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Challenges to Local Government Innovation: Legal and Institutional Impediments to the Exercise of Innovative Economic Development Policy by Subnational Jurisdictions

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Abstract

A local government can use innovative governance practices to expand its jurisdictional capacity, thereby promoting local economic development. There are, however, legal and institutional impediments to the exercise of such innovative economic development policy. Using the subnational jurisdiction of Shetland as a case study, this paper considers how local government innovation can be a key driver of economic development. Local government innovation can nevertheless become subject to legal challenges by authorities in the higher-level jurisdictions (Scotland, the United Kingdom, and the European Union in the case of Shetland). Community concerns related to standards of good governance can compound these difficulties, resulting in a significant decrease in democratic accountability and a weakening of the local government's de facto capacity to plan and implement policy. Before local governments can make the most of multilevel governance, local communities and high-level jurisdictions must re-assess standards of legitimacy for local government functions and structures.

Keywords: local government innovation, economic development policy, multilevel governance, European Union, good governance, Shetland

1. Introduction

Innovative governance practices can promote economic development in small jurisdictions, whether local governments, semi-autonomous territories, or small states (Baldacchino, 2012a). I have elsewhere argued that creative governance can also nurture a small jurisdiction's core competencies and make government policy more effective (Grydehøj, 2012). There are, however, significant obstacles to the practice of innovative local governance. The present paper explores some of these issues in the context of local governance in the European Union (EU).

This paper considers 1) how innovative local governance practices can support local economic development, and 2) legal and institutional impediments to maintaining this innovation. We begin by discussing jurisdictional status as a resource at all levels of government and describing the reality of multilevel governance in the EU in general and the United Kingdom (UK) in particular. We then look at how the exercise of innovative governance practice in Shetland, UK (a subnational jurisdiction in the EU) has promoted local interests. This is followed by an analysis of how Shetland's innovative governance has been confronted by legal obstacles as well as by public expectations of good governance that reflect the needs of the centralised administrative state and favour higher-level jurisdictions (regional, national, supranational, and international). In conclusion, we suggest that:

- 1) There may be a paradoxical tension between a strong sense of local identity, jurisdictional assertiveness by local government, and the willingness of the local community to accept strong local governance; *and*
- 2) Until higher-level jurisdictions and local communities come to look upon local governance as something essentially different than just a scaled-down version of national or supranational governance, subnational jurisdictions will find innovation difficult to sustain, regardless of its benefits.

Although structured around a case study of Shetland, many of the considerations and conclusions in this paper are applicable to local governments outside of the EU: Every subnational jurisdiction is, after all, subject to national regulation, and although the EU is a particularly developed example of a supranational jurisdiction, it is far from the only body exercising international authority. In order to prevent confusion, we shall henceforth use the term *entity* instead of the generally more helpful and descriptive *jurisdiction* when referring to a subnational, regional, state, or supranational political unit.

2. Jurisdiction and multilevel governance in the European Union

It is increasingly recognised that jurisdictional capacity represents an exploitable resource. *Jurisdictional capacity* involves the competence of a political entity “to pass laws, build effective administrative processes, facilitate inward capital flows, encourage education and support the development of a climate conducive to economic growth” (Baldacchino, 2002, p. 349). As globalisation accelerates and the role of national entities (sovereign states) changes, the concept of jurisdictional capacity is useful for distinguishing between the powers available at different levels of government as well as for describing ways in which these powers may be used. The concept of jurisdictional capacity presupposes that governance takes place on multiple levels in every political system and is thus not limited to a view of *multilevel governance* – “the dispersion of authoritative decision making across multiple territorial levels” (Hooghe & Marks, 2001, p. xi) – within the EU alone.

Jurisdiction has always been subject to negotiation and contestation within and between national entities, yet it has been further blurred by the rise of supranational and international entities and authorities. Such negotiation is not always formal: Political entities often seek, either consciously or unconsciously, to enhance their jurisdictional capacities in practice (*de facto*) as well as in law (*de jure*). Indeed, this paper considers the case of a particular subnational entity (Shetland) in which *de facto* jurisdictional capacity exceeding *de jure* jurisdictional capacity has been central to local economic development for the past three decades. *De facto* jurisdictional capacity is, however, fragile, and Shetland's jurisdiction is in the process of being cut back due to pressure from the local community as well as from the relevant national and supranational entities.

The exercise of governance does not always mirror formal structures of government (Loughlin, 2001, p. 20). This is particularly true for local governments inasmuch as participatory governance carried out by policy networks of public and private actors tends to be relatively noninstitutionalised (Sørensen & Torfing, 2007, p. 26). Such locally based governance, involving an active local government embedded in a network of stakeholders (Bang & Sørensen, 1999), is difficult to conceptualise in terms of *accountability*, *democracy*, and *good governance* when one's standard points of reference are dichotomised understandings of liberalism and the centralised administrative state. When, on the other hand, such policy networks are formalised and institutionalised, for instance in the case of public-private partnerships, other problems arise, such as lack of accountability (Hodge & Greve, 2010, pp. 16-17). This has prompted some researchers to adjust perceptions of good governance to take into account the increased prominence of network governance as a whole (for example, Bang & Esmark, 2009).

