government becomes more heavily involved in the allocation of resources, more resources will flow into counterproductive rent-seeking activities and fewer into productive ones. With time, this exchange of favoritism for political support will increase, and a system of crony capitalism will emerge. Finally, it is important to recognize that the political process does not have anything like profit and loss, which tend to encourage productive projects and discourage unproductive ones. Economic inefficiency will arise from each of these aspects of public decision-making.

Because of its asymmetrical treatment of the political process, examples of market failure are rampant in principles courses, but “government failure” is almost totally absent. This point can be easily verified. Check the number of entries on market failure and its various components in leading principles of economics texts, then do the same for entries on government failure and its various categories. The former will appear many more times than the latter. Within the framework of scholarly analysis, this omission is inexcusable.

Because they omit public choice, most economics classes ignore the central economic issues: How do alternative forms of economic organization work, and which ones tend to result in more growth and prosperity? Real-world choices are always between market and political organization, both of which have shortcomings. One can never choose between idealized government intervention and flawed market activity, but mainstream economics focuses on the latter and assumes the former is an option.

Most students will never take an economics course that uses the tools of economics to examine how both market and political processes work. This omission is highly unfortunate. It is further compounded because so many high school government and civics classes present unrealistic and romantic images of how government operates. Students get the impression that voting and decisions made by majority rule are a wonderful way to run both government and the economy—everybody participates, and therefore voting is a wonderful way to make decisions. Little or no attention is paid to the issue of how voting affects the efficiency of resource use and the living standards of the citizenry.

#### *E. Central Planning*

The modeling of government as an entity available to impose optimal solutions generates a harmful secondary effect: it leaves students with a naïve and unrealistic view of central planning. After the fall of communism, the gloss was removed from the central planning of an entire economy. But the methodology of mainstream economics continues to imply that the government can effectively plan major sectors of the economy, such as health care, banking, and the auto industry. Economists often develop models based on information about consumer preferences, production costs, productivity of resources, and the cost of spillover effects. The assumption is that this information can be known and thus ideal



solutions can be derived within the framework of the models. The models often incorporate numerous equations and complex mathematics to derive the optimal taxes, subsidies, and regulations necessary for the achievement of the ideal outcome. The entire process appears to be both brilliant and scientific.

But there are numerous problems with this approach. The models almost always assume the availability of information that is both unknown and unavailable to any central authority. Thus, derivation of a solution based on such information is largely a pointless exercise (Hayek, 1988). Moreover, the world is dynamic; innovations and dynamic change mean that today's idealized policy may well be a source of future inefficiency. Further, apparent "optimal" solutions often alter incentives and result in secondary effects concealed by the model.

Finally and perhaps most important, even if the implications of a model are largely correct, the political incentive structure will often undermine the adoption of productive policies. For example, even if the costs of pollution were known and could be incorporated into an upfront tax on purchases, such a policy is not likely to be adopted in the form proposed by economists. Contrary to the mainstream economic view, real-world political decision-makers are neither saints nor benevolent omniscient social planners. Instead, they are motivated primarily by the winning of the next election, and when pursuit of this goal conflicts with idealized efficiency, the former will dominate the latter.

The bottom line is straightforward: idealized models make centralized government planning appear far more feasible than the reality of the situation warrants. Insufficient information, dynamic change, secondary effects, and political considerations undermine the potential effectiveness of government planning of industries and sectors, just as they undermine the central planning of the entire economy. Contrary to the implications of the idealized models, extensive use of government planning will tend to result in cronyism and inefficiency rather than in improvements in the outcomes of markets.

### **III. Economic Freedom and Economic Education**

The cornerstones of economic freedom are: (a) personal choice, (b) voluntary exchange, (c) freedom to enter and compete in markets, and (d) protection of persons and their property from aggression by

others. These four cornerstones imply that economic freedom is present when individuals are permitted to choose for themselves and engage in voluntary transactions—as long as they do not harm the person or property of others. Free economies are characterized by private ownership of resources and businesses, the rule of law and even-handed enforcement of contracts, dynamic competition, entrepreneurship, and reliance on markets rather than the political process to allocate resources.

Since the time of Adam Smith, a substantial share of the economics profession has argued that free economies will be more prosperous than those that are less free. Nonetheless, examination of this issue is omitted from almost all principles courses today. This is indeed unfortunate, because we now have better information on this topic than at any other time in history. During the past two decades, the Canadian Fraser Institute has developed a comprehensive measure of the consistency of institutions and policies with economic freedom for a large set of countries (Gwartney, Lawson, and Hall, 2012). The Heritage Foundation has developed a similar measure (Heritage Foundation, 2012). These data make it possible to examine empirically the relationship between economic freedom and measures of performance such as investment, GDP growth, per capita income, and the poverty rate.

