Substitute goods essay

In economics, one kind of good (or service) is said to be a substitute good for another kind insofar as the two kinds of goods can be consumed or used in place of one another in at least some of their possible uses. Classic examples of substitute goods include margarine and butter, or petroleum and natural gas (used for heating or electricity). The fact that one good is substitutable for another has immediate economic consequences: insofar as one good can be substituted for another, the demand for the two kinds of good will be bound together by the fact that customers can trade off one good for the other if it becomes advantageous to do so.

Thus, an increase in price for one kind of good (ceteris paribus) will result in an increase in demand for its substitute goods, and a decrease in price (ceteris paribus, again) will result in a decrease in demand for its substitutes. Thus, economists can predict that a spike in the cost of wood will likely mean increased business for bricklayers, or that falling cellular phone rates will mean a fall-off in business for public pay phones.

It is important to note that when speaking about substitute goods we are speaking about two different kinds of goods; so the “ substitutability” of one good for another is always a matter of degree. One good is a perfect substitute for another only if it can be used in exactly the same way, at exactly the same cost, and with exactly the same quality of outcome; that is, when there is no particular incentive for a customer to prefer one over the other.

Needless to say, there are relatively few perfect substitutes except between two goods of the same kind. Much more common is for goods to be imperfect substitutes for one another. Compact discs and cassettes, for example, can both be used for the same purpose (as media for recording and replaying sound), but there are significant differences between the two in terms of durability, sound quality, and the cost of the recording media and the equipment used to record on it.

As a result the two can be substituted for one another, but there are significant trade-offs involved in deciding to substitute one for the other: if you buy a tape instead of a CD, you may pay less, but you will get lower sound quality and a less durable good; if you buy a CD instead of a tape, you may get better sound quality but you will pay more and you may not be able to listen to the CD in your car. Nevertheless, CDs and cassettes are substitute goods (though only imperfectly): and so if changes in the market tend to erode the advantages f choosing cassettes over CDs (such as a decrease in CD prices or increased availability of car CD players) it will tend to increase the demand for CDs and decrease the demand for cassettes. The opposite of a substitute good is a complement good. In other words, good substitution is an economic concept where two goods are of comparable value. Car brands are an example. While someone could argue that Ford trucks are much different from Toyota trucks, If the price of Ford trucks goes up enough, some people will buy Toyota trucks instead.