

CONSIDERATIONS REGARDING PRICE IN OLIGOPOLISTIC STRUCTURED MARKETS

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Abstract: *Economists report price rigidity in markets with oligopolistic structures, while explaining the phenomenon. If an oligopolistic firm raises prices, other prices will remain stable in oligopolistic firms, so we will see a significant decrease in sales volume in the firm which increased prices. To avoid this situation an oligopolistic company will not initiate price increases. If oligopolistic firms lower prices, other oligopolistic firms will reduce prices promptly and the result will be that of lower volume of sales - will sell the same physical volume of goods but at a lower price. To avoid this situation, the company will not initiate oligopolistic price decreases.*

Key words: *oligopolistic market, price rigidity, oligopolistic interdependence, collusion.*

1. Price rigidity in markets with oligopolistic structures

Oligopolistic structure has been the subject of numerous investigations. *Cournot, Bertrand, Galbraith, Nicholson* are just some of the economists who have studied this topic. Oligopolistic market structure has a number of features that customize the market in relation to other structures. Thus, on the market, sellers are only a few large companies, their products are relatively homogeneous. Market entry is difficult, because of relatively high costs, to large firms and, unlike other market structures, the interdependence of oligopolistic firms is significant, their behavior being a strategic one. Oligopolistic firm's strategic behavior means that each action is considered in terms of its impact on other oligopolistic firms and their reactions, because of the strong interdependence between the

companies on the market. Strategic behavior involves two important consequences. The first is that profit-maximizing decisions of oligopolistic firms is not based on clearly defined rules, but on how it believes that other firms will act in response to these actions. The second is that the results of these decisions will depend on how other companies will act in response to these actions.

2. The general theory of price determination

In specialist literature [1] we have found the general theory of oligopolistic market price determination, starting from the premise that there are some companies that produce a single homogeneous product, the market being perfectly competitive in terms of demand. Four possible models have been proposed.

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a. A quasi-competitive model: the price is accepted as required, fixed. This model is similar to perfect competition in which each firm accepts the price as being given. Each firm believes, probably incorrectly, that its decisions do not affect market price. Since on the Oligopolistic market there is only a small number of firms, their assumption will determine the competitive price formation.

b. Collusive model: firms may conclude agreements on pricing. An alternative to the first model is the case in which a group of companies believe they can influence market prices and coordinate their decisions so as to obtain monopoly profits. Since their coordinated plan requires achieving a certain level of profit for all firms, the plan will establish how the expected monopoly profit will be split (should be as high as possible). This model has three shortcomings. First, most agreements are illegal. Second, this model requires the acquisition by the parties to the agreement of information on demand and marginal cost of each firm, and some of them may be reluctant to provide them. Thirdly, the most important danger is lurking instability. If oligopoly managers lack the ability to control this risk, the cartel will collapse.

c. Cournot model: each firm believes that its decisions influence the price. French economist Augustin Cournot formal analysis conducted in 1838 regarding duopolist behavior has shown that this strategy can lead to obtaining a higher profit to that of a cartel.

d. The conjectural variations model: the profit of a firm responds to changes in the profit of other firms. On oligopolistic markets (highly concentrated markets, such as automobiles, computers, energy), obviously, every company is thinking how others will respond to their decisions. Economics problem was how to express the strategic decisions in a short analytical model. Such is the game theory [1] model

that was developed since 1920. Basics of game theory were introduced in the work of *John von Neumann* and *Oscar Morgenstern*, *The Theory of Games and Economic Behavior*, published in 1944. They have defined the game as *any interaction between various agents, governed by a set of specific rules that determine the possible moves of each participant and earnings for each combination of moves*. This description can be applied to almost any social phenomenon. Thus, people realize that their actions result depends not only on how we shape them, but also the actions of other participants. From the simplest to the most complicated decisions, the decisions ranging from private and public, they can be scientifically analyzed using game theory. Thus, game theory has found many applications in social sciences, including economics. Game theory uses three fundamental assumptions: players behave rationally, everyone knows that others are rational, all players know the rules. To understand a game, it is necessary to know the rules, as to find out which actions are allowed (possible) at some point. Then, you need to know how the players choose an action from the set of possible actions. [2]

