

# **Property Rights and Regulation of Environmental Quality under Asymmetric Information**

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## **Abstract**

We analyze the impact of a standard about environmental quality on the efficiency of local contracts and derive some normative implications about property rights generated by the presence of asymmetric information. We prove that a benevolent regulator can improve welfare by setting an intermediate standard for the quality of the environment, yet allowing for renegotiation at the local level. We consider the case that at the local level, one party has private information. We show that in this instance the allocation will be distorted away from the efficient solution in the direction of the threat point. The threat point is defined by the standard (the definition of property rights). From a normative perspective, we prove that the regulator can do better than allocate the property right to either of the players. It is shown that efficiency can be increased by setting the standard between either extremes.