

ENVIRONMENTAL POLICY IN A FEDERAL STATE **Bert SAVEYN en Stef PROOST**

Center for Economic Studies, Naamsestraat 69, B3000 Leuven, Belgium

Abstract

We discuss the environmental policy in a federal state (i.e. a central government with a number of autonomous jurisdictions). We start by explaining the rationale behind decentralization. Further, we develop three interactions caused by decentralized policy. First, pollution may show spillovers to other jurisdictions (i.e. transboundary pollution). If the jurisdictions do not manage to cooperate, they have not enough incentives to optimally solve the environmental problem.

Second, the jurisdictions use the environment to compete for capital, firms and investment. This competition may be detrimental for an efficient environmental policy, and lead to a “race-to-the-bottom”.

Finally, the environmental policy influences the tax bases of all government levels. Hence, environmental policy affects the budgets of all government levels. Environmental policy in a federal state causes vertical tax externalities.

Key Words: Environmental federalism, transboundary pollution, inter-jurisdictional competition, vertical externalities

JEL Code: Q58, R5