These concerns are perhaps of special interest in the EU, a primary tenet of which is the subsidiarity principle. Article 5 of the Treaty of the European Union defines *subsidiarity* thus:

In areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. (qtd. in Eurofound, 2009)

Proponents of a Europe of the Regions have regarded subsidiarity as a tool for achieving local self-determination (for example, European Free Alliance, 2006), and others see subsidiarity as a rallying cry for “deglobalisation” or a rescaling of production and consumption (Oram & Doane, 2005). More generally speaking, the emergence of supranational governance and the wider increase in globalisation have strengthened subnational entities *vis-a-vis* national entities and heightened the dependence of national entities on non-traditional public and private political actors (Chan et al., 2012, pp. 13-16). Various levels of government are ever-more firmly interlinked and interdependent (Lorentzen, 2008, p. 43), freeing space for innovative subnational entities to experiment with new forms of governance practice (Baldacchino, 2010, pp. 22-32).

What is sometimes missing from the more liberatory discussions of subsidiarity within the EU is an acknowledgment that the very existence of a relevant supranational entity or intergovernmental organisation represents at least a qualitative weakening and at most a quantitative decrease in the jurisdictional capacity of constituent entities: Jurisdiction is a zero-sum system in the sense that one political entity's accrual of *de facto* or *de jure* jurisdictional capacity can only result from another entity's absolute or relative loss of this

same capacity. Entities at all levels can thus gain or lose jurisdiction. For instance, in the absence of regulatory (i.e., *de jure*) measures, the systemic reality of the EU's practice (i.e., *de facto* conditions) has led to "polity pressure" and jurisdictional change among member states, the governments of which move to structurally conform with European institutions (Esmark, 2008). As I shall argue below, subnational entities in the EU and elsewhere are under similar pressure to institutionally emulate higher-level entities. In a more active sense, the EU has used judicial interpretation to *de facto* legislate on issues that are within the *de jure* jurisdiction of member states (Martinsen, 2011).

One illustrative example of subsidiarity in practice is the UK, a national entity that attained its present geographical and institutional form as a result of a series of territorial acquisitions and losses over the course of centuries. The English kingdom integrated Ireland and Wales in the 12th and 13th Centuries respectively. In 1707, the two national entities of Scotland and England (including Wales) were united under a single parliament, and in 1800, Ireland's parliament was merged into what became a single, pan-British parliament. In the 1920s, the island of Ireland split into an independent national entity (now the Republic of Ireland) and Northern Ireland, which remains part of the UK. Complex though this chain of events may appear, this narrative is, in fact, highly simplified, ignoring the gradual unification of local English kingdoms in the Middle Ages; Scotland's acquisitions from Norway of the Outer Hebrides and the Isle of Man (1266) and Orkney and Shetland (1468 and 1469 respectively); the historically intricate jurisdictions of the Isle of Man, Jersey, and Guernsey; the fate of the UK's former colonies in Africa, Asia, and the Americas; *etc.*

The UK joined the European Economic Community in 1973 and subsequently entered the EU with the 1993 Maastricht Treaty. Over the years, the UK has gained a reputation for being a reluctant player in Europe, resisting expansions of the EU's jurisdictional capacity in order to safeguard its own sovereignty. In 1997, the UK's then-Labour Party government followed up on its election manifesto commitment to hold referendums into limited devolution of power to Scotland and Wales. Both of these referendums received positive results, leading to the establishment of the Scottish Parliament and the National Assembly for Wales, which possess different competences relative to the UK parliament. Certain self-governing powers are also held by the Northern Ireland Assembly, established in 1998. It should be noted that the main separatist parties in Scotland and Wales (Scottish National Party and Plaid Cymru respectively) have contributed three of the current six elected representatives of the European Free Alliance, a European Parliament political party advocating greater rights for regional ethnic communities (the Scots, Welsh, and Cornish in a UK context). The UK would thus seem to be a standard bearer for subsidiarity within the EU.

Subsidiarity, however, is a matter of degrees. At the same time as UK politicians warn of the centralisation of power in Brussels, all three of the major UK political parties are agitating against the attempt by the Scottish National Party (the dominant party in the Scottish Parliament) to bring about a form of independence from the UK. The Scottish National Party's argument for independence is on both cultural and economic grounds, the latter of which depend in part on tax revenues from North Sea oil, which currently go to the UK central government. As we shall see though, the desire for subsidiarity does not stop at the regional level, and some subnational entities in the UK are demanding greater powers as well. Indeed, nationalist or autonomist movements at one level of government can influence drives for jurisdictional change by parallel or lower-level entities (for instance, Ackrén & Lindström, 2012, pp. 507-508), and the movement toward Scottish independence may have unpredictable effects on "ethnopolitical mobilisation" elsewhere in the UK (Cartrite, 2012).

We use the UK as an example above because it fits the case study below, yet subsidiarity and the devolution of power are complex issues throughout the EU. Inasmuch as European integration has taken place unevenly across the continent, and some national entities have proven more recalcitrant than others in the face of EU policymaking (Hansen & Wæver, 2002), it is impossible to set forth pan-European standards of multilevel governance in practice. Similarly, there is no theoretical consensus on the precise terms by which subsidiarity ought to be practiced or its relationship with multilevel governance. The EU's subsidiarity principle *per se* does not promise *de jure* increases in jurisdictional capacity by constituent subnational entities. The present paper shall, in fact, argue that the legal and institutional impediments to localised governance put in place by the EU's supranational governance have the potential to cancel out many of the *de facto* opportunities that globalisation offers to innovative subnational entities.

3. Innovative governance in Shetland, UK

The North Sea archipelago of Shetland (population 22,000) is a subnational entity that is subsidiary to the devolved Scottish government based in Edinburgh and hence the UK government based in London. As such, its municipal authority, the Shetland Islands Council (SIC), is regulated by Scottish, UK, EU, and international law.

