

Chapter 3:

Economic systems and their production methods

Preview

The progressive advancements in thought led to the formulation of the fundamental principles underlying the two major systems in modern economic history: the capitalist system, which is based on the principles of both classical and Keynesian schools, and the socialist system, which is founded on the doctrines of the socialist school. The two systems presented unique approaches to the economic challenge and outlined the most efficient strategies for allocating limited resources and improving societal well-being, thus granting them credibility and public support. This chapter aims to clarify the fundamental components linked to capitalist and socialist frameworks, along with the solutions each offers to the economic challenges at hand. Capitalist and socialist systems represent pivotal economic paradigms throughout history, each striving to enhance societal welfare. Nevertheless, shortcomings have prompted reforms and integration aimed at improving welfare, fostering growth, increasing employment, and optimizing resource utilization. Academics propose the Islamic economic system as a plausible alternative, integrating the advantages of both frameworks while addressing their limitations.

1. Concept of the economic system and economic problem

The economic problem holds immense importance among the priorities of decision-makers in countries due to the many intertwined negative repercussions it leaves on economic activity and the well-being of individuals and communities, as well as its impact on the present and future of nations. Therefore, the economic system was developed as an organized and coordinated structure to address the economic problem by performing specific functions. In this section, we will highlight the most important aspects of the economic system and economic problems.

1.1. Concept of the economic system

A system is generally defined as a set of homogeneous, consistent, and interconnected structures, elements, and ideas, which are sometimes more complex but are linked in a common plan to achieve a common goal. As for the economic system, it is a set of interconnected, related, coordinated, or homogeneous economic, institutional, legal, and social structures aimed at achieving specific economic goals¹.

¹ Aouissi Amin & Faisal Chiad, The Philosophy of the Islamic Economic System Compared to Traditional Economic Systems (Capitalism and Socialism), Share: Jurnal Ekonomi dan Keuangan Islam, Vol. 05, No. 02, July-December 2016, pp. 167, 168. 167, 168.

Similarly, the economic system is a set of ideas, principles, mechanisms, and institutions that manage economic activity and decision-making and implement decisions related to production, income, and consumption¹.

The economic system is defined as the sum of mechanisms and institutions that deal with individual economic behavior and guide it to achieve socially desired outcomes².

Some define the economic system as a set of necessary rules and foundations aimed at solving economic problems, as it determines the correct framework for the relationships between economic units, meaning it encompasses the relationships between them and defines the scope of action and decision-making. The economic system is viewed as part of the prevailing social system, and therefore, it is greatly influenced by the beliefs and ideologies that prevail in any society³. The economic system is considered a practical application of the economic doctrine, which represents a set of rules and principles aimed at organizing economic life, addressing issues of production, consumption, and distribution, and providing solutions to economic problems according to specific concepts. It is worth noting that the formation of an economic system takes a long time and requires supporting institutions. However, institutions that include property rights, contract enforcement, and coordination mechanisms are formed in a somewhat evolutionary manner. In this regard, North defines institutions as the constraints created by humans that structure political, economic, and social interaction. Moreover, North mentioned that institutions include both formal rules (constitutions, laws, and property rights) and informal constraints (sanctions, taboos, customs, traditions, and codes of conduct).

1.2. Concept of the economic problem

1.2.1. Definition of the economic problem

The economic problem arises from the imbalance between human needs and the economic resources necessary to satisfy them. While human needs are characterized by their multiplicity and renewal, making it impossible to set limits on them, economic resources are relatively scarce and limited, making it impossible to satisfy all needs. This imbalance necessitates the formulation of policies and the making of decisions to allocate resources to specific needs, prioritized according to their urgency, while respecting the uniqueness of each society⁴.

¹ Aouissi Amin, *The Economic System and Social Culture (Relations and Outcomes)*, Dar Ihya for Digital Publishing, Syria, 2004, p. 27.

² Byung-Yeon Kim, *The Studies of Economic Systems and Institutions: Some Views on Future Direction*, *The Journal of Comparative Economic Studies*, Vol.7, 2012, p. 12.

³ Hani Saleh, *How Today's Economy Works?* Al-Obeikan Publishing, Saudi Arabia, 2008, pp. 32-33.

⁴ Byung-Yeon Kim, *op.cit.*, pp. 6, 16.

