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By calling voters to a referendum on the subject of Icelandic taxpayers taking on the debt of Icesave bank, President Grimsson caused shock waves to break out in the world's financial community. For the first time during this global financial crisis, a country was challenging its "sovereign" debt - the debt of a nation represented by its government - and repayment of which was being sought by two European countries, Great Britain and the Netherlands.

Realising the enormity of what these two governments were intending to impose on the Icelandic population, the European press (even the right-led and financial press) expressed its indignation. The inhumanity of the two governments was criticised. Images of Shylock demanding his pound of flesh from bankrupt borrowers sprang to mind.

These governments are indeed inhuman and userers too. They were demanding a rate of 5.5% while the European Union (strangely silent on the case of Iceland, admittedly, not an EU member State) was giving loans at a rate of 2% to bail out Hungry and the big States were bailing out their banks at real interest rates of next to nothing.

But unlike Shylock, neither Great Britain nor The Netherlands had ever lent anything to Iceland's taxpayers. The Icesave debt is a private and not a sovereign debt. So what happened?

Firstly there was the financial deregulation recklessly operated by the ruling class, the bankers and the politicians of the right in an island of fishers with a population no bigger than the average English city.

At the time of entering the European Economic Area, a small group of people put in place relatively lax legislation and internationalised the banking sector. Very quickly the volume of this sector's activity grew to exceed eight times that of Iceland's gross domestic product. This meant that approximately 90% of these activities were taking place abroad especially in Great Britain and the Netherlands: 300,000 depositors, at Icesave alone, the British branch of Landsbanki, the equivalent of the population of Iceland !

Iceland was, essentially, an offshore centre for these countries: even though the assets and liabilities were mainly British, the banks' headquarters were accountable to the weak Icelandic rules. Hence the scope to take greater risks and give higher interest rates. And yet Iceland was not exactly a tax haven nor merely a post box number. To open branches in the European Union the Icelandic banks had to meet the requirements of European directive 94/19 which requires each country to set up a "Deposit Guarantee System" (DGS). This is a national insurance fund which is financed by levies taken off deposits and designed to guarantee deposits of up to a maximum of 20,000 euro per person. The Icelandic DGS only covered some of the banks' liabilities but it was considered that all of the banks could not lose all of their assets all at the same time.

Was the Icelandic DGS particularly weak? Was it, perhaps, especially poorly supervised? This was not the view of Richard Portes, head of the Royal Economic Society. In an official report dating from 2007 he wrote:

« The institutional and regulatory framework appears highly advanced and stable. Iceland fully implements the directives of the European Union's Financial Services Action Plan (unlike some EU member states) »

Such was the "well informed wisdom" of the financial community, an assessment offered to the public by one of its most prestigious representatives, Nobel-worthy and British.

We know today that this international community, its representatives and its 3 rating agencies got it completely wrong. In September 2008 the world economy of debt collapsed. The refusal of the US government to bail out the Lehman Brothers bank made the situation worse. If the State didn't intervene all of the banks would go under. And so every State in the world rushed to the rescue of their big banks, and to avoid the onset of panic, extended the deposit guarantee with sovereign power at home, that is, both to nationals and to residents.

The Bank may well be a collection of private institutions but it is also a "Service of General Economic Interest" which means that if it doesn't work then currency, a public good par excellence, won't circulate.

Iceland followed suit and was one of the first to do so. Was its DGS too insignificant to genuinely guarantee deposits? The Icelandic government extended its guarantee to home depositors but it didn't have the means to rescue its banks with massive loans like the big countries. The British government then took two major steps: it seized Icelandic financial assets and offered its guarantee to Icesave's British depositors. The Dutch government did likewise.

First question: Were these three governments legally obliged to extend their guarantee over and above what the DGS could pay to cover the deposits in the Icesave accounts? On this point the European directive governing the issue (94/19/EC) is perfectly clear: no!

« This Directive may not result in the Member States' or their competent authorities' being made liable in respect of depositors if they have ensured that one DGS (...) have been introduced and officially recognized. »

And it is easy to understand why. A DGS is an insurance scheme between banks which protects debts into which banks contract with their depositors and which is funded by contributions from these contracts themselves. To say in advance that public authorities would "cover" incidents like a free open-ended insurance policy would first of all reward banks for their careless behavior (a paradox called "moral hazard"). It would also reward the bigger countries who are better able to cover their banks with taxpayers' money (not just depositors' money). That would be contrary to European norm of competitive "level playing field". Finally and above all, using taxpayers' money to pay a private debt to which taxpayers themselves are not a party constitutes a serious attack on private property: the revolutions of Modern Times (English, Dutch and French) sought to put such serious decisions strictly within the control of the citizens.

I was shadow reporter for the Greens in the European Parliament at the time of the two amending directives to 94/19/EC. At no time was there ever any question of going back on the fundamental principle of public non responsibility for private debts.

The Icelandic, British and Dutch governments were obviously exercising their right when supplementing the insufficiencies of local DGSs. Once the crisis had started, it was indeed their duty to do so for reasons of public order and social and economic stability. But it was a sovereign decision, subject to their rules of internal democracy.

Of course, in the framework of the European Union, when a State grants public assistance of this nature, articles 106 and 107 (formerly 86 and 87) of the treaties governing the functioning of the Union place an obligation on the State to treat all companies and residents on its territory in the same way: this is the principle of non-discrimination. The Icelandic State could for example limit the offer of the extension of the DGS guarantee to Icelandic residents but it had to do this for all local depositors of all branches of foreign banks in Iceland as well.