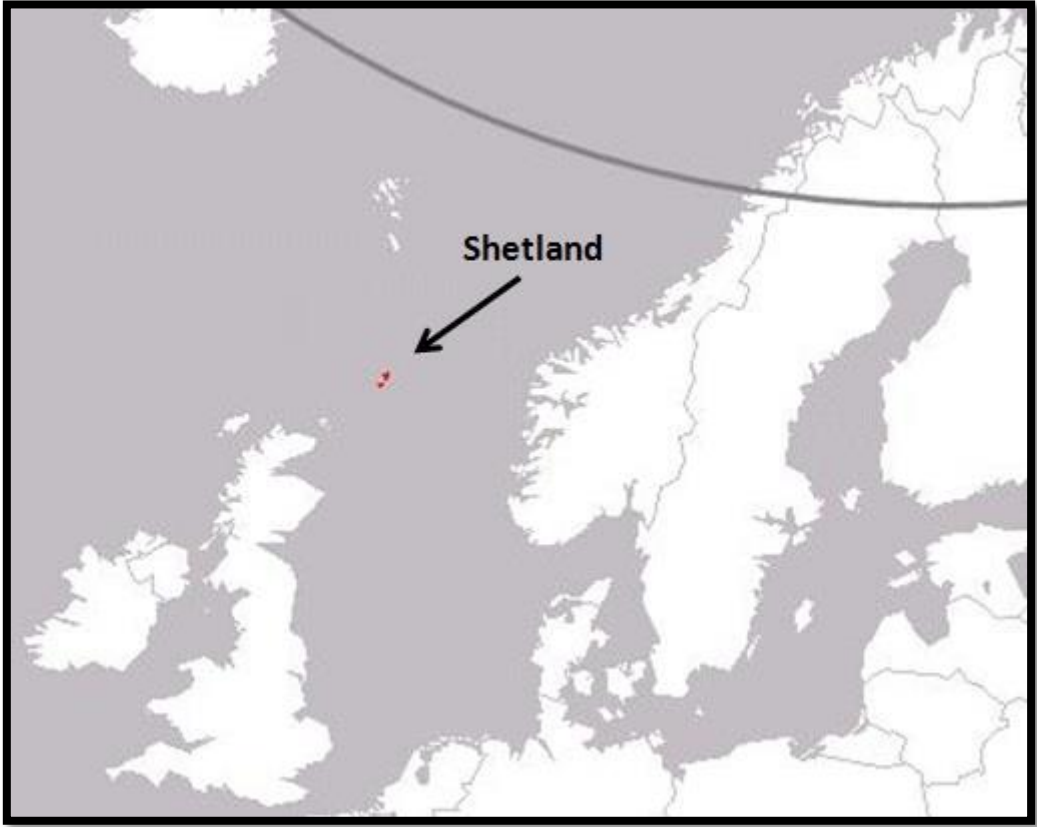


Figure 1: Map of Northern Europe (Source: adapted from http://commons.wikimedia.org/wiki/File:Blank_Template_for_Greater_Europe.PNG)

Shetland possesses relatively typical *de jure* jurisdictional capacity relative to other Scottish local authorities. The SIC (consisting of 22 elected councillors) is, however, uniquely empowered in one small but crucial respect: With the discovery of North Sea oil in the late 1960s, local politicians and civil servants fought successfully for limited additional powers in the context of plans to build an oil terminal and carry out oil industry work in Shetland. The Zetland County Council Act (1974) (hereafter, the ZCC Act) represented:

An Act to impose upon the county council of Zetland duties of conservancy and development, and harbour duties; to enable the Council to exercise harbour jurisdiction and powers, including powers to construct works and to acquire lands; and for other purposes.

The most important powers hereby gained by the SIC were *de facto* rather than *de jure*. With its new authority over local planning, the SIC forced the international oil companies to bring all of the oil ashore at one site, Sullom Voe. This in turn allowed the SIC to negotiate a harbour fee of £0.01 per tonne of oil passing through Sullom Voe, a significant figure considering that over 1 billion tonnes of oil have arrived since 1978 and that the oil companies also financed and paid an additional annual 2% of the harbour facilities' capital costs. The ZCC Act furthermore allowed the SIC to strong-arm the oil companies into entering into a Disturbance Agreement (12 July 1974) to compensate for social and environmental disruption caused by the oil work: A one-off payment of £2 million and a further £0.02 for each tonne of oil (Lindsay, 1982, p. 9).

At the time, Jack Fleming (qtd. in Wills, 2009), a UK Cabinet Office civil servant, expressed concern over the SIC's muscular use of its new jurisdiction: "The ZCC Act itself did not give the County Council a power to levy charges. What it did was give them wide powers of control which then enabled them to blackmail developers into making payments." The SIC's masterstroke, however, lay in what it did with the harbour fees and disturbance receipts. The ZCC Act permitted the SIC to establish a Reserve Fund to receive excess revenue from the harbour, which could then be used for "any other purpose which in the opinion of the Council is solely in the interests of the county or its inhabitants" (Zetland County Council Act, 1974, §§ 67.1-67.3e).

The result was that the SIC created a *de facto* two-pronged local government consisting of:

- 1) *The SIC proper*: The municipal authority could fulfil its statutory duties as well as exercise its subsidiary (discretionary) powers as necessary, with investments in the Reserve Fund serving as a source of emergency funding.
- 2) *The Shetland Charitable Trust (CT)*: The CT was founded as the Shetland Islands Council Charitable Trust in 1976 with the aim of making "grants or loans with or without interest [...] for any purposes which [...] are solely in the interests" of Shetland and its inhabitants (Shetland Islands Council, 1997, p. 2). The sheer breadth of the CT's objectives virtually replicates the scope of the SIC's funding powers, with the key difference being that the trust is not subject to the responsibilities and legal constraints of a municipal authority.