In economic terms, a game is actually a competition where each firm tries to maximize profit, but it depends on the reaction of other firms. In a market where there are only a few companies, competition has a strategic character. The game is an activity that takes place after explicit or implicit rules and to obtain the desired results, players need more strategy, that is action plans designed as reactions to other players actions. Games can be zero-sum and positive-sum. The zero-sum describes situations in which players have opposite interests, so that a player gains are the others losses. Positive-sum games are more suited to reality, since both players can win at the same time. They can be

based on cooperation or no cooperation. Cooperation can be achieved by the end of tacit or explicit arrangements, followed voluntarily or by coercion. Constraint may take the form of lighter, such as threat, or hard, such as applying rules, *An Eye for an eye, tooth for tooth and If caught Cheating – you are Removed*. Using these methods we determine that the temptation to cheat is minimal and long-term results of simultaneous or infinite to be maximal. [3]

In a oligopolistic market, each firm must be concerned with how his behavior and decisions affect the market price competition. The study of these issues has led economists to develop a model case of the conjectural variation model that is the price leader (price leadership). This model is based on the assumption that the market is composed of a price leader, a company that sets the product price in that market, and other quasi-marginal competitors. This model explains very difficult how the price leader is chosen and what happens when a company decides to change the price to overcome the leader and occupy the first position. It raises two important questions about the nature of oligopolistic equilibrium. On the one hand, which is the relationship between the total number of firms and final balance? In general, it is considered that if the number of firms increases, equilibrium oligopolistic competitive solution approaches. On the other hand, how the equilibrium price changes from one period to another? In general, the analysis of oligopoly is confined to a single period so that companies can not obtain information about rivals' reactions and use them in future periods. [4]

3. Oligopolistic behavior analysis

Going through the abovementioned models we can formulate some conclusions about the behavior of economic agents on the oligopolistic market. Economic agents may conclude

agreements, express or implied, regarding the price to be practiced on the market. The express ones face difficulties regarding the execution, masking and compliance with them permanently being in danger of not being respected. The tacit or implicit ones call for coordination of price without „conspiracy” in the classic sense of the term, without communicating or committing other detectable acts. This phenomenon has been called, conscious parallelism, and for the special case of oligopoly phenomenon known in economics as the „oligopolistic interdependence” or „tacit collusion”. [5]

Explicit price fixing agreements are prohibited by antitrust laws and in trials with this object is trying to answer the question whether or not the parties concluded an agreement courts requiring this evidence (such as the practice of uniform prices consistently or written evidence regarding the agreement, meetings, consultations). If no such evidence can be brought forward, the agreements are beyond the scope of antitrust law and this solution is somewhat, natural if we consider that judges and lawyers are not at all familiar with the economic theory on pricing. This approach to issues of anti-competitive agreements or antitrust policy has brought damages to the effectiveness of antitrust policy in the world, distorting the efforts of the competition supervisors. Most often sanctioned were price-fixing attempts, since the actual uniformisation of price could not be proven by magistrates.

Resources were wasted for small cases, major cases remain undiscovered or unproven. Increasingly more, courts and enforcement authorities use economic instruments to identify market segments that are prone to price fixing - those market segments where research can be successful - and to highlight the fact that the price practice is significantly higher than a competitive one.

The case of the oligopolistic market structure raises the question whether the practice should be treated as a uniform price tacit understanding (and therefore punished) or be treated as dictated by oligopolistic market structure and not the choice of companies (and therefore should not be punished). In economic theory there is talk about the oligopolistic interdependence as follows. In a market with many sellers with equal power, the individual seller is too small to influence market prices. He will sell at market prices and not higher than this. He will be able to drop the price and by this action bring additional customers (a small fraction of the total), but will not substantially increase supply. He should not worry how others sellers will react. The fewer companies, the higher the market share held by them and the initiative to decrease price is less in competition. In an oligopolistic system, anyone of the large firms in that market will be able to set a lower price than tacitly agreed between them. This will lead to a general loss of control over price. All companies know this danger and do not condone such behavior and there, is a tacit agreement to respect the fixed price, almost perfectly respected. Price decline is considered a hostile action. The company that lowers the price itself may suffer losses, so that the tacit agreement will be respected by everyone in the legal conditions and appearance of honesty. It is a remarkable example of the ability to identify and meet community interests when it comes to money, the famous economist **J. K. Galbraith** observed. [6]

In an Oligopolistic market, where there are few major vendors, if one of them reduces the price, this measure leads to a substantial increase in its sales and corresponding decrease in sales of others. Anticipating a prompt response from rivals, which will eliminate the advantage by reducing in turn the price, the seller

concentrated market will not take the initiative to reduce the price as in a atomized market. Those in favor of oligopolism live in an interdependence in fixing the price, they rely on the opponent's reaction and, consequently, they will avoid rigorous competition in prices.

