

Social Justice and Solidarity as Criteria for Fiscal Equalization

Thomas O. Hueglin

Wilfrid Laurier University, Canada

For the purpose of this paper I will define fiscal equalization as the redistribution of uneven revenue for the purpose of providing citizens across subnational boundaries in a federal state with equitable public services. This definition contains a narrower meaning of equalization than the one called for by the German Basic Law with its obligation for the provision of “equitable living conditions” (Art. 72(2)). Equitable living conditions can be achieved by a variety of policy means that include fiscal equalization but go beyond it. The German “joint tasks,” for example, or the Structural Funds in the case of the European Union, aim at the provision of equitable living conditions by means of regional development policy and/or joint program financing. The narrower scope of fiscal equalization in turn finds exemplary expression in the stipulation of Section 36(2) of the 1982 Canadian Constitution Act as the provision of “reasonably comparable levels of public services at reasonable comparable levels of taxation” for all provincial jurisdictions. Art. 106 (2.3) of the Basic Law contains a similar provision on revenue distribution with reference to a more onerous “uniformity of living conditions.”

According to public finance theory, the allocation of revenue sources in systems of divided jurisdiction should follow principles of proportionality yet bear in mind mobility threats (Oates 1972; Boadway and Shah 2009).

Governments should have guaranteed access to revenue sources in proportion to their expenditure needs so that constitutionally assigned tasks can be accomplished autonomously and remain accountable to the citizens whose money is spent. At the same time, while mobile tax sources (income, wealth) should be centralized in order to prevent a tax race to the bottom, immobile tax sources (property, natural resources) are safer candidates for decentralization. As a consequence, there is in practice both vertical fiscal imbalance (VFI) because some of the revenue sources with the highest yield (income) are typically centralized, and horizontal fiscal imbalance (HFI) because of regional differences in resource endowment as well as uneven economic development more generally.

The material need for fiscal equalization across jurisdictions in this sense arises both from equitability obligations and proportionality requirements. A more normative justification of fiscal equalization, however, is embedded in the conceptualization of federalism itself. It pertains to **(1)** the mutual promise of federal comity, **(2)** existential guarantees of membership equality, **(3)** the acknowledgment of collective group liberty, **(4)** checks and balances as a prerequisite for the rule of law, and **(5)** subsidiarity as a principled guideline for power allocation at the lowest possible level.

(1) Federal Comity (*Bundestreue*)

The creation of a federal state is typically based on a carefully negotiated agreement for a common constitutional order among its constituent members. This makes federal constitutional orders different from those in unitary political systems, which may come about by revolutionary fiat (France) or

incremental evolution (Britain). By pledging themselves to this constitutional order, the constituent members of a federation commit to principles of mutual aid and respect. This commitment is not usually written explicitly into constitutional documents but rather emerges as “unwritten constitutional law” (Wolf 2000) from constitutional intent. In the German Basic Law, it flows from the obligation to maintain a federal order in Article 20 (*Bundesstaatsgebot*). In a landmark decision, the German Federal Constitutional Court declared, for example, that the “federal principle” obliges “all other members of the federal community” to extend “aid” to a particular member afflicted by a “budgetary emergency” (BVerfG 86, 148 UPR 1992).

The obligation to maintain a federal order, in other words, not only pertains to the explicitly institutional division of powers between different levels of government but also includes an implicitly procedural commitment to federal comity (*Bundestreue*) in the sense that the members of a federation have an obligation to act in such a way as to make the maintenance of the federal order meaningful to all in an existential and/or material sense.

Belgium, where mutuality is severely tested by deep cultural diversity, may be the only case with an explicit obligation to “federal loyalty” (*loyauté fédérale*), which was written into the 1993 constitution (Article 143(1)). The fact, however, that in practice not much loyal love is lost between Flemings and Walloons in Belgian federalism (Maesschalck and Van de Walle 2006), only goes to show that federal comity in and by itself is not justiciable. But it provides an important normative yardstick for the interpretation of a federal constitution in its rights-based provisions of equitability.

Mutual aid is one of the most basic yet profound principles of political philosophy. It had its origin in the Aristotelian postulation of human beings as community-building beings (*zoon politikon*). In the early-modern conceptualization of federalism, the *Politica* of Johannes Althusius (1614), the principle of mutuality among Aristotelian citizens first was applied to a federal commonwealth in which the constituent members obligate themselves to uphold the common order through “mutual communication” (*mutua communicatione*; IX.1), the equitable sharing of “goods, services and rights” (*rebus, operis, juribus*; I.7). In the nineteenth century, mutualism as a form of political and economic solidarity became a rallying cry against liberal state and market and the neglect of social justice (Proudhon 1863; Kropotkin 1902). In the twentieth century, it resurfaced in theories of “integral federalism” (Roemheld 1977; Conze 2005) seeking to deconstruct competitive capitalism, which was held responsible for dictatorship and war, into a quasi-socialist regime of mutual economic cooperation parallel to political federalization.