1.2.2. Characteristics of the economic problem

The economic problem is characterized by several features, which are:

a. Relative scarcity: The economic problem arises from the relative scarcity of economic resources, meaning the insufficiency of available resources to satisfy all the needs and desires of individuals and societies. Once needs are satisfied, new needs emerge that require satisfaction, which forces decision-makers (consumers and producers) to prioritize and choose to satisfy some needs that achieve the most excellent possible satisfaction and benefit. If resources were available in the necessary quantities to produce all the goods and services that individuals need, the economic problem would not arise, and there would be no need for the science of economics¹.

b. Choice: The economic problem arises from the inability of economic resources, and consequently production, to keep up with the diverse, changing, and increasing human needs. This imbalance results in a decrease in consumer satisfaction and economic welfare², which requires deep thinking and long and thorough discussions to find solutions and adopt appropriate policies to reach an economic equilibrium point where the most urgent needs and desires can be satisfied, thereby eliminating the feeling of deprivation for the longest possible period³. The scarcity of economic resources forces decision-makers to rearrange needs and prioritize the most urgent ones to satisfy them, while postponing the satisfaction of other needs⁴.

c. Sacrifice: The problem of choice, resulting from the relative scarcity of resources capable of satisfying diverse and renewed needs, leads to sacrificing some needs that are less urgent or those that one's capabilities do not allow for acquiring in favor of those that are more urgent. The sacrifice accompanying the economic problem is referred to as the cost of choice or the opportunity cost⁵.

d. Method of production: The economic problem involves choosing the appropriate production method, which includes selecting the most suitable production combination and the most appropriate production techniques⁶. Some defined the mode or method of production as the forces of production and the social relations of production. The forces of production constitute the productive technology of a society. These consist of the current state of productive or technical knowledge, skills,

¹ Ben Sahnoun Samir, the economic problem ... Between capitalist economic thought and Islamic economic thought, Journal of Economic and Financial Studies, University of El Oued, Algeria, Volume 03, N° 08, 2015, p. 212.

² Ibid.

³ Ahmed Al-Ghandour, International Economic Relations, Dar Al-Nahda Al-Arabiya, Egypt, 1970, p. 7.

⁴ Daniel E. Saros, op.cit., pp. 134-135.

⁵ Ben Sahnoun Samir, op.ci., p. 213.

⁶ Hazem Al-Beblawi, The Foundations of Political Economy, Maktabat al-Ma'arif, Alexandria, Egypt, 1975, pp. 21-28.

organizational techniques, and so forth, as well as the tools, implements, machines, and buildings involved in production¹.

e. Distribution of production among members of society: The economic problem is characterized by complexity and intricacy, so the focus is not solely on production to address it. However, it extends beyond production, specifically the distribution of production among members of society, to achieve a fair distribution of the various production elements among the members of society participating in the production process².

f. Level of operation and production: The underutilization of resources at their full capacity indicates a mismanagement and misallocation of resources, leading to negative economic phenomena such as unemployment and economic recession. The presence of idle resources leads to the loss of the opportunity to satisfy needs and consequently a decline in economic welfare, which results in the sacrifice of several needs that could have been met using the idle resources³.

g. The general price level: Poor resource distribution often leads to rising prices and a decline in purchasing power, an economic issue that has long attracted the attention of economists and troubled decision-makers due to its negative implications for economic, social, and political stability⁴.

h. The level of productive capacity: The economic problem is concerned with how to obtain the maximum possible amount of goods and services to achieve the highest possible satisfaction by utilizing all limited resources. Hence, there is an urgent need to continuously increase productive capacity to keep up with the rising needs resulting from population growth to improve the standard of living and enhance economic welfare, meaning the economic growth rate must be increased⁵.

The development of the forces of production has resulted in a continuously increasing capacity for societies to produce larger social surpluses.

2. Capitalist system

Capitalism emerged very slowly over several centuries as the dominant social, political, and economic system, first in Western Europe and later in much of the world⁶.

¹ E. K. Hunt & Mark Lautzenheiser, op.cit., p. 4.

² Mohamed Albanna & Mahmoud Al-Mutayyam, Principles of Macroeconomic Theory (An Applied Approach), Dar Al-Khouli for Printing, Egypt, 2008, pp. 19-20.

³ Ibid.

⁴ Ahmed Al-Ghandour, International Economic Relations, Dar Al-Nahda Al-Arabiya, Egypt, 1970, p. 7.

