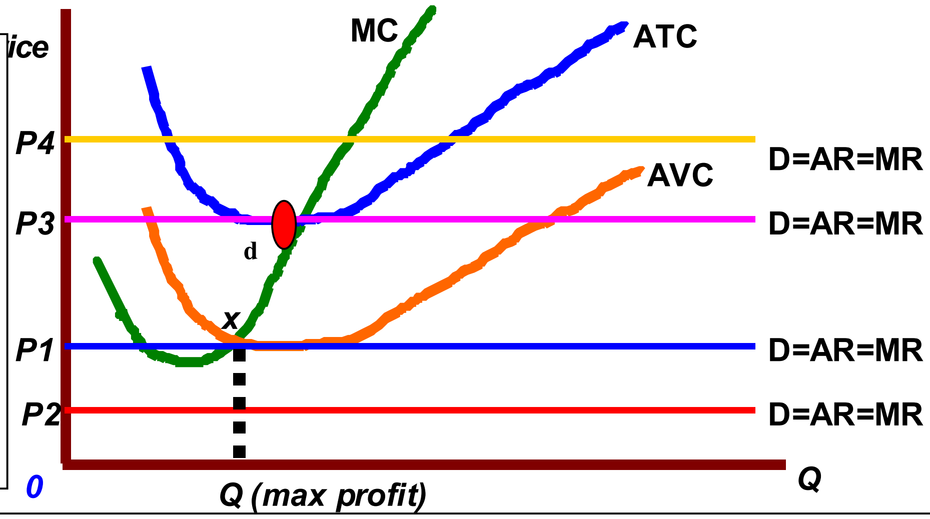
Webnote 1595 Syllabus: Item 55

Syllabus Reference 2.2: Shut Down Point of a PC Firm (HL)[1]

Diagram A. Shut Down Point of a Firm in Perfect Competition occurs at MR=MC=AVC

X = "shut down"

d = break even point



Shut Down Point for a firm in Perfect Competition

1. Shut-down occurs where P is lower than where **mr = mc = avc (see X in diagram)**. This would be any price lower than p1. If the firm does not cover its variable costs of production it will close down in the short run- see p 23 on diagram A

2. Shut downs occur most frequently in primary producing industries. Note that it may only be a temporary shut down.

3. It can afford not to cover its fixed costs in the short run only. The firm must at all times cover its variable costs.

4. a consequence of this is the conclusion that the supply curve of the firm is that part of the MC that lies above the AVC. **MC > AVC** = Supply curve of the firm

5. p 3 represents normal profit. **Ar = Ac**

6. P4 represents s/n profits. **Ar > Ac**

Exam Link:
IB HL 2 November 2007:
Q2 With the help of a diagram, explain when a firm should shut down in the short run.

[1] See Glanville pp121 to 129. See also Webnotes 213 and 214. Make cross references where possible.