

Institutional analysis, allocation of liabilities and third-party enforcement via courts: The case of the *Prestige* oil spill



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ABSTRACT

Coase, 1960 [13] constituted a starting point to the New Institutional Economics and the new Law and Economics. In the new institutional approach, institutional rules and enforcement-mechanisms are considered as key elements to internalise spillover effects in a society with high transaction costs. This paper reviews the case of the *Prestige* oil spill and performs an institutional analysis on the implementation of rules and the assignment of responsibilities by the courts of justice from the new institutional approach. In November 2003, the sinking of the oil tanker *Prestige* off the coast of Galicia (Spain) provoked an oil spill that resulted in one of the worst maritime disasters of the 21st century. The ex-post assignment of responsibilities for the disaster was characterised by errors in the technical inspections of the oil tanker, the inadequate prevailing rules and the inability of the courts of justice to determine responsibilities, which gave rise to an imperfect institutional solution. In this case, the polluter did not have to pay in accordance with the high level of pollution. In particular, the Spanish justice system acquitted the accused from committing an environmental crime, and in the absence of a crime, there were no civil liabilities for the damage caused by the oil spill.

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1. Introduction

The major ecological disasters caused by oil spills began when the tanker *Torrey Canyon* ran aground on the south west coast of the UK in 1967. Other black tides caused by oil tankers are shown in Table 1 [28]. Oil and chemical spills have been present on the north west coast of the Iberian peninsula, and more specifically in the region of Galicia (Spain), as evidenced by the cases of the vessels *Polycommander* (1970), *Erkowith* (1970), *Urquiola* (1976), *Andros Patria* (1979), *Cason* (1987) and *Aegean Sea* (1992).

On 13th November 2002, the *Prestige*, a ship carrying 76,972 tonnes of heavy fuel oil, made a distress call. In the following days, the Spanish coastal services were unable to prevent the ship from breaking into two, which produced an intense black tide that affected the coasts of Spain, France and Portugal. It has been estimated that the *Prestige* oil spill affected 2980 km of coastline, polluted 1137 beaches, impregnated 450,000 square meters of rocky surface with fuel, caused an estimated mortality of more than 115,000 sea birds and upset all marine ecosystems in the area [47]. The Galician coast was the area most heavily hit.

The *Prestige* oil spill was a disaster with major environmental consequences and economic losses. The process of implementation of rules and allocation of responsibilities by the courts of justice was slow, complex and imperfect. In this process, the two main court sentences for the allocation of responsibilities were acquittals. In August 2012 the US courts definitively dismissed the claim of the Spanish State against the classification society of the vessel. In November 2013, the Spanish courts of justice passed a sentence on the case, in which none of the accused were found guilty of environmental crime or civil liability, and as a result of which no one was held responsible for the damage caused by the sinking of the ship, which the Spanish public prosecutor estimated to be €4328 million for Spain.

This paper reviews the *Prestige* case and provides an institutional analysis performed from the approach of the New Institutional Economics, on the allocation of responsibilities from the main court rulings [50,33]. Section 2 explains the theoretical basis, which is based on Coase [13], and shows the importance of institutions and legal norms in the resolution of externalities. Section 3 presents the case of the *Prestige* oil spill, provides the characteristics of the vessel, its path and sinking, and the resultant black tide. Section 4 discusses the application of rules, the judicial proceedings and the principal court sentences. Section 5 addresses several institutional aspects of the case and Sections 6 presents a brief conclusion.

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Table 1

Major Oil Spills since 1967.

Source: ITOPF. Oil tanker spill statistics 2013 (the quantities have been rounded to nearest thousand).

Position	Shipname	Year	Location	Spill size (tonnes)
1	Atlantic Empress	1979	Off Tobago, West Indies	287,000
2	ABT Sumner	1991	700 nautical miles off Angola	260,000
3	Castillo de Bellver	1983	Off Saldanha Bay, South Africa	252,000
4	Amoco Cadiz	1978	Off Brittany, France	223,000
5	Haven	1991	Genoa, Italy	144,000
6	Odyssey	1988	700 nautical miles off Nova Scotia, Canada	132,000
7	Torrey Canyon	1967	Scilly Isles, UK	119,000
8	Sea Star	1972	Gulf of Oman	115,000
9	Irenes Serenade	1980	Navarino Bay, Greece	100,000
10	Urquiola	1976	A Coruña, Spain	100,000
11	Hawaiian Patriot	1977	300 nautical miles off Honolulu	95,000
12	Independenta	1979	Bosphorus, Turkey	95,000
13	Jakob Maersk	1975	Oporto, Portugal	88,000
14	Braer	1993	Shetland Islands, UK	85,000
15	Aegean Sea	1992	A Coruña, España	74,000
16	Sea Empress	1996	Milford Haven, UK	72,000
17	Khark 5	1989	120 nautical miles off Atlantic coast of Morocco	70,000
18	Nova	1985	Off Kharg Island, Gulf of Iran	70,000
19	Katina P	1992	Off Maputo, Mozambique	67,000
20	Prestige	2002	Off Galicia, Spain	63,000