⁵ Ahmed Hani, op.cit., p. 44

⁶ E. K. Hunt & Mark Lautzenheiser, op.cit., p. 3.

The capitalist system is considered one of the most famous and oldest economic systems, with its intellectual roots tracing back to Greek civilization through the writings of Aristotle, who advocated for private property and the freedom to engage in economic activities. During its development, capitalism experienced some failures over specific periods, but this does not negate the successes it achieved in terms of economic growth, prosperity, and job creation, which made it the most successful and widespread economic system, with most countries in the world adopting it in one way or another.

2.1. Definition of the capitalist system

The capitalist system is defined as that system in which an individual or a group of individuals can own the means of production absolutely or rent them without restrictions, establishing projects using modern machines and technologies to achieve profit and accumulate wealth. Thus, the system's strength is determined by maximizing wealth and increasing capital accumulation. In other words, the capitalist system is based on absolute freedom in economic activity, allowing individuals, referred to as capitalists, to combine the factors of production they own or rent (labor and land) into an industrial, agricultural, or service project that typically relies on the intensive use of machinery, production techniques, and labor to maximize profits and increase wealth accumulation¹.

2.2. Characteristics of the capitalist system

The capitalist system is characterized by a set of features, the most prominent of which are:

2.2.1. Supremacy of private ownership

Private ownership, or private property, of the means of production is a feature of capitalism. Capitalism is based on private ownership of the means of production, which transforms into capital. This ownership establishes social relations, as the class that owns the means of production can obtain economic surplus and exclude other groups (the non-owners), turning them into wage laborers, thus transforming the ability to work into a commodity².

In capitalism, commodity production is not a direct means of satisfying needs. Instead, it is a means of acquiring money by exchanging the product for money, which, in turn, may be used to acquire products desired for their use value. Under such conditions, the products of human labor are commodities, and the society is described as a commodity-producing society.

¹ Ahmed Al-Ghandour, op.cit., p. 8

² Aouissi Amin, op.cit., pp. 44-45.

Under private ownership, owners of capital are granted the right to decide how the raw materials, tools, machinery, and buildings necessary for production can be used, so they are free to employ their capital according to their self-interest. Such a right necessarily implies that other individuals are excluded from having any say about how these means of production can be used¹. In this regard, enshrining private ownership in laws is crucial so the owners of capital have an incentive to take the risks associated with allocating capital to the market. Private ownership is the cornerstone of capitalism, and it is part of the invisible hand cited by economist Adam Smith and discussed earlier².

2.2.2. Profit incentive or self-interest

In capitalism, most people are motivated by individualistic, acquisitive, and maximizing behavior, which is necessary for its well-functioning.

Achieving profit is considered the incentive for engaging in economic activity in the capitalist system. Capitalist systems believe that the ultimate goal of an individual engaging in economic activity, whether production or trade, is to achieve the maximum possible profit, regardless of the interests of others³. Profits are closely associated with the concept of private property; an individual only enters into a voluntary exchange of private property when they believe the exchange benefits them. The profit motive, or the desire to earn profits from business activity, is the driving force of capitalism. It creates a competitive environment in which businesses compete to be the low-cost producer of a specific commodity in order to gain market share. If it is more profitable to produce a different type of good, then a business is incentivized to switch.⁴

To maximize profits, producers create goods and services that consumers increasingly demand, as consumer preferences dictate producers' decisions, a concept known as consumer sovereignty⁵. Therefore, producers in a capitalist system strive to increase their investments through purchasing investment commodities to enhance production capacity, providing products that meet consumer desires by offering a diverse range of goods and services, thus allowing them freedom of choice⁶.

2.2.3. Economic freedom

¹ E. K. Hunt & Mark Lautzenheiser, op.cit., pp. 5, 6.

² Brian Dolan, Main Characteristics of Capitalist Economies, 22 November 2024, consulted on 15 July 2025, at <https://www.investopedia.com/articles/investing/102914/main-characteristics-capitalist-economies.asp>

³ El-Morsi El-Sayed Hejazy, op.cit, pp. 12, 13.

⁴ Daniel Liberto, op.cit.

⁵ Ali Hafiz Mansour, op.cit., p. 57.

⁶ Aouissi Amin & Faisal Chiad, io.cit., p. 175.

Capitalism is an economic system that focuses on a free market to determine the most efficient allocation of resources and sets prices based only on supply and demand, far from any external influence.