Numerous scholarly articles have used these data to investigate the impact of economic freedom on performance. Almost without exception, these studies have found that freer economies outperform those that are less free. The scholarly research has also found that movements toward economic freedom lead to improvements in performance. The findings of these studies could easily be incorporated into economics classes at both the high school and college levels. To date, this has not been the case. Given the failure of mainstream economics to incorporate the role of property rights, dynamic competition, and entrepreneurship, this omission should not be surprising.

#### **IV. An Innovative New Approach**

The authors have been involved in the development of an introductory course that integrates dynamic competition, entrepreneurship, public choice and economic freedom and has been taught at Florida State University, Wake Technical Community College, and Northern Michigan University. We sometimes refer to

the course as “Common Sense Economics for Life.” It is a one-semester course designed to make economics both informative and lively. It focuses on the fundamentals of economics—things that students really need to know. It stresses reasoning and analytical skills rather than mathematics and mechanics, and is designed for students who are likely to take only one course in economics. The course is suitable for use at either the college or high school level. Many community colleges and universities—as well as some high schools—have such an introductory course. While the course is not meant to prepare students for advanced study in economics, this way of teaching an introductory course is so interesting to students that it may well bring more students into the economics major.

The course pairs the economics primer *Common Sense Economics: What Everyone Should Know About Wealth and Prosperity* (Gwartney, Stroup, Lee, and Ferrarini, 2010) with videos, audios, readings, and other online materials. Following the format of that book, the course is divided into four parts:

1. The economic way of thinking
2. The sources of growth and prosperity
3. The economics of government and collective decision-making, and
4. Key elements of sound personal finance.

The core package contains 15 modules, one for each week of a 15-week semester. Each module includes the concepts, engaging discussion questions, a weekly reading assignment, weekly video and audio assignments, weekly homework (including suggested answers for instructors), and weekly quizzes. A test bank is provided for both quizzes and examinations over each of the four parts of the course. A lively *Controversies in Economics* video series is also part of the package.

Those who have had the experience of trying to awaken interest in economics while teaching classes the way they are structured today know that some students resist mightily. Thus, the student response to this course has been eye-opening. To illustrate this point, here are a few excerpts from student evaluations of the course taught by Kelly Markson at a community college. From a second-year student:

I valued everything we discussed pertaining to this class, simply because everything we discussed had significant

factors towards my future, and the future of my family. I guess I speak for everyone when I say, my first opinion of this class was that it'll be hard, and boring...but it ended up being the opposite. I especially enjoyed the videos, the discussions, and the chance to give feedback to classmates. This economics class was nothing like they taught in high school (I think you should teach those teachers your strategy)! In five years I will be able to look back and use some of your examples to better discuss taxes, savings, and important values to others. LOL!

From a mother of four pursuing a degree in accounting:

I have really enjoyed this class, I think that it touched on a lot of important topics and gave a broad overview of different things. It makes you want to go out and learn more about how the market works, savings and investing, and thinking about the future as far as retirement, insurance, and the purchase of big ticket items like housing, college, and family.

From a recent high school graduate:

Thank you for giving us such a great learning experience and showing me that economics is no longer a subject to be feared but an important part of our everyday lives that needs to be studied.

Economics does not have to be “dismal,” and it can truly enlighten students about the world around them.

#### **IV. Conclusion**

Economic education in the United States has done a relatively poor job of highlighting vitally important sources of growth and prosperity. These omissions include dynamic competition, entrepreneurial discovery, the role of private ownership, and institutions and policies supportive of economic freedom. Moreover, the omission of public choice analysis from mainstream courses results in a highly unbalanced view of issues involving markets and the political process.

In typical courses, markets are held to an efficiency standard. When the incentive structure undermines the achievement of that standard, students are informed that there is market failure. But government is treated differently. Instead of analyzing how the political process really works, mainstream economics merely assumes that government will adopt ideal solutions. In other words, there is market failure but no such thing as government failure. This leaves students with an unrealistic and naive view of economic growth and prosperity. As it currently exists, economic education is doing little to promote economic literacy.<sup>1</sup> In fact, in several areas it is leaving students with a false view of how economies work and what might be done to improve their performance. Major reform is needed if economic education is going to play a positive role in the future.

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<sup>1</sup> The 20 Voluntary National Standards of the Council for Economic Education (2010) provide a ray of hope for positive future change. These standards cover property rights, dynamic competition, entrepreneurship, and the economics of political decision-making, including government failure as well as market failure.

86 J.D. Gwartney and J.S. Shaw / *The Journal of Private Enterprise* 29(1), 2013, 73–86

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