As reconstructed after dictatorship and war, federalism in West Germany after 1945 surely was not a socialist project, and neither was the process of European integration begun with the European Coal and Steel Community in 1951. What can be said, however, is that the principle of federal comity contains a commitment to mutual trust and help, which runs counter to, and is meant to run counter to, the competitive forces of liberal market societies and the representation of their territorially particularized interests in federal systems.

(2) Membership Equality

To postulate that the members of a federation ought to practice federal comity by acting on noble principles of mutual trust and help as implied by their original agreement is one thing. To actually get them to do it is quite another. In his discussion of various forms of federal union, Althusius was quite clear what it would take: only through “federal equality” would “peace and friendship come about,” and this in turn would allow for “mutual help” (*aequo federe in pacem & amicitiam venirent . . . licet auxilia mutua*; XVII.49). At first glance, at least, the requirement of membership equality would appear to be hardly in need of explanation or justification. As in any other partnership, loyalty and stability require that the membership of each is full and not dependent on the goodwill of the stronger or richer. Mutual help is an obligation and not a charity at the discretion of those who can afford it.

Federal constitutions secure membership equality in several ways. As in the case of the aforementioned provisions for fiscal equalization, they do this on the basis of equitability rather than equality in an absolute sense. First, they divide powers between the two levels of government. In doing so, they assign to the constituent member units exclusive or concurrent spheres of political action, and they normally do so equally, with the same set of powers for each member. If the constitutional agreement was really meant to secure rights and powers equally for all members, such an agreement obviously only makes sense if it is backed up with the material capacity to do act upon those rights and powers.

As in discussions of liberal market societies, the question is whether equality is meant to be equality of opportunity only in the sense that the members of a federation are given equal rights or powers as a starting point for autonomous political action, but are then left to fend for themselves; or whether it is meant to be equality – or at least equitability – in a deeper sense including material guarantees that give meaning to rights and powers. It is inconsistent with this latter and deeper meaning of membership equality, for example, when, as in the case of the German “joint tasks,” the richer *Länder* can finance certain project even when joint planning does not accord them priority, whereas poorer *Länder* have to abstain from applying for prioritized funds they are entitled to because they cannot co-finance them (Benz 2010).

Constitutionally guaranteed member equality is backed up by deliberatively difficult amendment rules, super-majoritarian approval in both legislative chambers of a bicameral federal system, for instance, a two-step process of approval and ratification at both levels of government, or even direct plebiscitarian approval. These rules are meant to be difficult because constitutional amendment constitutes a change to the original agreement. Just how extensive subsequent agreement to constitutional change should be is a matter of confederalism v. federalism. In more confederal systems as the European Union, for instance, treaty changes require unanimity. In most of the established federations, some form of qualified majority is required.

Majority rule of any kind poses a threat to member equality. Its only and merely practical justification is efficiency. In its famous normative justification by John Locke, however, majority rule is thought to be legitimate because all citizens of a commonwealth are assumed to share the same interest,

the preservation and protection of property however defined (1690). A citizen on the minority or losing end of a decision is thought to still have enough in common with the majority position so that the decision can be tolerated: ‘you win some and you lose some,’ as the American saying goes. In federal systems, the same logic applies with the only difference that the winners and losers are collectivities. As they agree to be part of a union, the constituent members of a federal system are assumed to have acknowledged that they have enough in common that some form of qualified majority rule can be tolerated.

Contrary to formalized majoritarian democracy, however, federal systems are characterized not only by what has been called ‘compound majoritarianism’ (Elazar 1987), the required approval of two different manifestations of the popular will in the bicameral process of national legislation, and an even higher threshold for constitutional change, but also a need for cooperation that is grounded in the federal division of powers by which what happens at one level of government, or in one part of the federation, inevitably also has repercussions on the other level and other parts. Bismarck understood that when he negotiated with his counterparts despite Prussian might and the numerical ability to force majority decisions (Lehmbruch 2000), and the participants in European Council of Ministers meetings are aware of this when they routinely negotiate consensus instead of resorting to qualified majority rule (J. Lewis 2013).