Economic freedom allows workers to seek job opportunities with higher wages in exchange for the efforts they exert, commensurate with their competencies, qualifications, and talents. Capitalist systems are committed to ensuring the producer's freedom to produce what they desire, as they are better able to assess the goods that meet consumer needs and align with their decisions. The producer directs the resources and productive energies they possess to produce goods and services that respond to consumer decisions and maximize their profits. In doing so, a more efficient allocation of society's resources is achieved by improving production methods and means¹.

2.2.4. Supremacy of competition

Competition is considered an important characteristic of the capitalist system and the foundation for the establishment of economic freedom, as economic freedom, property rights, and the drive to achieve and maximize profits will encourage more independent competitors to enter the market².

Competition among producers prevents monopolies that distort production and trade, as it drives them to innovate and use more advanced and effective production and management methods. Consequently, costs decrease, which helps them continue their activities. Competition contributes to raising productivity levels, which lowers prices and directs production factors to the most productive branches of production. This benefits producers, whose sales and profits increase, as well as consumers, who benefit from the abundance of goods and services at reasonable prices.

2.2.5. The price mechanism or market forces

In capitalism, a person's productive activity has no direct connection to that person's consumption; exchange and the market must mediate the two³.

The price mechanism, or market forces, determines the performance of the capitalist economic process, where prices guide the producer's decisions regarding what to produce and the quantity of production, the location and activity in which to invest, the number of workers to employ, the quantity of inputs from raw materials and intermediate goods, the amount of reserves or stock, and other decisions over a specified period. Meanwhile, consumers, whether businesses or individuals, mostly

¹ Ben Sahnoun Samir, op.ci., p. 214.

² Jamila Mouallem, Development Experiences in Maghreb Countries and Alternative Strategies: A Comparative Study between Algeria and Morocco, PhD Thesis in Economic Sciences, Batna 1 University, Algeria, 2016/2017, p. 44, 46.

³ E. K. Hunt & Mark Lautzenheiser, op.cit., p. 5.

have the final say in how much a product or service is worth and what it should cost, based on a competitive marketplace. Consumers, influenced by the invisible hand, will pursue their profit motive in seeking to find the best product at the best price¹. Prices, along with the art of production, determine the cost of production, which in turn will determine the producer's profit and decisions².

2.2.6. Two-class system

As mentioned earlier, capitalism divides societies into two distinct classes of individuals: the capitalist class, which owns the means of production and distribution (the owners), and the working class, who sell their labor and time to the capitalist class in exchange for wages (the workers). However, in contemporary capitalism, the boundary is blurred; many workers are also stockholders, and business owners often earn a salary working as executives or directors³.

2.2.7. Freedom to choose

The freedom to choose a product from among various competitors' offerings is central to the capitalist economy. The principles of competition and the invisible force of supply and demand significantly influence the availability of freedom of choice in capitalist economies. Consumers ultimately determine demand, while corporations are free to pursue their profit motives as long as they provide an adequate supply. Capital will be drawn to those products for which demand is high enough to make it a profitable trade, meaning consumer demand is the linchpin of a capitalist economy. In the U.S., and this is the case for most of the advanced economies and emerging markets, consumer demand accounts for roughly 70% of economic activity, leaving consumer spending as the driving force behind the functioning of the world's largest economy⁴.

2.2.8. Less government intervention

Less government intervention is one of the hallmarks of a capitalist economy. Capitalist societies believe markets should be left alone to operate without government intervention, an idea known as *laissez-faire*, which was inherited from the physiocrats. Accordingly, the free market alone can create the right amount of supply to meet demand, and therefore, all prices will adjust accordingly.

2.2.9. More efficient allocation of capital resources: Labor and means of production follow capital in this system because supply follows demand⁵.

¹ Brian Dolan, op.cit.

² Muhammad Al-Sentris & Omar Salman, Introduction to the Study of Economics, Al-Bal Print for Printing and Photography, Egypt, 1999, p. 120.

³ Brian Dolan, op.cit.

⁴ Ibid.

⁵ Daniel Liberto, op.cit.

2.2.10. lower consumer prices: Capitalists compete against one another and so will seek to increase their profits by cutting costs, including labor and materials costs. Mass production also usually benefits consumers¹.

2.2.11. Wages and general standards of living rise overall: Wages under capitalism increased, helped by the formation of unions. More and better goods became cheaply accessible to vast populations, raising standards of living in previously unthinkable ways².

