



THE PROCESS OF ASSESSING AND COMPENSATING DAMAGES CAUSED BY OIL SPILLS : ELEMENTS OF ANALYSIS

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ABSTRACT

Assessing the costs of oil spills in monetary terms may serve several purposes. In practice, it is generally carried out with the primary view to establish the levels of compensation that would leave the victims of a spill whole, at least in financial terms. The cost of oil spills is also a key figure in debates on the development of preventive measures limiting the risks of pollution, and this at three levels. First, information on the costs of oil spills can be confronted with data on the means devoted to the prevention of accidents, in assessing the adequacy and effectiveness of such measures. Second, information on the costs of oil spills can be confronted with data regarding the amount of effort devoted to cleanup operations in any particular incident, in order to determine efficient response strategies. Third, measuring the monetary costs of damages caused by oil spills and identifying who they are charged to is also a key piece of information in discussions on the role of liability, and more generally of economic incentives, in achieving efficient levels of pollution prevention.

In practice, at least three categories of numbers seem to be produced in response to the question: “what was the (monetary) cost of this oil spill?”: (i) estimates of damages calculated applying economic valuation methodologies; (ii) claims for compensation following the spill; and (iii) compensation eventually paid to the victims of the accident. These figures are generally presented by different parties as their estimate of what an oil spill eventually cost, and they seem to often diverge appreciably in practice.

The objective of this paper is to look at the main factors explaining the differences between these three categories of numbers as they can be observed following oil spills. The discussion is based on a retrospective analysis of several major oil spills that took place in European waters in the past twenty five years, namely the Amoco Cadiz, the Tanio, the Aegean Sea, the Braer, the Sea Empress and the Erika cases.



In the first section, the information available on these cases is briefly summarized, with particular emphasis on existing estimates of the costs of damages, claims for compensation and compensation paid, estimated at the end of 2001 from available sources.

The second section is devoted to the main factors explaining the divergence between these figures. Analysis of the case studies allows identification of three categories of factors explaining the diverging numbers found, at various stages in the process of damage assessment and compensation.

First, at least in large spills, the context in which economic studies are carried out is usually one of crisis requiring quick answers to the question of damage quantification, on the basis of data of variable quality. More than anywhere else, damage valuation in such context is constrained by the availability of basic empirical information on the activities affected. Variations in cost estimates linked to the choice of the baseline “without spill” scenario, added to variations linked to the assumptions made where individual data is lacking, can lead to figures that diverge quite substantially in practice. Given the negotiated nature of the compensation process, this opens for the possibility of using numbers strategically, explaining in part the continued existence of different numbers for the same costs in practice.

Second, while damage valuation may be carried out with the purpose to establish a basis for the compensation of victims, it only enters as an element of information in the compensation process. In the accidents studied, individual victims display various strategies with respect to the decision to claim for compensation and to the amounts claimed, which may lead to substantial divergence between cost estimates and actual claims.

Third, the assessment and compensation of costs arising from these oil spills is carried out in an *ad hoc* institutional context defining the rules for accepting, or rejecting, damage valuation estimates, and claims for compensation.

The paper concludes with a discussion of the role currently played by economic studies in the current international system governing the compensation of the monetary costs of oil spills. In practice, studies are carried out with one or the other of two different objectives. The first objective is to establish as rapidly as possible following a spill the anticipated amount for which compensation will be claimed. Valuation studies in this case are of a specific nature, since they must take into account the decisions by victims to make a claim, and the institutional rules leading to accept certain claims and reject others. The second objective can be to establish estimates of the total costs of an oil spill in monetary terms (including, but not limited to the amounts claimed and compensated), and how these costs are shared among economic agents. Knowing who suffers which costs



and who is compensated of what amounts provides a better knowledge of how the burden imposed on society by an accidental pollution event is allocated. Such knowledge is essential in discussions concerning the effectiveness of liability rules *in practice* in achieving efficient levels of pollution.