2. The problem of social cost, institutional analysis and Law & Economics

Property rights are rights that individuals have to make decisions on natural resources, human and non-human capital and any assets. Individuals have property rights and transactions are property-rights exchanges. Transacting implies some costs and transaction costs are those that derive from the ex-ante subscription of a contract and its ex-post control and enforcement [17]. The delineation of property rights is a necessary requirement to make transactions.

The seminal paper of Coase [13] on “The Problem of Social Cost” gave rise to the so-called “Coase theorem”. It was not Ronald Coase who actually enunciated this theorem but it was George [44], who enunciated the theorem, after analysing the arguments put forward by Coase [13]: “under perfect competition private and social costs will be equal”.

In a world with zero transaction costs, the parties concerned would carry out all such transactions that would result in efficiency gains [13]. In this scenario, the transfer of rights into the hands of agents that most value them will be carried out, in a way that the winners, due to the allocation of such rights shall compensate the agents that cede the rights. In this world, the socially optimal solution would be achieved through transactions and the equilibrium would be that one in which the aggregate income is maximised. *Precoasean* neoclassical theory had forgotten transaction costs and it worked in a world without frictions and without institutions where all exchanges would be carried out in competitive markets [36]. In this neoclassical world without transaction costs, societies would achieve the best possible economic outcomes, therefore an efficient competitive solution would prevail.

However, as against this hypothetical scenario without transaction costs, the real economic markets are characterised by the presence of positive transaction costs, such that whenever these costs exceed the expected benefits from the transaction, it leads to cessation of transactions.

Coase [13] pointed out that mainstream economics had forgotten that transaction costs exist. Coase [14,15] argues that the world of zero transaction costs is the world of modern neoclassical economic theory, but it is not the “coasean world”.

As against the theoretical pre-coasean approach, there was need for a new institutional approach that incorporates the role of

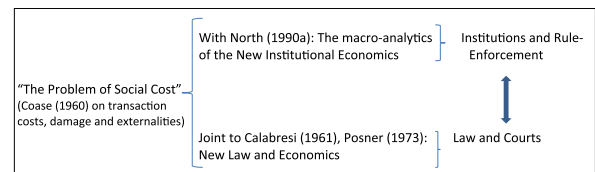


Fig. 1. New institutional theoretical foundations: institutions, law and courts. Source: Own elaboration.

positive transaction costs, property rights, incomplete markets and institutions. In this way Coase [13] becomes a central contribution to the emergence of the New Institutional Economics and to the program of Law and Economics (Fig. 1).

2.1. The New Institutional Economics (NIE)

This research program allowed the return of institutions into the main research agenda in economics and in social sciences [6], and the award of the Nobel Prize in Economics to Ronald Coase, Douglass North, Oliver Williamson and Elinor Ostrom consolidated the NIE [4]. The NIE has been developed since Coase's definition of transaction costs and North's notion of institutions [3]. Institutions are the rules of the game in society and they can reduce the level of transaction costs in the economy. Institutions are formal rules, informal norms and enforcement-mechanisms [37]. The New Institutional Economics (NIE) assumed orthodox neoclassical assumptions of scarcity and competition, but it rejected the neoclassical assumptions of perfect information and instrumental rationality, and it considered a theoretical framework with incomplete property rights, positive transaction costs and institutions, and assumed a world where the passage of time matters [39,33,29]. On the one hand, Coase [12] generated a micro-analytical approach of organizations which gave rise to “transaction cost economics” [48,49]. On the other hand, Coase [13] generated a macro-analytical approach that studied the relations between institutions and economic performance, as well as institutional change processes [37]. The NIE incorporates those two approaches, which are mutually inter-related, that is to say, the NIE studies institutions and how institutions interact with organizational arrangements within economy [33]. Ostrom [40] explains that “rules without enforcement are but words on paper”, therefore the study of the enforcement-

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