2.2.12. Spurs innovation and invention: In capitalism, inequality is the driving force that encourages innovation, which then pushes economic development.

Therefore, the capitalist system is an economic system in which private individuals or businesses own capital goods. At the same time, business owners employ workers who receive only wages; labor does not own the means of production but instead uses them on behalf of the owners of capital. The production of goods and services under the capitalist system is based on supply and demand in the general market, also known as the market economy. This arrangement is in contrast to a planned economy or a command economy, in which prices are set through central planning.

The purest form of capitalism is free-market or laissez-faire capitalism. Here, private individuals are unrestrained. They can choose where to invest, what to make or sell, and how much to charge. The laissez-faire marketplace operates without checks or controls. Today, most countries practice a mixed capitalist system that includes some degree of government regulation of business and some extent of public ownership of select industries.

2.3. Addressing the economic problem in the capitalist system

The economic problem arises from the relative scarcity of economic resources available to any society, which are insufficient to meet the multiple, infinite, and simultaneously renewed human needs.

In its approach to addressing the economic problem, the capitalist system believed in a market economy or price mechanism where supply and demand forces answer the questions related to the economic problem³. The solution to the economic problem under the capitalist system involves answering the following:

2.3.1. Determining the produced goods

In its approach to addressing the economic problem, the capitalist system believes in a market economy, or price mechanism, where supply and demand forces answer

¹ Daniel Liberto, op.cit.

² Ibid.

³ Mohamed Dweidar, op. cit., p. 308.

the questions related to the economic problem, as prices guide the actions of decision-makers and influence their decisions¹. The market is the defining feature of the capitalist system, where the factors of production, goods, and services move freely. There are a large number of producers and consumers, which allows buyers to negotiate lower prices and maximize their welfare, while preventing producers from forming monopolies that could hinder addressing the economic problem².

2.3.2. Determining the method of production

Regarding the question of how we produce, the price mechanism answers it by choosing the method of production through the forces of supply and demand, which determine the relative prices of production factors. These, in turn, influence the production method decision that producers adopt to reduce production costs and maximize profits. It is worth noting that the relative abundance of production factors plays an important role in determining their prices, which in turn determines the most suitable production method.

2.3.3. Distribution of production

Moreover, the price mechanism also determines how the output is distributed among the participants in its production, namely the owners of the factors of production. The price mechanism determines the share of each factor of production, with relative scarcity playing an important role in establishing that share. In countries with an abundance of job opportunities, wages tend to rise, and the same applies to other factors of production³.

2.3.4. Determining when production takes place

Regarding the question of determining when production should take place, countries must make decisions about future production early to meet the demands of population growth, changes in tastes and preferences, and changes in income. Countries must locally produce goods in which they have a comparative advantage and import other goods to meet demand and avoid inflation⁴.

2.3.5. Identifying the consumer

To answer the question of whom we produce for, the capitalist system believes in allocating resources to produce goods that can be purchased in the market by individuals who have sufficient purchasing power. Purchasing power and current and

¹ Ali Hafiz Mansour, op.cit., p. 63.

² Immanuel Wallerstein, *Analysis of International Systems*, translated by Hamdan Akram Ali, 1st edition, Arab Science Publishers, Lebanon, 2015, p. 46.

³ Ali Hafiz Mansour, op.cit., pp. 57-58.

⁴ Salman Shaikh, op.cit., p. 3.

future income expectations determine the size of the target market and motivate producers to meet the expected demand, with production decisions driven by self-interest and the goal of profit maximization¹.

2.3.6. Determining how to ensure the full utilization of economic resources

As for the question of how to ensure the full utilization of relatively scarce economic resources, the price mechanism will answer that. If an economic recession occurs and the unemployment rate among workers increases, the contraction of job opportunities will drive workers to accept wage reductions in response to producers' pressure to lower production costs in their quest to maintain their market share. Wage pressures may arise from producers threatening to relocate production activities to semi-peripheral countries where wage levels are low, thereby exerting pressure on wage levels in core areas. This decrease in wages, coupled with the desire to maximize profits through cost reduction, will encourage producers to increase their hiring of workers. The decline in wages will lead to a reduction in costs, which in turn will allow for a decrease in the prices of the products they produce. This will stimulate consumers to increase their spending, thereby boosting the producers' turnover and profits. In the end, the employment rate of workers will rise, and society will reach a level of full employment of labor². The advocates of capitalism defended the principle of labor freedom as the guarantor of employment development and the direction of resources towards the most suitable and beneficial uses for society, that is, preserving limited resources and avoiding their use in the production of less popular goods. The principle of labor freedom requires the neutrality of the state and the removal of all government restrictions that undermine the competitive market, such as price controls, restrictions on entering specific industries, and all monopolies imposed by the government on the production and distribution of certain goods³.