As the Supreme Court of Canada admonished intergovernmental litigants in a recent decision, the constitutional intention of federalism is “balance” (SCC 66, 2011). Balance requires respect, or, in Althusian terms, friendship and trust. Friendship and trust in turn are possible only on the basis

of equality. Equal rights are meaningless without at least equitable means to act upon them. Without ignoring serious arguments about transfer dependency and the lack of incentives for performance improvement that may or may not result from excessive fiscal equalization (Jeffrey 2002; Spahn and Föttinger 1997; Renzsch 2002), the federal bargain contains a fundamental commitment to the correction not only of locational inequality resulting from structural economic weakness but also and more essentially of the imbalances of an otherwise self-destructing market (Polanyi 1944; Picketty 2014). ‘Competitive federalism’ in this sense is a contradiction in terms. It questions not just the wisdom of fiscal equalization as written into the Basic Law but the federal form in its entirety.

That federal form is not narrowly based on an asymmetrical relationship of net transfer payers and net transfer receivers. It is meant to be a symmetrical relationship that is comprehensive because it is reciprocal and balanced. The net transfer receivers contribute to the stability of a larger market. The public services they provide reduce mobility costs. In the case of universities, for instance, their students can study where infrastructural and living costs are likely to be lower. Contrary to neoclassical economics, federalism is not a competitive positive sum game with its trickle-down assumptions. It is a zero sum game in which equality means sharing of scarce resources through fair redistribution.

(3) Group Liberty

Federalism, however, is more than an economic game about the most efficient allocation of scarce resources. It is also more than a system of fair

redistribution, which the liberal welfare state can undertake by means of individual income stabilization. Federalism is different in that it recognizes group liberty alongside individual liberty (Elazar 1987).

The federalist claim of group liberty is related to one of the most profound questions of philosophical inquiry: whether human beings are ‘unencumbered’ individuals in the sense that their identities exist prior to, and independently of, any social, economic or political membership (Rawls 1971), or whether these identities are indeed ‘embedded’ in the sense that they cannot be separated from shared communal practices and are defined by such practices (Sandel 1982; Walzer 1983; Kymlicka 2002). Normative justifications of federalism similarly emphasize that human beings naturally live in a plurality of smaller and larger communities with shared beliefs and practices, that federalism in this sense is a natural form of political organization, and that, in other words, “all social life is federalist in character” (Jerusalem 1949: 6-9).

Federalism, however, is primarily a territorial organization of plurality. While it can be assumed safely that territoriality coincided with community in pre-modern times, this may not be so in modern mass societies with access to rapid means of communication and migration. When the German princes negotiated with Bismarck, they still represented some form of regional identity. When the West German *Länder* boundaries were redrawn after 1945, the continued existence of such identities could be questioned. From a comparative perspective, then, it has been suggested to distinguish between cases of cultural federalism with strong sociological underpinnings and a tendency of decentralization, and cases of merely territorial federalism with weak or non-

existent levels of sociological difference and centralizing tendencies (Erk 2008).

From a perspective of group liberty, however, this distinction overlooks the extent to which patterns of regional identity and community may be rooted in political culture rather than sociology. The reconstitution of the East German *Länder* even before reunification, after forty years of unitary communism and in the absence of any kind of deep cultural diversity, points to a long memory of political community. The fact that in many if not most federations, regional electorates vote for political party configurations in opposition to those governing at the national level underscores the presence of diversity in political culture.

A particularly puzzling yet instructive case is Australia, which is said to be characterized not only by the absence of cultural diversity – an argument that conveniently ignores the presence of a distinctly separate Aboriginal culture - but moreover by a uniquely universal commitment to public policy uniformity. This uniformity is brought about by intergovernmental cooperation largely orchestrated by the Commonwealth government. The question arises why Australians would not more simply satisfy their quest for uniformity by reassigning public policy powers to the national government through constitutional amendment. The answer given is that such amendments, requiring a national referendum, would be rejected by the people (Saunders 2012). The people, in other words, seem to want uniformity that is nevertheless delivered by a plural form of governance.

Group liberty means collective autonomy. It can be based on deep cultural diversity such as in Belgium or in Canada. It can also be based on a

traditional or simply path-dependent preference for plural delivery of public services. In federal systems with their combination of economic union and divided jurisdiction, group liberty can only be meaningful if it is accompanied by fiscal solidarity ensuring that, in the words of the Commonwealth Grants Commission in Australia, “each would have the capacity to provide services at the same standard” (2004).

