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<p>Tiivistelmä-Referat-Abstract</p> <p>Over the last fifteen years, the connection between free trade and the environment has been the subject of considerable debate. Among other things, it has been proposed that freer trade may harm the environment if it induces national governments to compete by undercutting each others' environmental standards. We assess this proposition in a federal economy with free movement of capital and goods, but labour that is immobile.</p> <p>Our analysis shows that if the member states are small, firms perfectly competitive and pollution non-transboundary, the national governments' choice of environmental standards coincide with that of the federal government's. However, if the third assumption is relaxed, without cooperation, all states choose less strict standards than the federal government, even if pollution is only partially transboundary.</p> <p>If we assume monopolistically instead of perfectly competitive firms, the result that non-cooperative regulations are federally efficient when pollution is non-transboundary holds no longer. Nonetheless, there is nothing to suggest that environmental policy is less strict under non-cooperation than under cooperation. Intuitively, this is because the choice of emission tax by one country imposes a number externalities on the other. These externalities are partly positive and partly negative. Without assigning values to at least one of the model's parameters, we are not able to say whether the negative or the positive externalities dominate, that is, whether the non-cooperative equilibrium is characterised ecological dumping or not-in-my-back-yard. In the special case of perfectly transboundary pollution, we find that ecological dumping occurs regardless of the choice of values for the model's other parameters.</p> <p>We contribute to the literature in three ways. First, we show that the existence of pollution that spills from one country into another works in favour of ecological dumping both in perfect and in monopolistic product market competition. Second, we show that for ecological dumping to occur, a priori, pollution must be perfectly transboundary if firms are monopolistically competitive, whereas it suffices that pollution is partially transboundary if firms are perfectly competitive. Third, we show that perfect competition, and the standard results associated with it are obtained as a special case of monopolistic competition when the monopolistically competitive firms' market power is eliminated.</p>			
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