2.3.7. Determining how to maintain productive capacity

Regarding the question of how to ensure the continuous increase in productive capacity to meet the diverse, unlimited, renewable, and simultaneously increasing needs, the price mechanism plays an important role in answering this question. As is well known, investment is the main factor determining productive capacity. To increase productive capacity in society, the volume of investment must rise; however, increasing investment requires a growing volume of savings. In the context of limited income (resources), increasing the level of savings requires individuals to sacrifice part of their

¹ John Cassidy, *op.cit.*, pp. 52, 53.

² *Ibid*, p. 61.

³ Salman Shaikh, *op.cit.*, p. 3.

current consumption to boost their savings (opportunity cost), driven by rising interest rates¹.

3. Socialist system

Indeed, several economic and social conditions contributed to the emergence of the socialist system, with the most significant being the deterioration of working conditions and the scarcity of job opportunities caused by the widespread introduction of machinery in production, which competed with labor and posed a threat to the capitalist system. Despite this, many capitalist countries adopted some principles of the socialist system to reform capitalism and overcome its shortcomings. In this section, the socialist system will be highlighted by addressing its most important aspects.

3.1. Definition of socialist system

The socialist system is defined as a system in which the government intervenes in economic activity directly, clearly, and continuously to achieve goals that it believes individuals are unable to accomplish and to mitigate the harmful effects resulting from intellectual property, monopolies, capital accumulation, and its concentration in the hands of a few individuals. This concentration enables them to exert influence over economic activity and make decisions that serve their private interests, regardless of the repercussions on the collective interest. This poses a threat to economic stability, increasing the economy's vulnerability and sensitivity to external shocks, which can lead to economic fluctuations and financial crises².

The socialist system is a socio-economic system based on public ownership of the means of production and economic resources in order to optimally meet the needs of society for goods and services, achieve justice and equality among members of society regarding economic opportunities, and put an end to all forms of exploitation and class division that prevailed in feudal and capitalist societies³.

Joseph Schumpeter defined socialism as the system in which the central authority of the state controls the means of production, or the system in which the economic affairs of society are transferred to the public sector⁴.

Among the practical definitions of socialism is that which defines socialism as a system in which every person in the community has an equal share of the various

¹ John Cassidy, op.cit., p. 56.

² Salman Shaikh, op.cit., p. 5.

³ Global Development Policy Center, Comparative Economic Systems: Capitalism and Socialism in the 21ST Century, An ECI Teaching Module on Social and Economic Issues, Global Development Policy Center, Boston University, 2021, pp. 5, 9, 10.

⁴ Mohamed Adel Zaki, op.cit., p. 96.

elements of production, distribution, and exchange of resources. Such a form of ownership is granted through a democratic system of governance. Socialism has also been demonstrated through a cooperative system in which each member of the society owns a share of communal resources¹.

3.2. Characteristics of the socialist system

The socialist system is characterized by:

3.2.1. Government intervention in economic activity

The socialist system is characterized by its reliance on government intervention in economic activity, as its presence is deemed necessary to influence and direct the behaviors and actions of individuals to achieve the public interest. Under the socialist system, individuals do not have the same degree of freedom as those in the capitalist system. Individuals do not possess complete freedom in work, production, consumption, contracting, or exchange. The state, through the central planning apparatus, determines the quantity and quality of the production of goods and services, as well as the timing and location of production. It also determines what each individual consumes in terms of goods and services. Additionally, the state employs individuals in jobs deemed suitable for them according to the public interest, through a periodic economic plan that sets the final goals to be achieved².

In their intervention in economic activity, socialists defined the functions that the state can perform under the following conditions:

- Correcting market failures.
- Removing price distortions when the price mechanism fails.
- Providing public services (security, defense, justice, etc.), economic information, education, training, and formation of individuals that the private sector fails to provide (private sector failure).
- Redistributing income to enable the needy and poor groups to consume.
- Regulating the distribution of wealth and income.
- Maintaining macroeconomic stability³.
- Improving economic efficiency.
- Establishing diplomatic relations⁴.