Donald Turner, in an article published in 1962, wonders whether this interdependence should be seen as a price fixing agreement in violation of antitrust law. [7] Oligopolistic price can be described as an individual rational decision in the light of economic facts. Turner argues that there is no adequate legal sanctions applicable to oligopolistic interdependence. Thus, a sanction prohibiting each defendant to take into account the likely price reduction by competitors, it requires irrational behavior, which is impossible. Then, even if the ban should be stated to be effective, should require defendants to reduce prices to limit production costs (cost plus profit), which would put the court in a position to regulate prices, a thing which is not competent to do. Also, monitoring and enforcing price (public regulation) through government structures (agencies, government) resort is used less globally. Regarding a sanction to liquidate these companies, meaning their disappearance from the market, Turner mentioned it as a structural remedy for a bad behavior problem. Turner identified a possible remedy: division of oligopolistic firms in small companies.

It seems that Turner's analysis is almost flawless, yet it brings some criticism from antitrust literature. [5] It says that the theory exaggerates the impact of price reduction in an oligopolistic structure, as assumed that the response to this reduction will be immediate. This is not true, since in reality time is running out, a longer or shorter period, in which the company that has reduced the price makes a substantial

profit. This time lag can be amplified in the presence of factors such as: the ability to mask price reduction or other sellers unable to rapidly expand production to meet increased demand at a lower price. Reduce the price impact can still be mitigated in some cases (only some of the competitors will move customers to the company that has reduced the price, the price reduction was operated only for a segment of its production, competitors believe that the company will increase the price very soon) and then wears off and the response to this reduction of the market. Only a great price reduction can produce dramatic effects under oligopoly. If rivals will lose a lot of sales, they will want to counter this loss by increasing production.

Economic research has shown that any concentrated market, in which the price is equal to the cost (price competitive or equilibrium), tends to concentrate even more. One of the companies will increase prices above the competitive one and the others will do the same thing because they realise that they would earn more by charging the price (according to the prediction of the initial company price increase). On the oligopolistic market, once reached equilibrium, the decision to raise prices is avoided because it will lead to lower sales volume. Another aspect would be that, where a company decides to increase the price, one company could increase prices more slowly than the other, trying to profit at the expense of other (attracting a greater number of customers). Thus, it seems that every competitor is forbid to practice price leadership, knowing that others will be tempted to obtain short-term profit at its expense, delaying the price increase.

Regarding the choice of a company to reduce the price it will bring additional profit - by increasing the number of clients - the time needed for other companies will also reduce the price. Losing customers, competitors will also reduce the price so

that all firms on a long-term will register losses because they will be forced to sell more to make the same profits. Hence the reluctance of oligopolists in terms of price reduction. However, such behavior can not be excluded. Do not forget that lower prices mean more customers, increasing the quantity sold and therefore the need for enhanced supply, production, sales.

George Stigler [8] has developed an alternative approach to oligopoly, where the oligopoly price deal as a special case of price collusion. The rational decision of a firm to enter into an agreement, tacit or express, is taken after a careful cost analysis - income. Examining the factors that influence these costs and revenues we can identify those market structures that promote collusion and require very little communication. If we identify, the economical symptoms of collusion we can solve the problem and/or prevent it.

4. Factors that predispose to collusion

According to Stigler's theory, economic analysis of collusion must go through two stages: (1) identify those markets where conditions are conducive to collusion and (2) determine whether those markets are or not really practicing a collusive price. We make a further analysis of the factors that create conditions favorable conclusion cartel.

A.1. Concentration of a market. For quantification we use indicators such as market share held by major firms in number of 4 or 8 or the Herfindahl - Hirschman Index (HHI). Whatever indicator we use, the literature does not indicate a threshold above which the collusive price can become attractive. The views of economists are not converging in terms of a concentration threshold above which it becomes dangerous, some say we should worry about when the four major companies together have 70-80% of the market, while others argue that the

threshold of 45% is already dangerous. [9]

A.2. Lack of small sellers. If four companies hold 80% of the market, not whether the remaining 20% is owned by 2 or 10 companies. Price coordination between firms is easier between 6 than 14 companies. The Market share permanently unoccupied is in the cartel's people attention.

