**The Equilibrium Price**

We know from **previous** lessons that the demand curve and the supply curve show how buyers and sellers **respectively** respond to changes in the price of a good. In this lesson, we'll **show you** how the **interactions** of buyers and sellers **determine** the price.

Let's start with **the punch line**. **The equilibrium price** ***is the price where the quantity demanded is equal to the quantity supplied***, right here and this is the **equilibrium quantity**. Why is this **the** **equilibrium price**? At any other price, **forces** are put into play that will push the price **towards** the equilibrium price. It's kind of like a ball in a bowl where the ball always returns to one **stable position**.

***The equilibrium price is the only place where the price is stable.*** To see why, the first thing to understand is that buyers don't **compete** **against** sellers. Buyers compete against other buyers. A buyer **obtains** goods by **bidding** higher than other buyers. And sellers compete against other sellers by **offering** to sell at lower prices.

Think about it. Atan **auction**, the buyer with the **highest** bid gets the **item** and the seller with the lowest price makes the sale. So let's say the price of oil is currently $50 a barrel, that's **above** the equilibrium price of $30 a barrel. At $50, the quantity supplied is more than the quantity demanded. So we say there is a **surplus**, so what happens? It's sale time! When there's a surplus, sellers can't sell **as much as** they would like to at the going price so sellers have an **incentive** to lower their price **a little bit** so they could out compete other sellers and sell more. The price will continue to fall until the quantity demanded is equal to the quantity supplied and equilibrium is reached.

Now let's say the price is less than the equilibrium price, say $15 a barrel. At $15 a barrel, the quantity demanded **exceeds** the quantity supplied, a **shortage**. And what happens now? When there's a **shortage**, buyers can't get as much of the good as they want at the going price so they compete to buy more by **bidding up** the price.

Now since buyers are easy to find, sellers also have an incentive to **raise** the price. The price will **continue** to rise until quantity demanded is equal to the quantity supplied and equilibrium is **reached**. At any price other than the equilibrium price, the incentives of the buyers and sellers **push** the price **towards** the equilibrium price. Only the equilibrium price is stable.

Now let's take a deeper look at the market equilibrium and some of it's **properties**. **Remember** that there are many different users of oil and many different uses for oil each with **substitutes**, **alternatives** and **values**. At any **specific** price of oil there's a group of buyers who value oil enough to demand it at that price. And as the price changes, so do the buyers and their users.

On the supply side at **each** price on the supply curve, we're looking at a group of suppliers who's cost of **extraction** is low enough to be **profitable** at that price. At the equilibrium price, these higher value groups are the buyers and these lower value groups are the **non-buyers**. Also known as that every seller has lower cost than any of the **non-sellers**.

Since the buyers with the highest values buy and the sellers with the **lowest** cost sell, the gain from **trade**, the **difference** between the value a good creates and its cost is **maximized**. **In addition**, at the equilibrium quantity, every trade that can **generate** value does generate value up until the **very last trade** where the value to buyers is just equal to the cost to sellers.

In a **free market**, there are no **unexploited** **gains** from trade and there are no **wasteful** trades. If the quantity **exchanged** were greater than equilibrium quantity for example, we would be **drilling** deep and expensive oil wells just to produce more rubber duckies and that would be wasteful.

In a free market, buyers and sellers acting in their own **self interest** end up at a price and quantity that **allocates** oil to the highest value buyers produced by the lowest cost sellers in a way that maximizes the gains from trade, the sum of the benefits to buyers and sellers. This is one of the reasons Adam Smith said ***that the market process works like an invisible hand to promote the social good.*** If you want to test yourself, click Practice Questions or if you're ready to move on, just click Next Video.

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