3.2.2. Public ownership

¹ CFI Team, Socialism, 2025, consulted on 27 June 2025, at <https://corporatefinanceinstitute.com/resources/economics/socialism/>

² James Gwartney & Richard Stroup, op.cit, p. 604.

³ Abdul Hadi Maqbul, Lectures on Political Economy, Tanta University Library, Egypt, 1997, pp. 437-445.

⁴ Al-Mursi Al-Sayed Hijazi, op.cit., pp. 38, 93.

The state's intervention in economic activity through public ownership has become one of the most important principles on which the socialist system is based. Achieving the goals of the central plan set by the state to reach economic objectives has made the ownership of the means of production essential. Through public ownership, the state can possess a significant proportion of the means of production, while private ownership diminishes and even disappears in some branches of economic activity. Due to its alignment with the objectives of public ownership and the purpose of state intervention, the socialist system does not prevent the establishment of cooperative ownership, where the means of production are owned by a group of individuals¹. Since the ownership of assets is shared rather than concentrated within a small group, wage labor may be less common in socialism, and economic decisions may be guided more by principles of equality and solidarity rather than by narrow self-interest and profit motives².

3.2.3. Central planning

The planning of the economic system is the essence of socialism, as proponents believe that the government, thanks to its wisdom, can address the central problems of the economy by making decisions, such as what to produce. What is the process of producing? When do you produce? For whom is it produced? Moreover, how much do we produce? Moreover, the distribution of investment and consumption is determined by the government. The central plan may include decisions related to the quantities of raw materials and inputs, prices and wages, localization of facilities and industries, and employment of the workforce³.

The socialist system relies on the central planning apparatus to achieve the public interest and address economic problems. This apparatus is a high-level central body responsible for determining the goals set by the state and the means necessary to achieve them at the lowest social cost by formulating a plan that specifies specific objectives (mandatory planning) and allocating resources accordingly. To achieve the goals, all state institutions are committed to following the methods specified in the plan within a specific timeframe⁴.

The philosophy of socialist economic planning is based on the firm belief in the importance of the state and its fundamental role in increasing the rate of economic

¹ Fatima Hafid, *Economic Reforms and the Issue of Economic Growth in the Maghreb Countries (Algeria, Tunisia, and Morocco)*, PhD Thesis in Economic Sciences, Hadj Lakhdar University, Batna, Algeria, 2010/2011, pp. 66, 67, 73, 74, 75.

² Abdelhafidhi Ibrahim, *The Role of the State in Addressing Poverty Resulting from Economic and Financial Crises "A Comparative Study between Western Thought and Islamic Thought,"* Journal of Economic Notebooks, Zian Achour University of Djelfa, Algeria, Volume 04, N° 01, 2013, p. 170.

³ Global Development Policy Center, *op.cit.*, p. 6.

⁴ Jamila Mouallem, *op.cit.*, p. 81.

growth and comprehensive economic development, thanks to its ownership of the means of production. The state counts and mobilizes material and human resources, directing them to the most efficient uses (rationalizing uses) to achieve the set goals that serve society¹.

Planning is the strategic tool used by socialist systems to achieve their goals and satisfy social needs, and therefore, these systems rely on an authority or body for central planning.

3.2.4. Public interest

Achieving the public interest is considered the highest goal that the socialist system seeks to achieve, as it is from this that the socialist system derives its legitimacy. The socialist system recognizes the need for state intervention to preserve society's resources and allocate them to serve the public interest, thereby producing the goods and services necessary for the majority of society's members, despite the low profit margins involved, which the private sector typically avoids. Therefore, the public interest is considered the primary driver for utilizing relatively scarce economic resources, instead of the private interest, which is driven by profit maximization in any way, even if it conflicts with the priorities of society². The economic activities carried out by the state to achieve public benefit or public interest are called public economic utilities, which are sometimes referred to as public projects³.

3.3. Addressing the economic problem in the socialist system

The socialist system adopts a different approach from the capitalist system in addressing the economic problem. In the following, we will highlight the approach adopted in socialist systems to address the economic problem⁴.

