

Forum: Economic and Financial Committee

Issue: Addressing sovereign debt crises across Latin America and Caribbean nations

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Introduction



A map of the region (Wikipedia)

In early 2025, it was declared by the International Monetary Fund (IMF) that “*debt levels have stabilized and are projected to remain stable or slightly decline.*” (Debt Relief for Green and Inclusive Recovery, 2025) However, the current economic condition in the region is a clear sign for the fact that this does not apply to the Latin American and Caribbean Region where many countries are being crushed under massive debt burdens, which sometimes exceeds their GDP. The total debt across the continent is estimated to be over one trillion U.S.D with interest rates pushing this number even higher with each moment as many of the countries are unable to pay even the interests.

The debt crisis in the Latin American and the Caribbean Regions has a long historical background, which needs to be understood before trying to find solutions to the current day problems. A similar crisis was present in the region in the second half of the 20th century in a period called the “lost decade”, a period when many of the countries were unable to pay their debts. This not only fueled a problem for the debtor countries, but also for the lenders as well. Eventually, debtor countries were locked in a cycle where they had to borrow more debts to pay off their existing debts. Even though this crisis subsided for a period in some countries following certain solution attempts such as the Brady Plan, it is evident that the issue escalated again in recent years and still needs a long term, permanent solution.

This moment proves the importance of trust to prevent crises and protect prosperity. The crisis can only be solved with multilateral agreements between the lenders, debtor countries and several other relevant parties such as banks and the public. With regional collaboration and trust, the region can be saved from an economic collapse that awaits if the debts are to be defaulted. The solution needs to not only save the debtor countries from massive debt burden, but also protect the rights of lenders, banks and the people as well. Otherwise, the region is doomed to drift once again to crisis.

Definition of Key Terms

Debt: Debt is defined as “*something, especially money, that is owed to someone else, or the state of owing something*” (Cambridge Dictionary)

Loan: Loan is defined as “*an amount of money that is borrowed, often from a bank, and has to be paid back, usually together with an extra amount of money that you have to pay as a charge for borrowing*” (Cambridge Dictionary)

Interest: Interest is defined as “*money that is charged by a bank or other financial organization for borrowing money*” (Cambridge Dictionary)

Default: Default is defined as “*to fail to do something, such as pay a debt, that you legally have to do*” (Cambridge Dictionary)

Bridge Loan: Bridge Loan is defined as “an arrangement by which a bank, etc. lends a company or person some money for a short time until that person can get the money from somewhere else” (Cambridge Dictionary)

Bretton Woods System: A system where domestic currencies were fixed to an anchor currency (U.S. Dollar) and the value of the anchor currency were fixed to gold. (ScienceDirect)

Brady Bonds: Brady Bonds are defined as “sovereign debt securities, denominated in U.S. Dollars (USD), issued by developing countries and backed by U.S. Treasury bonds. (Investopedia, 2022)

General Overview

While reviewing the historical background of this issue, it is beneficial to separate it into different parts and analyze them on their own, as this will provide the delegates with a clear view of the emergence of the problems along with its reasons, solution attempts along with the extent they were successful and the reason they did not meet expectations.