(4) Checks and Balances

In one of the most famous passages of the Federalist Papers, a collection of 85 essays in defence of the American constitution written during the winter months of 1787/88, James Madison speaks of the “double security” that arises from a twofold separation of powers, horizontally between the three branches of government, and vertically between the two levels of government (The Federalist, No 51). While horizontal power separation has been an on-going preoccupation in political thought since its first preformulation as a mixed constitution in ancient Greece, the vertical dimension has been for the most part neglected even when its practice was evident (Riklin 2006).

Such practice was the case in the Holy Roman Empire of which it has been said that it was neither holy, nor Roman, nor an empire. Rather, the idea of a universal Christian empire was superimposed upon a plurality of dynastic realms. This idea of empire was problematic, as the rulers of these realms would not recognize one of their own as superior. When the elected emperor Sigismund summoned Europe’s rulers to the Council of Constance (1414-18) “as per the Imperial office” (*per imperiale officium*), for instance, the king of Aragon registered offence by replying that he “and other Spanish

kings do not recognize the emperor as superior” (*et altres reys de Spanya non regonexen per superior al emperador*; Engels 1977: 377-78).

Eventually, Europe’s plural rulers settled upon a formula of divided and shared rule that can be regarded as the first principled expression of a division of powers. Developed by the jurists at various European courts, and increasingly accepted from the 14th century onward, those rulers whose realms showed de facto sovereignty and independence, were considered to have “as much authority in regard to [their own] people as the emperor has in regard to the whole” (*rex imperator in regno suo*; E. Lewis 1974: 456).

De facto sovereignty and independence meant that these rulers had the means of withstanding attacks as well as the means with which, usually upon councilial agreement, they would support imperial causes. The empire was characterized, in other words, by a kind of reverse VFI. Checks and balances as intended by the *rex imperator* formula were materially underpinned by the superior financial power of the empire’s member units. This was so also in the case of Bismarck’s empire, which remained a “boarder” (*Kostgänger*) of the *Länder* (Lehmbruch 2000: 61), and it still is the case in the European Union even though its miniscule budget hardly constitutes a major bargaining chip.

In the modern federal state, however, there is the opposite situation with central governments usually controlling the lion’s share of revenue. But the same argument can be made *e contrario*: the federalist intention of mutual control through balance requires that the constituent member units have sufficiently autonomous and equal material strength to withstand central power encroachments as well as asymmetrical power collusions. In this sense, fiscal

equalization must be automatic and guaranteed rather than dependent on the goodwill of those stronger and richer.

Madison's "double majority" argument is usually – and rightly – interpreted as a conservative ploy against majority rule. Just how conservative that argument is, however, depends on what is meant by majority rule. This is not so much a matter of democracy as it is a matter of whether majority rule is bound by the rule of law. The rule of law in turn is intrinsically linked to the principle of power separation between functionally different branches of government as it developed in 17th century England and found its most famous expression in Montesquieu's formula of "power as a check upon power" (*le pouvoir arrête le pouvoir*; 1748: II. 4).

But, as Thomas Hobbes had already observed a century earlier, when the different branches of government are all in agreement, the liberty of citizens is by no means advanced (De Cive VII.4). The vertical division of power adds to the horizontal separation an additional safeguard against the accumulation of power in any one place. Therefore, as the founding fathers of the West German republic understood quite well, urged on, as they were, by the Allied victors looking over their shoulders, federalism is as intrinsic to the rule of law as the horizontal separation of government functions. Therefore also, just as judges are meant to be paid well to keep their independence as guardians of the rule of law, the governments in federal systems must be financially secure as guardians of political balance.

(5) Subsidiarity

The last and most boldly normative justification of fiscal equalization as a precondition for equality, balance and stability in federal systems is grounded in the principle of subsidiarity. In its most basic meaning, subsidiarity gives expression to the idea that each political decision should be taken as closely as possible to the people affected by it. This is fundamentally and normatively different from the idea of dividing powers between two or three levels of government.

The guiding rationale for power divisions is efficiency, which commands that decisions that affect, or should affect, the entire population of a federal system in the same way, are the ones that should be centralized. This was the rationale for the centralizing thrust of modern welfare state building in federal systems beginning with the American New Deal legislation in the 1930s. Subsidiarity runs counter to that efficiency rationale in that it postulates that decisions should be taken at the lowest possible level of government even when all member units share the same policy goal.

‘Possible’ in this context means that the goal can be achieved by separate and decentralized action even if central action might be more efficient. More efficient does not necessarily mean better in a qualitative sense. The subsidiarity stipulations of the European Union unmistakably state that Union action must lead to a demonstrably “better” result in both “qualitative and, wherever possible quantitative” terms than individual member state action (Lisbon Treaty, Protocol (2), Article 5). It does not say that Union action is appropriate when the same result may be achieved more efficiently.