3.3.1. Determining the produced goods

In determining consumer goods, the plan in which the state intervenes in economic activity identifies the produced goods based on the estimation of current and future demand. The state's exclusive possession of statistics regarding the size of available economic resources allows planners to determine the volume of resource combinations needed to produce a quantity of goods and services that aligns with purchasing power (effective demand) and adequately meets the most urgent needs.

¹ James Gwartney & Richard Stroup, op.cit, p. 605.

² Al-Mamouri Amer Imran & Al-Tameh Haidar Hussein, The Intellectual Analysis of the Mechanism of Transformation in the Role of the State in Economic Systems, Al-Qadisiyah Journal for Administrative and Economic Sciences, University of Karbala, Iraq, Volume 11, N° 2, 2009, p. 156.

³ Mohamed Dweidar, op. cit., p. 331.

⁴ Ibid, p. 51.

Under the socialist system, the consumer is free but not sovereign, the consumer remains free to allocate their income between current spending and saving the remainder and free to consume what they want and when they want. However, this does not determine the priorities of the plan, as the state may not respond to those desires, and consumer priorities may not be included when setting production priorities¹.

3.3.2. Determining the method of production

The planning authority determines the production method and specifies how to utilize the relatively scarce community resources, thereby ensuring that production units are not left with the freedom to make this important decision. The planning authority directs the production units to the combinations of community resources they use according to the specified plan².

3.3.3. Distribution of production

The state's ownership of society's resources and means of production allows it to determine the prices of production factors and the volume of each resource used in the output. Consequently, the profit generated from the output is directed into the state's treasury instead of the capitalists' accounts in the capitalist system. Determining the mode of production in the socialist system automatically allows it to determine the pattern and distribution of national income in the plan³.

3.3.4. Determining how to ensure the full utilization of economic resources

The plan aims to achieve the full utilization of community resources and avoid the emergence of idle resources. The state's possession of devices capable of counting the size of the workforce and its growth rate, and thus forecasting its trends, allows for determining the optimal size of investments and their distribution, ensuring the employment of the workforce. The same applies to the market for goods and services, where the planning authority's possession of accurate information about purchasing power allows it to determine the size of production and investment to achieve a balance between supply and demand for goods and services⁴.

3.3.5. Determining how to maintain productive capacity

¹ Mohamed Dweidar, op. cit., p. 54.

² Tahir Hamdi Kanaan & Hazem Taysir Rahahleh, *The State and the Market Economy: Readings on Privatization Policies and Their Global and Arab Experiences*, 1st edition, Arab Center for Research and Policy Studies, Qatar, 2016, p. 43. 43.

³ Ali Hafiz Mansour, op.cit., p. 70.

⁴ Ibid, pp. 68-69.

To achieve an increase in production, the planning authority determines the distribution of societal resources between consumption and investment, as well as the distribution of investment between consumer goods and capital goods.

The central government, following a specific plan, makes decisions regarding production in terms of its quantity, timing, and distribution, which allows it to allocate resources to achieve that production. This process is referred to as planning¹.

The following figure illustrates the main differences between the capitalist system and the socialist system:

Table 2: The main differences between the capitalist system and the socialist system

	Capitalist system	Socialist system
Property rights	The ownership of non-human resources is private (for individuals or companies, for example).	Non-human resources are state-owned.
Labor	Workers operate for themselves or in private establishments.	The central authority or the public sector is responsible for employing workers.
Investment	The private sector, which aims to achieve profits and maximize future income, invests.	The government determines investment according to the goals it sets.
Distribution of goods and resources	The interaction of market forces determines the distribution of goods and resources.	The distribution of goods and resources is determined through central planning.
Income distribution	The distribution of income is determined by market forces that set the production reward and ownership of economic resources.	The distribution of income is determined by central planning agencies that may work towards achieving equality or other patterns of income distribution.

Source: James Gwartney and Richard Stroup, *Macroeconomics: Private and Public Choice*, translated by Abdel Fattah Abdel Rahman and Abdel Azim Mohamed, Dar Al-Mareekh Publishing, Saudi Arabia, 1988, p. 606.

¹ Ali Hafiz Mansour, op.cit., pp. 69-70.

Summary

Capitalist and socialist systems are significant economic frameworks in history, aiming to optimize well-being. However, deficiencies have led to reforms and integration to enhance welfare, growth, employment, and resource utilization. Scholars advocate for the Islamic economic system as a viable alternative, combining the strengths of both systems while mitigating their drawbacks.