A.3. Inelastic demand at competitive prices. If on the relevant market of a product, it is not easily substitutable at the current price charged, we have evidence that the demand for that product is inelastic. And if demand is inelastic at current market price when the price increases to the cartel prices it becomes very attractive - the total profit increases while costs decrease as production drops (the cartel acts as a monopolist).

A.4. Market entry is difficult. We must take into account the specific sector or branch. Barriers that make entry may be required by law, such as permits, capital, dues or high taxes or may be determined by specific activity, namely the high cost that it involves the organization of work (purchase of machinery, equipment, installations, raw materials, labor cost, long lead times necessary to organize work).

A.5. The possibility to purchase the remaining part of an unconcentrated market. We have already shown that the market segment which is concentrated is always in the attention of large companies, encouraging collusion.

A.6. Standard products. The less the production is standardized, meaning that production is small series, they are unique or customized products, the price-fixing cartels will be harder to accomplish. These products are not favorable to market collusion. Per a contrario the high degree of standardization promotes agreements.

A.7. Durable products. If, for example, a farmer buys a drill, whose operation is

guaranteed 10 years, he ensures the production of 10 future crops, while a vendor selling sowers will lose 10 sales. Lost profits creates the temptation to cheat, the favorable conclusion being that of agreements on price. On the opposite side there is a market for short-lived, including perishable products.

A.8. Uniform prices. If this producer practices the same price in relation to all en-gross seller there is a likelihood for them to conclude agreements on the low retail price regarding that they have different costs. The imposition and enforcement is difficult and that agreement is not effective.

A.9. The difficulty of price competition. It is the most important form of competition. Price reduction is a safe method to attract customers, the more attractive it is if the product life is short. They Seller may increase the cost of other forms of competition (advertising, quality, security, presentation) even at the cost of the entire profit erosion, and after he reached and grabbed for the desired market segment, it will raise prices above competitive.

A.10. The large share of fixed costs. [10] In a market where fixed costs have a large share in the total cost, competition can easily lead to bankruptcy. Fixed costs, by definition, can not be adjusted to any decline in demand, so a company with high fixed costs is vulnerable to any economic change as it is forced to reduce production or reduce prices, because revenues will be reduced much faster than costs. The company, taking into account this will be inclined to charge higher prices than the competitive price.

A.11. Cost structure and similar production processes. The companies are more like in terms of production and cost structure, the easier will be the conclusion of agreements on price. Cartel price will be based on costs that companies and firms

with different cost structures and manufacturing will hardly form a cartel.

A.12. Demand is constant or decreases over time. Agreements are more difficult to achieve in a market where demand increases over time, only one in which demand is constant or even registers a decrease. A firm outside the cartel constituted on a market where demand is falling or constant will not suffer because they lose customers, but because it fails to attract new ones and keep pace with the rapid growth of competitors. If demand decreases and fixed costs are high, entry is not attractive, resulting in a favorable situation of collusion.

A.13. Prices may change quickly. If a company reduces the price of his product, how quickly competitor may also reduce the price, the less profitable will be the reduction in price. But the price decline implies a prior analysis of efficiency which may delay the response. The more difficult the change of the price, the greater will be the time in which to profit from the discount.

A.14. Auctions. To avoid corruption, public institutions contract services and works through auctions. Agreements on price can be detected if identical offers are made or if a bid price is very low compared to that provided by other offers.

A.15. A local market. The smaller the market the more favorable it is with both concentration and collusion. The fewer the sellers, they will communicate much more easily, no need for written agreements that can be used as evidence in court. Commitments made by firms in the local market will be respected, because violation would bring a bad reputation.

A.16. The existence of cooperative practices. The degree to which firms cooperate (exchange information on costs, prices) in the forms permitted by antitrust laws, differs from one industry to another. The closer relations between firms, the

smaller transaction costs of collusion are and appear more likely.

After we established during the first phase if the market is favorable or not for collusion, we need to seek economic evidence with which to demonstrate the actual price collusion. We can several pieces of evidence.

B.1. Allocation of market segments. If large firms have equal market segments maintained for a long time this is proof that they have divided the market by allocating geographical areas or by allocating sales quotas, thus eliminating competition between them. In terms of competing companies which are fighting each other for customers and sales the market segments held vary.

