
CONTENT ARTICLES IN ECONOMICS

What Should We Be Teaching in Basic Economics Courses?

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Advanced Placement economics leaves thousands of high school students with a misleading impression of modern economics. The courses fail to cover key sources of growth and prosperity, including private ownership, dynamic competition, and entrepreneurship. The tools of public choice economics are totally ignored. Government is modeled as a corrective device available to impose ideal solutions. Market failure is covered, but there is no such thing as government failure. The macroeconomics course reflects the simplistic 1960s Keynesian view of stabilization policy. Time lags, incentive effects, secondary effects of budget deficits, and other factors that complicate effective use of stabilization policy are almost entirely ignored. In contrast, the 20 *Voluntary National Content Standards in Economics* of the Council for Economic Education illustrate what a balanced course in modern economics would look like.

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Economics is about how the structure of incentives influences choices. The predictive power of economics emanates from the basic postulate: If an option becomes more costly, people will be less likely to choose it. Correspondingly, if the benefits derived from an action increase, people will be more likely to choose it. While this basic postulate is simple, it is a powerful tool with which to promote understanding of human decision-making and alternative forms of economic organization. The basic postulate and the structure of incentives provide powerful insights on the operation of both the market and political processes. These insights will equip students, including those who may never take another economics course, to make more informed choices as consumers, investors, and citizens.

I submit to you that currently the economics profession is poorly serving students of basic economics. The Advanced Placement (AP) microeconomics and macroeconomics courses, materials, and released tests provide insight on what is being taught in pre-college economics. Because AP courses generally attract the brightest and most highly motivated high school students, their

content is particularly important. According to the College Board (2010, 1–3), AP macroeconomics and microeconomics represent what is being taught in these courses at the college level. Depending on the college, students can earn college credit when passing the exams at acceptable levels. The content descriptions of these courses are readily available at the Web site of the College Board (<http://apcentral.collegeboard.com>). These descriptions list the topics covered, provide sample questions and answers, and even provide a breakdown for the percentage of the multiple-choice and free-response questions focusing on each topic. Because the AP courses are widely taught throughout the country and the course descriptions provide detailed information about their content, the critical comments below are generally directed at the AP economics courses. However, to the extent that the content of AP economics is broadly representative of other high school economics courses and even college-level introductory courses, these criticisms will also often apply to the teaching of introductory economics more generally.

While the comments below are often critical, I want to make it clear at the outset that I am a supporter of the AP program. There are several highly positive attributes of AP economics, including the preparation of students for college, economical opportunity to earn college credit, and the training of high school economics instructors. Further, the AP course and exam provide excellent coverage of several topics, and this fact should not be overlooked. The coverage of scarcity, opportunity cost, comparative advantage, gains from trade, demand, supply, determination of market prices, and the impact of price controls is excellent. Coverage of price elasticity, market structure, relationship between product and factor markets, national income accounting, measurement of unemployment, and money and central banking is also strong. While one might criticize the balance between mechanics and economic reasoning of past exams in some of these areas, this is an issue of lesser importance.

The major shortcoming of AP economics is the misleading impression the curriculum creates with regard to the power of economic reasoning and the status of modern day economic scholarship. My objective is to improve the program in these areas. The deficiencies of AP economics can be divided into two general categories: (1) omission of important content that leaves students with misleading impressions and (2) coverage of macroeconomic analysis in an unbalanced and misleading manner. The article now turns to these topics.

CONTENT OMISSIONS THAT CREATE MISLEADING IMPRESSIONS

The AP course fails to cover three key topics, and these omissions leave students with misleading impressions of how the real world works and why nations prosper. Let us consider each omission and the distorted view the omission creates.

Private Ownership

The structure of ownership rights exerts a major impact on the present and future use of resources. Private owners have a strong incentive to maintain and care for what they own because they will bear the cost if they fail to do so. They also possess a strong incentive to develop their property, including their knowledge base and labor skills, in ways that are highly valued by others. Doing so will lead to higher incomes and returns on their investments. Private owners also have a strong incentive to conserve resources for the future, particularly if their price is expected to rise as the

result of increased scarcity. Moreover, private ownership holds owners accountable. Liability law holds owners liable for damages imposed on others precisely because the resources are under their control.

Private ownership is important because of the incentive structure that it generates. When resources, including the skills and expertise of individuals, are privately owned, well-defined, and enforced, open markets will bring the interests of owners into harmony with those of others. Economic growth and progress will result. However, the incentive structure emanating from private ownership and its importance as a source of growth and prosperity are almost totally ignored in AP and other basic economics courses. Given this omission, the current generation of students is left with little understanding of the role played by private ownership and its importance for the efficient use of resources and wise practice of conservation. If students do not learn these things in basic economics, where do we think they will be learned?