This point is, in reality, only a detail. Article 107 states that it is up to the European Commission to object to any irregularity. It didn't; such was the extent to which this "nationalistic" attitude was the norm in fall 2008.

The British government didn't wait for the Commission. It seized the Icelandic financial assets on its territory! On what basis? On the basis of the right contained on the antiterrorist law passed in the wake of 11 September 2001 to "freeze" the assets of Al Quaeda. Without a smidgen of evidence or the slightest suspicion, Great Britain was treating Iceland like a terrorist State.

There is of course scope to question the extent of Icesave' s losses and where these losses went. This is to be the subject of a criminal investigation with which the highly respected Green Member of the European Parliament Eva Joly has been mandated. In the absence of any evidence of financing terrorism, the action of the British government comes across as an abuse of power.

But the British and Dutch governments went further again. Having, in a sovereign way reimbursed their residents for the supposed losses of "their" depositors in Icesave well beyond the scope of the Icelandic SGD (which was their right and maybe their duty) they then expected to demand that the Icelandic government compensate them for what they had paid out. Paid out to their residents, not to Icelanders! In other words they were expecting to transform Icesave's private debt into the public debt of the Icelandic nation.

It doesn't take long to do the calculation: every Icelander, including babies, the elderly and the unemployed would find themselves indebted to the tune of 12,000 euro, repayable at an extortionate rate, essentially indebted for life, and possibly over several generations. In Latin America, they speak of the "peonaje": the peasant who is indebted for life to the local landlord and kept in a situation of medieval servitude.

This is what has caused the justified outcry amongst Icelanders and European indignation. But all emotions aside, we must remember that there is absolutely no legal basis, as we have seen, for such an expectation: the States have no responsibility beyond "introducing and recognising a DGS". And this is for the three reasons set out above. If Icelanders want to do it, it is their choice, but it is appropriate to ask them by means of a referendum.

The English and British governments can only, at the end of the day, invoke the route of jurisprudence: "especially gross negligence" in the duty to supervision, which could be considered as incumbent on the Icelandic authorities. The quotation from the Portes report referred to above bears out such an accusation. There certainly has been gross negligence but neither more nor less than in most governments and institutions around the world dazzled by the vision of "self regulating markets". The responsibility is well and truly shared and it could even be set out in what proportion. Because even though the two "virtuous and prudent" governments - the British and Dutch - had had their doubts about Icesave and had considered that the deposits of their residents were more effectively guaranteed at home than in Iceland, what did they have the right to do as Icesave's "host countries" ?

The answer is set out in directive 94/19 and is specifically dealt with in the guidelines in its Annex II.

"Host Member State schemes will be entitled to charge branches for supplementary cover on an appropriate basis which takes into account the guarantee funded by the home Member State scheme. To facilitate charging, the host Member State scheme will be entitled to assume that its liability will in all circumstances be limited to the excess of the guarantee it has offered over the guarantee offered by the home Member State."

In short, the host country can offer supplementary cover to the guarantee and to do this is entitled to require a local branch to make contributions in the host country in addition to the payments made in the country of the bank's headquarters. In reality the British and Dutch authorities never wished to limit Icesave's capacity to offer particularly high rates of interest to their depositors but by taking more risks. These authorities, therefore, had a duty to warn these depositors and bore the civil responsibility of not having imposed the complementary measures envisaged by the directive (an excellent way of limiting the off-shore perverse risks!)

As rapporteur in 2001-2002 for the directive on "Prudential supervision of financial conglomerates," I had the European Parliament adopt a generalisation of this "principle of main host country" by stating that the authorities responsible for monitoring a transnational group were automatically those of the host country of the main activity within EU. In the case of Icesave: Great Britain, which was right to reimburse its depositors but wrong to subsequently turn against Iceland.

This argument could of course be challenged. There is a Court which has responsibility for interpreting directives: the European Court of Justice in Luxembourg. A point which both British an Dutch governments insist to ignore. It is time that Great Britain and the Netherlands returned to the principles of the Rule of Law (to which these Nations contributed so much, for the universal glory of their history), turned to the decision-making of this Court and abandoned the threat of extracting a pound of flesh from every Icelander including the babies.

One last point. The government and parliamentary majority which initially believed that they had to accept the Anglo-Dutch diktat, not daring to have recourse to the Judiciary power, are these same women and men that Icelanders, already up in arms, had summoned after the failure of the ultraliberal model and its politicians, who from November 2008 capitulated in the face of this diktat. These new representatives of the people, who came to power with weak experience of financial battles, believed that they had to yield to the threats of these two countries, calling to their service the shameful blackmailing of the IMF and the equally shameful silence of the Barroso Commission. Today Spain, which currently holds the Presidency of the European Union, clarified matters: there is no link between the repayment of the Icesave debt and Iceland's application for membership of the European Union. One would have expected an equally firm clarification from Dominique Strauss-Kahn on the subject of the IMF credits.

But I suspect in the naive "availability to repay" of many Icelanders and their representatives, a sort of guilt: like a divine punishment after years of the delusion of easy money. I say calmly to this strong and courageous people: You are neither legally responsible not morally guilty for the base acts of internationalised finance.