

Economic Systems and Resource Allocation

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Every society faces the same three fundamental questions arising from scarcity. How a society chooses to answer them determines what kind of economic system it operates.

The Three Resource Allocation Questions

- **1. What to produce?** — Which goods and services should be made, and in what quantities? Producing more cars means fewer houses, hospitals, or schools.
- **2. How to produce?** — Which combination of factors should be used? Labour-intensive or capital-intensive methods? More automation or more workers?
- **3. For whom to produce?** — Who gets the goods and services that are produced? Should they go to those who can pay the most, those who need them most, or be distributed equally?

Different economic systems answer these questions differently, based on who owns the factors of production and what role the government plays.

Goods and Services

Before examining systems, two distinctions matter:

Goods vs services: Goods are tangible — they can be physically touched and stored (a car, a bag of rice). Services are intangible — they exist only at the moment of delivery and cannot be stored (a haircut, a medical consultation).

Producer goods vs consumer goods: Producer (capital) goods are used to make other goods (a tractor, a lathe). Consumer goods are purchased for direct use by households (food, clothing).

Direct vs indirect services: Direct services are consumed directly by a person (teaching, medical care). Indirect services support production but are not consumed directly (transport, banking).

The Four Economic Systems