Dynamic Competition, Creative Destruction, and Entrepreneurship

Dynamic competition involves the introduction of new products and discovery of alternative production processes that reduce cost. It is a vitally important source of improved efficiency and higher income levels. Just think of the new products that have been introduced and improved and have replaced relatively old products in recent decades. E-tablets, smart phones, plasma televisions, MP3 players, hip replacements, Lasik eye surgery, and laparoscopic surgeries come immediately to mind. But competition of this type is almost totally absent from AP economics courses. Instead, the focus is on the idealized conditions of the pure competition model and the static inefficiency that results from monopolistic competition, oligopoly, and monopoly. Moreover, the potential of government regulation to correct the alleged static market inefficiencies is highlighted. The possibility of government playing a role in helping special interest groups form the monopoly, oligopoly, or monopolistic competitors is ignored.

When markets are open and entrepreneurs are encouraged to try out new ideas, discovery of better ways of doing things provides one with a competitive advantage relative to rivals. As Joseph Schumpeter highlighted decades ago, and as recent experience has surely reinforced, entrepreneurial discovery of new products and lower-cost production methods are central to the competitive process, economic growth, and achievement of high levels of per capita income. However, the brightest of our high school students have to find this out on their own. These topics are missing from AP economics. This omission is tragic because today's students have a strong interest in entrepreneurship and dynamic change (Rocca and Pruitt 2009). The world of today's multi-media students is riddled with smart phones, e-tablets, new apps, and rapid change, which make it easy for them to recognize that entrepreneurship and dynamic competition are important sources of economic progress. If you do not believe this, just ask your students about how important it is for them to update the apps on their latest and greatest smart phones or e-tablets.

Public Choice

The gravest omission of the current teaching of basic economics is the virtual exclusion of the economics of public choice. Instead of using the tools of economics to analyze how the political process works, basic courses generally treat government as a corrective device. AP economics

and other basic courses focus on the derivation of optimal market solutions requiring modeling assumptions that are often highly unrealistic. Further, the difficulties involved in implementing the “ideal solutions” and the likelihood of their adoption through the political process are almost totally ignored. This approach leaves students with a naïve and misleading view of both economics and how the political process works.

It is as if the basic tools of economics apply to market decision makers but not voters, legislators, bureaucrats, and other political decision makers. There is overwhelming empirical evidence that this is not the case. Consider four of the most important lessons of public choice economics and how they enhance our understanding of today’s world

- 1) *Rational ignorance effect.* Voters will invest very little time and effort into acquiring information about political candidates and issues because their payoff from the casting of an informed vote is so small. In contrast, market decision makers can make choices for themselves, and they have a strong incentive to make informed choices. They are both able to capture the benefits of wise choices and forced to bear the consequences of those that turn out poorly. This is not the case for voters. Most people recognize that their vote is unlikely to decide the outcome of the race for Senate, the House of Representatives, and other offices involving a large number of voters. Thus, there is little incentive to acquire the information needed to cast an informed vote. The evidence is supportive of this view. Most voters—70 percent in a recent survey—cannot accurately identify the name of their two U.S. Senators, let alone know where they stand on a broad set of issues.
- 2) *Special interest effect.* Public choice analysis indicates that political officials will have a strong incentive to favor the position of well-organized interest groups receiving concentrated benefits at the expense of costs that are not easily identifiable and spread thinly over the vast majority of voters. The rational ignorance effect strengthens this proposition. Since the costs of these projects are relatively small to each voter, most voters will be uninformed on special interest issues. In contrast, the recipients of the concentrated benefits will feel strongly about the issue, and they are more likely to be informed. Moreover, the concentrated-interest groups provide a readily available source of campaign contributions and other forms of political support. Thus, elected political officials have a strong incentive to support their positions even if the political action is counterproductive. Again, the empirical evidence is highly consistent with this analysis. The popularity of tariffs, quotas, agricultural subsidies, ethanol mandates, business subsidies and tax breaks, bailouts of highly unionized firms, and senior citizen programs reflect the special interest effect.
- 3) *Shortsightedness effect.* Public choice analysis indicates that the democratic political process is myopic. Issues with easily identifiable current benefits (prior to the next election) at the expense of costs that are difficult to identify and observable mostly in the future are attractive to elected political officials. Issues structured in this manner can be political “winners” even if they are counterproductive. Once again, examples abound. Current government spending financed with debt, unfunded promised future benefits, and various forms of price controls all generate visible current benefits to constituents at the expense of costs that are observable mostly in the future. To a large degree, programs like these reflect the myopic nature of the political process.
- 4) *Rent-seeking and political favoritism.* Rent-seeking is a natural outgrowth of political favoritism. When subsidies, tax breaks, and regulations bestow favors on a concentrated