B.2. Price discrimination. Price discrimination practices means the sale of identical products to different customers at different prices, even if it generates the same cost. Price discrimination becomes an attractive strategy to increase profits. A systematic discrimination is evidence of monopoly or cartel because some consumers pay more than the cost of products, unlike a competitive market.

B.3. Exchange of information on the price. Markets with many sellers exchange information on prices to contribute to a better base for them, avoiding losses due to lack of information, which therefore is favorable to competition and consumers. Markets with few sellers have an ignorance issue price which is less serious and therefore the exchange of information on prices can be considered a step towards cartelization.

B.4. Regional variations in price. It is possible that a product be sold in different geographic markets at different prices through different costs. Most price-fixing agreements are regional or local rather than national, because sellers are fewer and there are smaller markets.

B.5. Rigged auctions. Aspects of the auctions have already been analyzed.

B.6. Price, production and production capacity change with cartel formation.

Successful formation of a cartel is usually followed by higher prices and reduced production, unexplained reduction in production costs. This is proof that a strategy was applied to price fixing, while changes in the opposite direction shows that the agreement was ruined. Another proof would be creating excess production capacity, unexplained by changes in demand or mismanagement. The existence of excess capacity demonstrates an unstable cartel in which cartel members fear that it will break up and maintain production capacity even though their production has decreased. If we have a stable cartel, production capacity will be reduced in proportion to reduced production.

B.7. Resale price maintenance in the entire industry may be evidence of cartelization.

B.8. Diminishing market segments held by major companies. Practicing price monopoly (cartel) attract new competitors tend to monopoly profits. Major companies that market will have two options: either to reduce prices to discourage new firms to enter the market to maintain prices and to accept the gradual reduction of market share held by them. The first alternative is contrary to the cartel and the colluders will give hardly the monopoly profit, so they usually take the latter. Thus, a long-term decline of major companies on the market can be a symptom of collusion, but of course the analysis must not stop here.

B.9. Amplitude and fluctuation of price changes are relatively small. A monopoly and a cartel reacts more slowly to changes in costs and demand than the small vendors in a competitive market due to difficulties in negotiations.

B.10. Elasticity of demand. It examines the evolution of this coefficient.

B.11. Profit level. We cannot on the basis of statistical analysis of profit levels. A large profit may result from cartelisation, as it can be the result of senior management and a low profit or no profit can be the result of mismanagement, as well the result of a cartel profit.

B.12. The market price inversely proportional to the number of firms or elasticity of demand. The market is more concentrated and inelastic demand, the price will be higher (compared with competitive price). But this evidence must be received with caution and correlated with each other, as, for example, price increases may be due to increased production costs leading to market exit of less efficient firms and thus to market concentration.

B.13. Price basis points. This is a system in which vendors added to the selling price and the price of delivery - price includes transportation to the buyer - but does not calculate the price of transport from the factory, but from a point called the basic point. Thus, if the buyer is closer to point basis than factory price plus the cost of delivery will be lower than actual. If the buyer is closer to plant than basis points plus the cost of delivery price will be higher than real, what is called cashing seller „shadow transport". This practice can be used to draw customers closer and easily collect additional profits. It may conclude an agreement, tacit or express, in this respect.

B.14. Exclusive practices. Granting privileges to certain customers is an indication of collusion.

5. Conclusion

We can not say that there is difficulty in interpreting economic evidence on collusion, but they are not insurmountable. Evidence plays an important role in

antitrust and evaluation processes. It would be improved if lawyers and judges would better understand economic phenomena. If the economic evidence presented in cases indicates that there was an understanding, there is no legal reason to insist on presenting new evidence showing if it was a tacit or explicit understanding, especially since legal presumptions are evidence. The fact that there was a communication between the parties or have made a proper scheme of price fixing is the only economist and not a sacred detail.

There is no doubt about the tacit understanding of consideration as a form of anticompetitive practices, evidence that they are prohibited by antitrust laws, including Romanian. The problem is that oligopolistic firms increase prices, but that they will be motivated to grow more than justify the costs. If all firms apply the same pattern of growth is clear that it is a tacit understanding with which the supervisory authorities of competition and justice should not be lenient.