By the time the Disturbance Agreement expired in 2000, the CT had received around £81 million from the Reserve Fund (Shetland Times, 2009). Due to a policy of spending investment revenue and not capital, the CT currently has funds of around £220 million (Shetland Charitable Trust, 2011). This is in addition to nearly £269 million (of which around £62 million is in the Reserve Fund) held in reserve by the SIC itself (Audit Scotland, 2011).

Whatever the reasons for the CT's creation, it has come to function as a proxy government — and not just the proxy of any government, but a proxy government that closely resembles the SIC. This is because, in its founding incarnation, the CT had the SIC as its only trustee. Post-1990, the CT was modestly differentiated from the SIC when its governance structure was changed to consist of 26 trustees: The Lord Lieutenant of Shetland, the headmaster of Anderson High School, two independent trustees, and the 22 elected SIC councillors.

The CT has had a remarkable scope of activity. In the 2010-11 financial year alone, the Charitable Trust had expenses of around £11 million, including grants totalling around £4.3 million to its three associated charities (Shetland Amenity Trust, Shetland Arts Development Agency, and Shetland Recreational Trust) and £5.4 million to other charities. As an example of the CT providing funding for programmes that the SIC is legally entitled but not legally required to provide, the CT has provided most of the capital and running costs for the eight leisure centres scattered across the islands and managed by the Shetland Recreational Trust, “ensuring that no cost is attributable to the Council taxpayer” (Shetland Recreational Trust, [n.d.]). The CT funds a wide range of cultural and heritage programmes via the Shetland Amenity Trust. It is the CT that has given Shetland its extraordinary level of social and cultural provision, which is surely unmatched on a per capita basis in the UK today. This has freed the SIC from the necessity of funding these programmes itself, allowing the council to spend heavily on transport, infrastructure, and education over the past three decades.



Figure 2: Shetland's high standard of living is a result of innovative economic development policy exercised by the Shetland Islands Council and the Shetland Charitable Trust (Island of Whalsay, Shetland, 2007; Photograph by Anne Grydehøj).

4. Shetland's conflicts with European law

The CT has traditionally been regarded as a body that can both do things that the SIC does not *need* to do and do things that the SIC is *unable* to do. This is illustrated by the first major legal challenge to the role of the CT, which took place in 1999 when an unnamed Member of European Parliament alerted the European Commission (EC) to a possible breach of EU state aid rules.

The challenge related to a scheme by which a subsidiary company of the CT purchased fishing quotas from UK fishermen and subsequently rented these out to other fishermen. In 2003, the EC determined that this scheme represented illegal state aid. In the event, two Scottish fishermen's organisations protested to the EC against the scheme, arguing that it provided Shetland fishermen with preferential conditions for doing business: In practice, Shetland fishermen could participate at far lower rates than could non-Shetland fishermen. As the national entity accused of having provided state aid, the UK government submitted evidence in the scheme's defence.

Having decided that Shetland fishermen were, indeed, obtaining favourable rates, the EC sought to determine whether the CT's activities represented state aid and thus a distortion of competition within the Common Market. In its decision, the EC did not contest the CT's status as a private body (i.e., as legally distinct from the SIC). Instead, the EC followed the money trail in reverse: 1) Fishermen rented quota from Shetland Fish Producers' Organisation Ltd, which managed the scheme; 2) this rental income was then passed on to the CT, minus a management fee; 3) the CT itself had purchased these quota with the help of a £2 million loan from the then-Shetland Development Trust; 4) Shetland Development Trust was funded out of the Reserve Fund; and 5) the Reserve Fund had received its money from the Disturbance Agreement and other harbour-related fees.

The EC's decision rested on ambiguity over the status of the money in the Reserve Fund, some of which originated as a result of the SIC acting as a private company (receiving payment for services rendered) and some of which originated from the apparently compensatory disturbance receipts, which the UK government described in its evidence as "a charitable gift" to the SIC. The EC, however, did not regard payments resulting from the Disturbance Agreement as true charitable gifts inasmuch as the Disturbance Agreement was open to arbitration and renegotiation, implying that it was originally a product of negotiation. If, in the EC's view, none of the money in the Reserve Fund originated from truly charitable sources, then all of the money in the Reserve Fund was state money. This meant that the CT had acted as a state investor rather than as a private investor. Although the EC demanded that the scheme be stopped, it did not demand that any of the "unlawful aid" be recovered from the beneficiaries (i.e., repaid to the CT by Shetland fishermen) because both the fishermen and the Shetland authorities could reasonably have assumed that the scheme did not represent state aid (European Commission, 2003).

In deciding that the Reserve Fund was funded with money acquired by the SIC in a private capacity rather than from charitable donations, the EC set a worrisome precedent for the CT's attempts to promote important at-risk local industries. Indeed, on the basis of this precedent, the EC deemed illegal in 2005 the CT's acquisition of shares in the Shetland Seafish Ltd company on the basis of this investment not meeting the market economy investor principle. Besides referencing its earlier decision, the EC's 2005 decision noted that:

The trustees of the Charitable Trust are the councillors of the SIC. Although these councillors act as trustees *ex officio*, the fact that they are nominated by the SIC means that the latter is able to exercise a dominant influence over the trust and [its subsidiary company] SLAP as well as over the funds at their disposal. There is therefore a set of indicators showing that decisions can not be taken without regard for the requirements of the public authority (European Commission, 2005, §§ 21-24).