few at the expense of others, rent-seeking will expand. Resources allocated to rent-seeking will be unavailable for the production of goods and services that are highly valued relative to costs. As the research of Gordon Tullock (1967) and Anne Krueger (1974) indicates, tariffs, quotas, government grants of monopoly, subsidies, and other forms of government favoritism will generate rent-seeking costs over and above the deadweight losses highlighted by the static neoclassical model. Businesses and other organized interests will “invest” resources in lobbying and other political activities designed to secure the windfall gains and above-normal profits generated by government favoritism. As a result, resources will be diverted away from productive activities toward wasteful rent-seeking. As the work of Tullock and Krueger illustrates, this inefficient use of resources will nearly always exceed the deadweight losses implied by the static analysis.

Favoritism provides politicians with something they can trade for political support. Exchange of government favors for political support is not a rare occurrence that sometimes arises when resources are allocated politically. Rather it is a central feature of political allocation of resources. When the government becomes more heavily involved in providing contracts, subsidies, tax breaks, and other political favors to some at the expense of others, the share of resources flowing into inefficient rent-seeking activities will expand and the share channeled into productive activities will shrink. In turn, output and income will fall below their potential.

The omission of public choice analysis from basic courses results in an imbalanced treatment of markets and government. Investigation of the AP curriculum makes this point clear. The AP outline covers market failures in the form of economic instability, absence of competition, externalities, and public goods. Potential ideal solutions to market failures also are provided. But there is no coverage of the special interest effect, the myopic nature of political decision-making, rent-seeking or other forms of government failure. The possibility of government failure is not even mentioned, and there has never been an AP exam question on this topic. This may have been acceptable 30 years ago, but it is a misrepresentation of economic scholarship today.

The tools of economics enhance our understanding of both the market and political processes. They indicate that both have various types of shortcomings—that there is both market failure and government failure. George Stigler once remarked that a person who considers only market failure is like the judge of a singing contest, who immediately declares the second contestant the winner after hearing the performance of the first (Tregarthen and Rittenberg 2000, 304). This is basically the approach of AP economics.

Moreover, the government as a corrective device approach leaves students with the impression that economic analysis is out of touch with reality. Even though other social science classes at the high school level often present an idealistic view of government, many of today’s students have some awareness of the importance of special interests, pork-barrel spending, and the tendency for large political contributors to “win” government contracts and other special favors. They are also aware that persistent budget deficits have driven the outstanding debt of various countries to unsustainable levels and that the current federal debt of the United States is at a historic high. Students are highly interested in analysis that ties these elements together in a generalized logical manner. This is precisely what public choice analysis does. It also highlights the relevance and explanatory power of economics. My own teaching experience indicates that this approach attracts student interest in economics and encourages them to take additional courses, including graduate studies in the field.

IMBALANCED COVERAGE IN MACROECONOMICS

Not surprisingly, macroeconomics constitutes the major area of misleading coverage. This is an area of both substantial change and continuing debate among economists. If the AP course is an indication, the modern debate has not found its way into introductory economics courses. The AP course reflects the Keynesian view that active uses of fiscal and monetary policy are powerful tools with which to promote economic stability. If there is a problem of recession, expansionary macroeconomic policy can stimulate aggregate demand and thereby promote recovery. Similarly, if there is a problem of inflation, restrictive macro policy can restrain aggregate demand and promote noninflationary, full employment, equilibrium. This simplistic view dominated macroeconomics in the 1960s and 1970s, but this is no longer the case.

Today, economists of most all persuasions recognize that institution of stabilizing fiscal and monetary policy is far more complex than the Keynesian analysis of the 1960 to 1980 era implied. It takes time for changes in fiscal and monetary policy to exert a major impact on demand, output, and employment. Thus, if the changes are going to be timed correctly, policy-makers need to anticipate the future direction of the economy. But, this is not an easy task because our forecasting abilities are limited. These limitations complicate the ability of policy-makers to institute changes in a stabilizing manner. Further, the substitution of borrowing for taxes will generate secondary effects, including higher future interest and tax rates that are generally ignored in the simple Keynesian analysis of AP economics. The modern view also recognizes that the impact of a temporary policy change will differ from one that is more permanent, and that changes in tax rates also generate incentive as well as income effects. Moreover, as public choice analysis indicates, political decision makers will find borrowing more attractive than the more highly visible taxes. As a result, budget deficits will be more common than budget surpluses. This bias also may push government debt to high levels that will retard future growth. All of these factors will impact the implementation of countercyclical macroeconomic policy, but they are virtually ignored in AP macroeconomics.