Similarly, the practice of *Länder* self-coordination in Germany is underwritten by subsidiarity considerations. Centralizing education, for instance, might be considered more efficient than agreement on transferrable report cards through horizontal negotiation. Yet education and culture have remained *Länder* responsibilities and hence closer to the people even though the ultimate goal is harmonization or even uniformity. As the Bavarian Minister President Hans Ehard admonished his colleagues early on, at a meeting in 1954, centralization of policy issues in the common interest was not desirable as long as the *Länder* would “manage to resolve them reasonably and intelligently through mutual cooperation” (cited in Laufer and Münch 1998: 256).

When subsidiarity considerations entered the post-World War debate on German federalism as a remedy against centralized Nazi totalitarianism, the term was borrowed from Catholic social doctrine (Marquardt 1994), and it entered the European subsidiarity debate in 1988 when then Commission President Jacques Delors got an earful about it from the Minister Presidents of the German *Länder* who feared that further European integration under the Maastricht Treaty sooner or later would infringe upon areas of exclusive *Länder* power (Schaefer 1991). However, Delors’ own research team identified a different and Protestant source of inspiration, the 1571 General Synod of the Dutch Reformed Church in Emden, and the *Politica* of Althusius (Luyckx 1992).

While it certainly does not matter whether the insertion of the principle of subsidiarity into the 1993 Maastricht Treaty was a Catholic or a Protestant achievement, it is importantly instructive to bear in mind the differences

between these two conceptualizations of subsidiarity. The Catholic conceptualization is enunciated in two papal encyclicals, *Rerum Novarum* (1891) and *Quadragesimo Anno* (1931). *Rerum Novarum* stipulates that in the regulation of human conduct “the law must not undertake more, nor proceed further, than is required for the remedy of the evil or the removal of the mischief.” *Quadragesimo Anno* then elaborates more precisely that it is “an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and subordinate organizations can do.” Those “in power” therefore should observe “the principle of ‘subsidiary function’” by which a “graduated order is kept among the various associations.”

At the 1571 General Synod at Emden, by comparison, it was resolved that “provincial or general assemblies must not deliberate on matters already decided at a lower level,” and that “they shall concern themselves only with such matters as pertaining to all churches generally” (Die Akten 1971: 79-83). And while Althusius does not use the term explicitly, subsidiarity nevertheless permeates his entire theory as a political code (Føllesdal 1998). The Althusian commonwealth comprises a plurality of smaller and larger political communities or “consociations.” Justice requires that “the rights of each member must be preserved and not diminished or augmented at the cost of another (*membro cuilibet suum jus conservetur, non miniatur, aut in perniciem alterius augeatur*; *Politica* XXIX: 2). And what these rights are at each level of consociation is determined by common agreement among its members (Hueglin 1999).

The difference between these two understandings of subsidiarity is the following: While the intention of Catholic social doctrine is “to determine the bounds of the private sphere,” the Protestant conceptualization, as also evident in German or European Union federalism, is concerned with “the allocation of power within the public sphere” (Barber 2005: 313). Subsidiarity in this latter understanding, in other words, cannot be invoked as an argument simply for less government as it was by Rick Santorum, a Catholic social conservative and one of the contenders for the Republican nomination in the 2012 American presidential election, who referred to subsidiarity as a defence for his involvement in President Bill Clinton’s 1996 *Personal Responsibility and Work Opportunity Reconciliation Act*, which allowed contracting out welfare services to charitable, religious and other private institutions (Gerson 2012).

In the context of federalism, subsidiarity means, then, in accordance with its Althusian/European understanding, appropriate allocation of public power at the lowest possible level of government. But as Althusius advised his readers, subsidiarity in the context of federalism is as much a constructive principle for the retention of particular autonomy as a commitment to common social and regional balance. This commitment “requires the faculties, strength, aid and dedication of all” (*omnium facultates, vires, auxulia & sanguinem requirit*; *Politica* XVII. 60). Subsidiarity is a “modality of solidarity” (Buttiglione 1994: 49).

But it is a modality of public solidarity pointing to organized and accountable political cooperation. This is how it is different from private charity. It cannot be misconstrued as a concept allowing for the maximization of particular self-interest or parochial withdrawal from common responsibility.

In this way, subsidiarity sums up all the characteristics of a just and equitable federal order compelling its members to fiscal equalization as a precondition of balance and stability: federal comity, member equality, group liberty, and the rule of law secured by the plural allocation of political power.

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