The EC's decisions denied the possibility of the SIC avoiding EU regulations by using the CT as a proxy. This meant that similar activities by the SIC proper were likewise illegal. An anonymous complaint from a UK citizen in 2004 led the EC to consider a set of fisheries aid schemes being paid for by the SIC out of the Reserve Fund. In 2007, the EC declared three of these schemes illegal, namely a fish factory improvement scheme, fishing vessel modernisation scheme, and first time shareholders scheme. In these cases, the EC held that its earlier decisions not to demand the recovery of unlawful aid did not apply since the SIC could not have had legitimate expectations that the schemes did not represent state aid, even if the money used to pay for them had come from the same pot as in the CT cases. The SIC was thus ordered to recover the unlawful aid, plus compound interest, from its fish factory, fishing vessel, and fishermen recipients (European Commission, 2007abc).

The decision regarding the first time shareholders scheme caused considerable distress: From 1996 to 2003, the SIC had contributed £7500 each to 78 new fishermen to aid them in purchasing their first share in a used fishing vessel. The decision struck at the core of the SIC's muscular economic development policy, and the required recovery of funds meant for the first time that grants or loans from the CT or the SIC risked doing more harm than good, placing a major financial burden on a significant number of private citizens. The SIC responded strongly by appealing – without the UK government's support – the requirement to recover unlawful aid. In 2010, after years of contention, the EC dropped its requirement that all 78 affected fishermen repay their grants so that, ultimately, aid was recovered from just six recipients, amounting to £55,097 out of the approximately £1.5 million that the EC had demanded repaid (Shetland News, 2010).

5. Shetland's conflicts with Scottish law

In recent years, three major political conflicts have divided the SIC and the local community as a whole, prompting challenges to the CT by the Scottish government: The construction of the Mareel cinema and music venue in the main town of Lerwick, the erecting of a large number of wind turbines in Shetland's North and Central Mainland, and the construction of a new building to house Shetland's secondary school. The conflict over the school building is somewhat peripheral to the present discussion inasmuch as most of the political battle has centred on the SIC alone, yet the acrimony connected with this issue has influenced the handling of the other two cases and led to the first major appearance of concerns regarding conflicts of interest between the CT and the SIC.

Planning for what would become the Mareel cinema and music venue began in 1997, led by the SIC and the Shetland Arts Trust, now the Shetland Arts Development Agency (hereafter, Shetland Arts), which is, in practice, a subsidiary charity to the CT. Work on the project began in earnest in 2004, with the commitment of partial SIC funding, followed by the raising of external funding. In the end, the SIC provided funding of £5.2 million, supplemented by £6.9 million from the European Regional Development Fund, the Scottish Lottery Fund, and other sources. Construction on the building began in 2009, and the facility opened in August

2012. Although it is projected that Mareel's operations will eventually be self-funding, management of the complex and financial responsibility rests with Shetland Arts.

Due to length of time that elapsed between Mareel getting the go-ahead from the SIC and funding finally being in place, some of the SIC councillors who originally voted for the project had been replaced by other politicians by the end of the project's preparatory stage. In addition, the global financial crisis that had occurred in the interim had prompted a degree of public concern over the wisdom of significant public spending on the project. The SIC reviewed its support for the project in 2008, and three councillors – Allison Duncan, Gary Robinson, and Jonathan Wills¹ – proved particularly vocal in their opposition, arguing that Mareel's business plan was overly optimistic (i.e., that Shetland Arts would require constant top-up funding from the CT in order to maintain operations) and that the SIC's investment could either be saved or better used on other projects. When the SIC finally voted on the project again on 25 June 2008, the result was a 9-to-9 split of those councillors present and voting. Sandy Cluness, then-convener of the SIC, used his deciding vote to approve the project.

Less than a month after the SIC vote, the EC received a pair of anonymous complaints alleging that the bar and café central to Mareel's financial sustainability represented unlawful state aid. Although these complaints were quickly dismissed by the EC, the idea that unidentified members of the Shetland community had attempted to use the EC as a weapon against the SIC – at the same time as the SIC was fighting against repayment of the First Time Shareholders scheme grants – proved unsettling and exacerbated divisions within the council chamber (N. Riddell, 2008ab). Shortly afterward, councillor Wills raised the stakes by writing to both Audit Scotland and the Scottish Public Services Ombudsman, complaining that the SIC had displayed poor leadership and financial management (N. Riddell, 2008c).

These discussions coincided with the early stages of the Viking Windfarm debate. Work on developing a proposal for a major windfarm in Shetland began in 2003, leading to a 2005 memorandum of understanding between the then primarily SIC-owned Viking Energy Ltd and SSE plc, a major UK power supplier, resulting in an ownership structure of SSE (50%), SIC (45%), and Shetland Aerogenerators Ltd (5%). The plan was to build the UK's largest windfarm, with costs and profits split equally between Viking Energy and SSE, thereby providing a new source of income for Shetland's post-oil era. In September 2007, the SIC sold its 45% share in the joint venture to the CT. This was done due to EU restrictions on sale of electricity by local authorities (Robertson, 2011b).

The Viking Windfarm project provoked a negative reaction from a significant portion of Shetland's residents, and in October 2008, Paul Riddell (2008a) wrote of how the debate had caused a "palpable fissure in this small community":

The SIC's rationale for becoming involved is predominantly financial. As the outgoing acting head of the charitable trust, Jeff Goddard, pointed out recently, before the latest round of turmoil on the world's financial markets, the [Charitable] trust is living beyond its means. Its capital base is being eroded by revenue rather than investment spending. [...] The scale of the financial commitment is enormous. The 50:50 partnership between the SIC and SSE that is Viking Energy will demand a £50 million investment from the charitable trust and a further £200 million raised through equity and/or bank loans.