What would a well-rounded macroeconomics course look like? It would certainly cover the potential impact of fiscal and monetary policy on aggregate demand and their possible uses to help promote macroeconomic stability. But it would also cover time lags, imperfect forecasting abilities, and other factors that limit the implementation of macro policy in a countercyclical manner, and the historic fact that policy errors have often been a source of macroeconomic instability. It also would take note of the considerable debate among economists with regard to the potency of budget deficits and the importance of incentive effects accompanying changes in tax rates and the structure of government spending.

AP macroeconomics makes activist countercyclical policy look easy. At the same time, it ignores the potential dangers accompanying large budget deficits and high levels of debt relative to gross domestic product (GDP). The potential dangers accompanying high levels of government spending as a share of the economy also are ignored. Are these omissions laying the groundwork for economic policies that will stifle future growth and prosperity? At this point, there is not an obvious answer to this question. But fallacious ideas have impacted policy in the past. The import restrictions to “save jobs” provided the foundation for the Smoot–Hawley tariff bill of 1930. The balanced budget orthodoxy provided justification for the huge tax increase of 1932. Both of these actions increased the length and severity of the Great Depression. Similarly, the Phillips curve analysis of Nobel Laureates Paul Samuelson and Robert Solow (1960) indicated that inflationary

policies would reduce the rate of unemployment.¹ This fallacious idea provided the foundation for the inflationary policies of the 1970s.

VOLUNTARY NATIONAL STANDARDS VERSUS AP ECONOMICS

It is revealing to compare and contrast the content of the *Voluntary National Standards* of the Council for Economic Education (CEE 2010) with AP economics. In 1997, the CEE (formerly the National Council on Economic Education), the National Association of Economic Educators, and the American Economic Association's (AEA) Committee on Economic Education developed a set of 20 voluntary national content standards for economics. The standards were developed with the consultation of economic educators, other economists, and the K–12 community. The AEA Committee on Economic Education played a central role in the development of these standards, and the committee approved the final version. The 1997 standards were revisited and refreshed in 2010. These standards are designed to reflect the current status of scholarship in the discipline.

The *Voluntary National Standards* cover scarcity, tradeoffs, marginal analysis, role of incentives (Standards 1 through 4), gains from trade (Standards 5 and 6), market prices (Standards 7 and 8), the role of money (Standard 11), interest rates (Standard 12), investment as a source of growth (Standard 15), and the circular flow of income, unemployment and inflation, and fiscal and monetary policy (Standards 18 through 20). All of these topics are covered in AP economics, as well as most basic college-level economics courses.

But the *Voluntary National Standards* also cover the competitive process (Standard 9), institutions and the protection of property rights (Standards 10 and 16), and profit and entrepreneurship (Standard 14). Market failure (Standard 16) is covered, but so, too, is government failure and special interest politics (Standard 17). Thus, the standards cover the role of property rights, entrepreneurship, dynamic competition, and both market and government failure. It is the omission of precisely these topics from the AP course that results in its misleading nature. Moreover, Standard 20 on monetary and fiscal policy states, "Students will understand that: Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices" (47). In contrast with the AP outline, this standard does not presume that Keynesian fiscal policy provides a reliable tool with which to promote economic stability. The *Voluntary National Standards* indicate what a balanced presentation of modern economics would look like, and they stand in stark contrast with the imbalanced coverage of AP economics.

CONCLUSION

The curriculum of AP economics is imbalanced and omits several vitally important topics. The roles of secure property rights, dynamic competition, entrepreneurship, and innovation as sources of growth and prosperity are almost totally ignored. Market failure is covered, but government failure is omitted. Instead of analyzing the impact of special interests, rent-seeking, and the shortsightedness effect on political decision-making, AP economics models government as a corrective device that can be used to achieve ideal solutions. Reflecting this view, AP macroeconomics is about government choosing the proper fiscal and/or monetary policy to

achieve full employment and price stability. The problems presented by time lags, forecasting limitations, and political incentives are ignored, as is the possibility that instability might occur as the result of prior policy errors.

All of this is tragic because it is leaving our best and brightest with a false impression of economics, its power to enhance our understanding of both markets and government, and its ability to enhance our knowledge about how to get more out of our scarce resources. As it is currently structured, economic education is poorly served by the curriculum of AP economics. The 20 *Voluntary National Standards* of the CEE, which have been approved by the Committee on Economic Education of the AEA, provide a road map for content changes that would improve AP economics. The criticisms presented in this article come from a friend of AP economics, and it is hoped that they will play a constructive role leading to both curriculum improvement and a strengthening of the program.

NOTE

1. In a presentation to the AEA, Samuelson and Solow stated, “In order to achieve the non-perfectionist’s goal of high enough output to give us no more than 3 percent unemployment, the price index might have to rise by as much as 4 to 5 percent per year. That much price rise [inflation] would seem to be the necessary cost of high employment and production in the years immediately ahead” (1960, 192).

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