So in a sense the alleged tacit understandings can be responses to externalities such as rising raw material costs, and this behavior cannot bring any reproach. But if companies adopt the same pattern of declining production and increasing prices above the competitive, there may be complaints that they have a tacit understanding. Recall the purpose of this analysis: to try to find answers to the question if oligopolistic structure, the practice of uniform prices to be treated as a tacit understanding and therefore should be punished or treated as dictated by oligopolistic market structure and therefore should not be sanctioned. We recall the argument of Turner: the assumption that firms' oligopolistic behavior would not be a strategic one, they would be irrational. Overseeing competition authorities and courts could choose an answer enshrined in the economic theory of oligopolistic

interdependence, but could pay attention to **Professor R. Posner** opinion establishing a rebuttable presumption of collusion to oligopolistic market structure: oligopoly is necessary and sufficient condition to tacit collusion. [5] In this last aspect all evidence must be considered, including whether or not the price is a over competitive one.

The remedies provided for such actions is awarding damages, with which the injured could be compensated and the prohibition by law of tacit agreements. Fear of being condemned to pay damages could lead to oligopolistic companies to think twice before giving up business, relying on competition to reduce price reaction. [5] If tacit agreements are prohibited by law, as is the case with the Romanian legislation, fear of punishment would be a reason not to practice over competitive prices. Oligopolistic companies are irrational if they ignore this threat.

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3. Nicholson, W.: *Pricing in Imperfectly Competitive Markets, in Microeconomic Theory*. Basic Principles and Extensions, The Dryden Press, Chicago, 1989.
4. Posner, R.: *Antitrust Law*. Second Edition, The University of Chicago Press, Chicago and London, 2001.
5. Turner, D.: *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*. in Harvard Law Review No. 75, 1962.

Notes

- [1] Nicholson, W.: *op. cit.* Chapter 20 Strategy and Game Theory, pp. 559-590, 591-611.
- [2] Contributions to the explanation and development of game theory have been rewarded over time by awarding the Nobel Prize for Economics. Thus, John Forbes Nash, a professor at Princeton University in New Jersey, was awarded in 1994 with the award for fundamental analysis of non-cooperative equilibrium in games, and Robert J. Aumann, a member of the National Academy of Sciences of the States United, and Thomas C. Schelling, professor at the University of Maryland, received the 2005 Nobel Prize in Economics for their contribution to the development of game theory.
- [3] Typically, in economic theory distinguishes between short and long term without defining it precisely. However, there is a criterion of demarcation. Thus, short-term trader has limited flexibility in its actions, while the long term he enjoys more freedom.
- [4] Friedman, J. W.: *op. cit.* Chapter 11: Oligopoly Theory, pp. 491-534.
- [5] Posner, R.: *op. cit.* pp. 57-60, 96, 99. Professor distinguish between explicit or explicit collusion, or express agreement fixing the price on the market, specific cartels and tacit collusion, that tacit agreement fixing prices such as those that occur between oligopolistic firms.
- [6] Galbraith, J. K.: *op. cit.* p. 153.
- [7] Turner, D.: *op. cit.* p. 655, Turner graduated from Yale Law School and obtained his doctorate in economics at Harvard. He taught at Harvard and led the Antitrust Division of the Department of Justice in the '60s. He was in the '50s and '70s antitrust, the first who made an economic analysis of antitrust law.
- [8] Stigler, G.: *A Theory of Oligopoly, in The Organization of Industry*, 1968, p. 39, quoted in R. Posner *Antitrust Law*. Second Edition, op., pp. 60-61, Stigler G. received the Nobel Prize for Economics in 1982 for his studies on the functioning and market structure.
- [9] Romania Competition Council identified in 2009, seven sectors with low degree of competition in the Romanian economy: banking, retail trade, concessions, energy, pharmaceutical industry, the liberal professions and taxi. See, in this sense, the Competition Council. Academic Society in Romania. Single Market, National Market: competition policy in key sectors. 2009 <http://www.consiliulconcurentei.ro/documente/Raport>.
- [10] Fixed costs (rent paid for production facilities, insurance, banking, maintenance and repairs, depreciation, fuel and electricity, transport hire and other services provided by third parties, such as security services, sanitation, recruitment, training, consulting, for example) are those costs that remain unchanged for a certain period of time, regardless of production and variable costs (wages, for example) are those costs which develops in proportion to volume production. While variable costs are highly flexible in that it easily adapts to the level of production (resources are purchased as needed), fixed costs are not so easily adapted to reflect the resource needs. However, the higher production volume increases, which is fixed cost per unit decreases.