Note the conflation of the SIC and the CT as well as the assumption that the CT would automatically approve the project if the SIC chose to do so. The project was, at this point,

anticipated by Viking Energy to bring in average annual returns of £18 million, in addition to £1 million of community benefit payments and numerous jobs (P. Riddell, 2008a). The councillor and Viking Energy coordinator Allan Wishart argued that “If we want to live in the kind of Shetland we live in now, we are going to have to find a lot of money to sustain these services” (qtd. in P. Riddell, 2008b). Whereas the debate over building Shetland’s new secondary school with money from the CT had prompted concern that the dual councillor-trustee role prevented trustees from appropriately serving the charity, the windfarm debate made some residents ask whether this same dual role prevented councillors from appropriately serving their constituents rather than focusing on the finances of the charity (P. Riddell, 2008b).

The Office of the Scottish Charities Regulator (OSCR), the governmental body tasked with monitoring charities in Scotland, began making inquiries into the CT in 2008 on account of concerns over conflicts of interest faced by CT trustees (i.e., that the CT was insufficiently independent of the SIC). The primary argument given in favour of the system of councillor-trustees was that the system increased accountability inasmuch as trustees were regularly elected by the population of Shetland as a whole. Furthermore, with the local population being so small, the SIC and the CT expressed “concern that the experience and expertise that is available to the community is not spread too thinly in a desire to ensure independence” (Martin, 2011, pp. 3-4). While OSCR applied pressure on the CT, Audit Scotland (2011, pp. 9-11) was admonishing the SIC for not including the CT and its subsidiaries in its annual financial statements — implying, in essence, that the SIC was concealing part of its *de facto* budget deficit from the Scottish government. At issue for both OSCR and Audit Scotland was that the CT “endeavours to ‘top up’ public services, in line with the community’s needs, which are complementary to those provided by national and local taxation” and thus that it was in the SIC’s interest that the CT provide certain services. Similarly, there were situations in which the SIC’s interests and those of the CT were in direct opposition: For instance, in the purchase of Viking Energy Ltd, it would have benefited the SIC to obtain the highest possible sales price whereas it would have benefited the CT to pay the lowest possible sales price (Martin, 2011).

With OSCR threatening to intervene and remove trustees from their posts unless the CT was reformed (Robertson, 2010), the CT sought legal advice. The Edinburgh attorney Roy Martin (2011) advised that significant reform of the CT was unavoidable if OSCR was to be appeased. Taking into account the existing CT board’s wish that any future CT include a significant number of SIC councillors as trustees, Martin recommended a slimmed-down CT board consisting of a minority of SIC councillors and a majority of independent trustees, structured so that it would be impossible for the board to pass a motion with the assent of SIC trustees alone. Although the CT accepted elements of Martin’s advice, its attempted implementation of this advice provoked fury from councillor-trustees Robinson and Wills (2011) inasmuch as the plan involved all independent trustees being directly appointed by the councillor-trustees, thereby addressing the conflict of interest problem at the expense of the CT’s democratic credentials.

In September 2011, amid growing frustration on all sides, Sandy Cluness recommended that a referendum be held to ask the people of Shetland whether they would prefer: 1) the status quo, 2) seven councillor-trustees and eight independent trustees, or 3) a body consisting solely of independently elected trustees. This prompted OSCR to warn that it would seek to legally block the CT from proceeding with referendum plans, which it viewed in part as a tactic for delaying reform (Robertson, 2011a). Cluness urged the community to stand up to OSCR on

this matter, arguing that “the community has the right to say what kind of system they want without having one imposed on them” (Cluness, qtd. in Robertson, 2011a).

Nevertheless, ordered by OSCR to present a plan for reform by the end of the year, in December 2011, the CT voted 9 to 6 to accept a board of seven councillors and eight independently selected trustees. Wills (the staunchest proponent of reform) and Cluness (the staunchest opponent) resigned from the CT’s board following this vote, both arguing for different reasons that the new CT structure would be undemocratic: Wills felt that trustees should be independent and elected whereas Cluness felt that the close CT/SIC relationship had historically benefited Shetland (N. Riddell, 2011). This would seem to have been the end of the debate, yet in February 2012, the SIC voted 10 to 8 to ask the CT to rethink its proposed restructuring. This vote was spearheaded by councillor Robinson, with the support of Wills and Cluness (Robertson, 2012a), and was hardly conducive to fostering the image of the CT as independent of the SIC. In the event, however, the CT still proposed to OSCR a reform involving a mix of councillors and appointed independent trustees, a proposal that OSCR approved in July 2012 (Young, 2012).

With new elections to the SIC (and hence, a new set of CT trustees) looming in May 2012, the CT sought in late April to dedicate another £6.3 million in funding toward the Viking Windfarm project. OSCR, however, intervened to prevent the CT from making any funding decisions prior to the SIC election (OSCR, 2012). The election a few days later involved a substantial turnover in councillors but did not significantly alter the balance of opinion within the SIC (and hence the CT) regarding the Viking Energy investment. Indeed, councillor Drew Ratter, a former director of Viking Energy, was subsequently elected chairman of the CT, with Jonathan Wills, who is also broadly in favour of the windfarm, elected vice-chairman (Robertson, 2012b).

6. Impacts of the conflicts with European and Scottish Law

The conflicts of the Shetland government (broadly understood as the SIC and the CT) with European and Scottish authorities exemplify tensions between subnational, regional, national, and supranational decision making. Each of these levels of government has sought to protect its own interests. In the cases we have considered, Shetland went from being the winner in the 1970s, 1980s, and 1990s to being the loser in recent years. The EC’s decisions, though justifiable from the perspective of European competition law, were directly against the interests of the community in Shetland. As for OSCR, it has monitored the CT since 2008 and exercised direct oversight since 2010. By seeking to uphold accepted standards of good governance, this oversight temporarily reduced the CT’s capacity for decision making and has permanently reduced its accountability to the Shetland public.

In the wake of the EC’s November 2007 decision against the SIC, then-convenor Sandy Cluness emphasised that activities such as the fisheries schemes in question were precisely the sort of initiatives the Reserve Fund was established to support:

I cannot believe that European politicians ever intended to use state aid rules in this way crippling the development of our traditional industries and threaten [*sic*] the sustainability of a peripheral community like Shetland. This is particularly galling in that individuals and businesses in our community are being punished for the council deciding to use its oil funds for the specific purposes for which they were intended. [...] Not only are we very concerned with this specific outcome, but for the consequences to other investment schemes currently being

operated and unless we can find a way to use our oil reserves to assist the development of our local economy I fear for the future of this community (qtd. in Fish Update, 2007).

The same could be argued with regard to the OSCR case. The laws levelled against the Shetland government by the EC and OSCR may be different, but the effect is the same, representing a trimming of the government's jurisdictional capacity and the power of Shetland's elected officials.

Cluness' implicit question is what, given the current legal situation, Shetland can meaningfully do with its financial reserves. The simple answer, of course, is that Shetland could stop practicing its creative political economy and instead choose to play by the rules. If the CT were truly independent of the SIC, then it could act as it wished, undertaking activities currently closed to the SIC. The SIC has, in fact, to an extent engaged in self-policing: For instance, fear of violating state aid rules has convinced the SIC that the Shetland logo/quality mark that resulted from a place branding strategy developed in 2002-03 must be restricted to use by the local tourism promotion body (Grydehøj, 2008, p. 186). Nevertheless, the EC decisions of 2002 and 2003 – which do not question the charitable nature of the CT – mean that, even after the CT's governance has been reformed, it will be severely limited in its scope for action.

It is difficult to conceive of what Shetland would be like today were it not for the infrastructure modernisation and high level of service provision that has been paid for out of the Reserve Fund, making an exceptionally high standard of living possible in a small, remote community. Infrastructure spending of the kind that took place in the past may not contravene European law, but neither is it sustainable. Shetland already maintains the largest local authority per capita in the UK (Grydehøj, 2011, p. 126). Further progress in economic development that does not necessitate continually depleting the Reserve Fund until there is nothing left requires a competitive private sector. The activities against which the EC decided all sought – wisely or otherwise – to encourage a private sector that could make the most of the SIC's and CT's more traditional funding of infrastructure and services.

The flexing of jurisdictional capacity can be central to strategies for promoting local development, but the innovative governance practices that make such an increase in *de facto* jurisdictional capacity possible very often conflict with the *de jure* limits to a political entity's powers. With sufficient political will, Shetland's government could be capable of overcoming these legal obstacles to its attempts at exercising innovative economic development policy. Higher-level entities do sometimes yield when confronted by recalcitrant lower-level entities (for instance, Grydehøj, Grydehøj, & Ackrén, 2012, p. 107), if only because the alternative – an exercise of coercive power – is neither palatable nor productive. A prime example of this is, in fact, Shetland's original victory against the UK and the oil companies regarding the development of oil facilities.

Shetland no longer possesses the strength of community will that makes such strong political will possible. It is worth asking why the Shetland government's problems with European and Scottish authorities cropped up first in the 2000s rather than in the 1980s or 1990s. Worryingly for Shetland and instructively for other subnational entities engaging in innovative governance practices, the answer has less to do with the national and supranational authorities in question than with divisions within the Shetland community itself.

It is interesting that a number of SIC councillors have supported the use of legal apparatuses belonging to higher-level entities to influence local government policy. Just as interesting

though is that councillors Duncan, Robinson, and Wills retain support from a significant segment of the Shetland community, and all were re-elected in May 2012. Although their techniques and political personalities are not universally popular, their stances are frequently regarded as principled and worth supporting. The EC's 2007 fisheries case is anecdotally rumoured to have been prompted by a complaint from a dissatisfied Shetlander, and the EC cases in general seem to have at least partially inspired the contacting of OSCR by anonymous individuals. In combination, the EC and OSCR cases will fundamentally alter the way in which Shetland is governed.

Local opposition to the close relationship between the SIC and the CT is often explicitly associated with disagreement concerning individual policy decisions. For instance, opposition to Mareel leads to opposition to the SIC's role in this CT project, and opposition to the Viking Windfarm leads to opposition to the CT's role in what is regarded as an SIC project. What is of interest here is not whether Mareel and the Viking Windfarm are good ideas. Rather, it is of interest that the generalisation of opposition to such policy decisions has not led to significant changes in the sort of representatives that Shetlanders elect (i.e., the 'electing better politicians' approach); instead, it has led to moves to disempower Shetland's elected politicians for perpetuity (i.e., the 'cutting off one's jurisdictional nose to spite one's face' approach).

7. Good governance in small, strong jurisdictions

An implied rationale behind opposition to the structure of government in Shetland is that this structure runs contrary to standards of good governance drawn from similarly powerful governments (i.e., the governments of large national entities). A number of the smallest national entities (microstates) are smaller than Shetland in terms of population (Tuvalu, Nauru, and Palau), and many microstates are smaller in terms of land area. Keeping in mind that Shetland itself is a small subnational entity in terms of population, there are countless other subnational entities that possess greater human and/or natural resources than microstates. Innovative, power-seeking local governments are akin to microstates in terms of their lack of resources and ambition to exercise a wide range of governance functions, and like microstates, they struggle to meet expectations of good governance. Although the world's microstates possess varied forms of government (Anckar, 2006), we can generally state that it is difficult for these human resource-poor political entities to follow standard prescriptions for effective governmental administration. Nevertheless, "small states are pressured to establish organizational structures comparable to those in larger countries" (Raadschelders, 1992, p. 28), complete with a "tendency to proliferate the number of horizontal and vertical divisions within the public service" (Baker, 1992, p. 15).

If these pressures are significant for microstates, they are even worse for innovative local governments, which will tend to lack not only potentially superfluous "emulatory" organisational structures (Baker, 1992, p. 15) but also structures essential for carrying out the local government's expanded functions. As Baldacchino (2010, p. 59) notes:

Unless a territory has enjoyed a separate status within a colonial relationship, such a territory appears most unlikely to have the basic political raw material which could eventually be nurtured into a sovereign state, or even a quasi-sovereign one.

Scottish local authorities were not designed to undertake the level of administration and political activity necessitated by Shetland's *de facto* expanded powers. It is thus that the SIC –

perhaps through adaptation as much as through design – developed the solution of *de facto* expanding its civil service via the CT.

Seen in this light, accusations of institutionalised conflicts of interest may be missing the point: The conflict of interest only exists if the CT is regarded as independent from the SIC. Of course, in order to carry out functions that are legally closed to the SIC, the CT *must* be independent, yet this is a result of the necessity of complying with regional, national, and supranational law rather than because any inherent benefit is thereby accrued. Accusations of personalised partiality and conflicts of interest, meanwhile, remain valid, but only to the extent that they are more or less unavoidable in any microstate or innovative local government, where political, civil service, business life, and NGO roles all overlap and where individuals with key skills typically hold numerous positions of responsibility (Baldacchino, 2012b). With approximately one elected councillor per 1000 residents, the SIC has a closer relationship with the electorate than one could expect in a large national entity. Regardless of the local government’s structural limitations, it is arguably more directly democratically accountable and responsive than are larger governments. Shetland’s government thus lacks the form of legitimacy, not its substance. Baker (1992, p. 18) argues that, in large countries, “blurring the boundaries between official and personal roles is clearly seen as bypassing the rules of fairness and neutrality, but in small states it may well be the only practical way of doing business. The rest is pretense.”

It is precisely pretence that is being demanded of Shetland’s government. For it is not that there is widespread local desire to see Shetland’s government slip back into the role of a typical UK local government. Councillors Duncan, Robinson, and Wills and many of the constituents they represent believe strongly in the benefits of an assertive local government. They certainly do not wish for the Shetland public to lose the benefits of the CT. But it seems likely that they do wish to see a Shetland government that follows the standards of good governance associated with higher-level government functions. In other words, they want Shetland to *de facto* wield a national entity’s power and *de jure* fulfil a national entity’s administrative expectations.

8. Conclusions

In the long run, strong local government is not concomitant with a sense of local identity, nationalism, or a desire for greater self-determination. People the world over distrust their politicians (Ogden, 2007, pp. 60-63) and are not always eager to empower their local politicians in practice even if they would like to empower local politicians in principle (Grydehøj & Hayward, 2011). There may, indeed, be a sort of a paradox of local nationalism in which a strong feeling of local identity prompts local governments to assert their power via innovative policy, the exercise of which heightens unrealisable expectations of conformity with standards of the centralised administrative state, leading to a reigning in from below of the jurisdictionally assertive government. This reigning in can take such diverse forms as the election of oppositional politicians and appeals to higher-level entities (Baldacchino, 2012b, p. 109).

Sometimes, however, a community may side with its assertive local politicians in regarding a local government’s actual or perceived institutional deficiencies as consequences of unfair restrictions imposed by higher-level entities, leading to pushes toward greater autonomy or independence. Baldacchino (2010, p. 60) notes the existence of “rogue politics” in which subnational entities pursue policies deemed illegitimate by higher-level entities “but where

critical local public opinion may be swayed in favour of the lurch and thereby act to legitimize its stance democratically, if not legally or constitutionally.” Higher-level governments are liable to turn a blind eye to legally questionable attempts at expanding *de facto* jurisdictional capacity if the local community is firmly supportive of its local government simply because the alternative – the exercise of coercive power – is unworkable in practice.

Former convener Sandy Cluness challenged Shetlanders to challenge the EC and OSCR. In the main, Shetlanders declined to do so. The consequent loss of *de facto* jurisdictional capacity and democratic accountability and responsiveness thus ultimately owes as much to the political will of the local community as it does to the actions of higher-level entities. That said, while it is possible for subnational entities to force subsidiarity upon higher-level entities, the law remains in these higher-level entities’ favour. Authority may not be strictly ‘nested’ and hierarchical from the perspective of multilevel governance, but regulations set by higher-level entities still take precedence over those of their constituent entities. If national and supranational governments truly wish to encourage local decision making, it is necessary to for them – and for local communities – to first re-assess standards of legitimacy for local government functions and structures.

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¹ We have decided to use the names of these and other local politicians for a number of reasons. All of these figures are named in relation to their public capacities as elected local government councillors and charity trustees, in which context they have all engaged in varying degrees of media relations, including the granting of interviews and the writing of articles and open letters in the local and Scottish press. Moreover, in light of the Shetland government's exceptional *de facto* jurisdictional capacity relative to its status as a subnational entity, we feel it is important to accord Shetland's local politicians the same respect as we would national politicians, i.e. to properly attribute their words and actions.