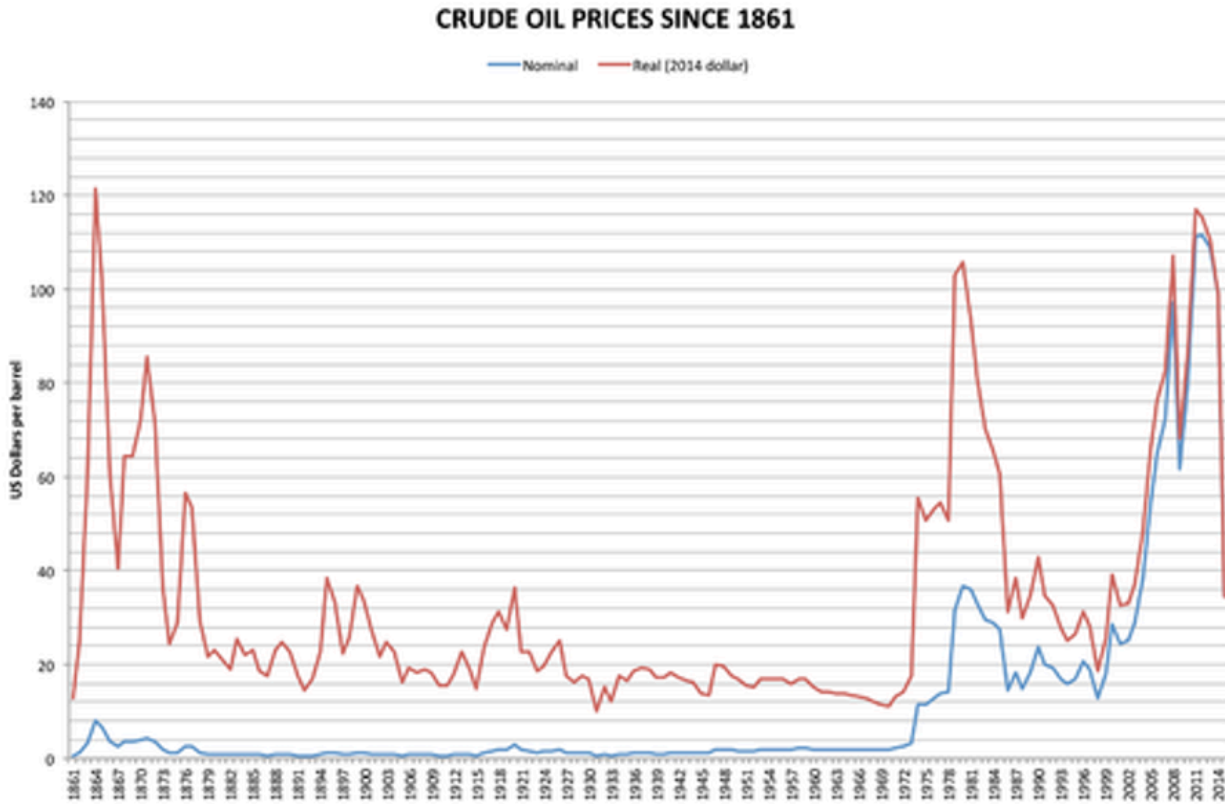
The Formation of the Loan System and the Consideration of Different Financial Sources

Following the end of World War 2, the Bretton Woods System was implemented to oversee and coordinate the economic development around the World. It basically was a system aiming to set up an anchor currency (the USD) and make that anchor currency fixed to gold to create fixed exchange rates around the World. Following this, the IMF was founded and was given the task to “grant loans to countries in order to forestall economic recessions.” (UPenn, 2024) Even though some restrictions limited the amount of money lent by the IMF, such as contribution and compliance, it has been a major source of funding for many years. However, as inflation increased in the late 1960s, the member contribution to the IMF did not increase at the same rate, which significantly reduced the IMF’s purchasing power. Not only that, but it was also unable to oversee the currency exchange rates, which led not only to some currencies being overvalued, but also to deficits in payments.

At the same time, sovereign countries started to consider some alternatives as new sources of funding. The 1970s saw a dramatic increase in the amount of loans granted to sovereign countries. A primary reason for this was the fact that many of the financial institutions in the U.S receiving large amounts of funds and looking for new markets for investment. As export prices in Latin America were increasing simultaneously, and the less developed countries in the region looked for sources to stabilize their economies and expand their growth. As they discovered these financial institutions and banks as a source, they gradually abandoned the Bretton Woods System and the IMF. Borrowing money from the IMF became the less preferable option due to restrictions and prerequisites being present. As this was not

the case with financial institutions, countries looking for capital preferred to borrow money from them. In 1973, only one third of the financing to the Less Developed Countries were provided by private banks, this rose nearly to ½ of all financing in a span of only three years.

Economic Crisis



A chart illustrating crude oil prices in Mexico, a spike can be seen in the 1970s (Wikipedia)

The oil crisis of the late 1970s caused several problems in the region's economy. Oil prices surged in markets, placing oil dependent industries in economic hardship. Many Latin American countries were forced to borrow more and more debts to be able to keep their economy and industry functioning, as it was dependent on oil. This caused the debt burden to increase rapidly. Additionally in 1981, the U.S increased its interest rate, this caused the debtor countries to be in need of paying higher interest payments than they initially expected. Following these events, Mexico in 1982, was the first country to declare that it could no longer pay its debts, followed by several other Latin American Countries. This was a problem not only for the debtor countries as their economy collapsed, but also for the banks and debt lending financial institutions as many of them loaned out more money than they actually had in their reserves. If the debtor countries were to default on their loans, or the loans would be declared nonperforming (if interest payment is not paid after 90 days) and taken off the balance sheets, they would

go bankrupt. In order to prevent total economic collapse in the region, several solutions were implemented.

Solution Attempts

First action taken by the financial institutions after the debt crisis was announced was to lend out new loans called “Bridge loans”, which aimed to provide the debtors with the necessary capital to pay off the interest of their previous debts. This prevented the previous loans from becoming nonperforming but placed the debtor countries under even greater debt burden.

Another solution discussed was the restructuring of debts. Many payment schedules and deadlines were rearranged in order to give more time to the countries with debts before payments are due. In order to plan and coordinate these efforts, a steering committee, acting as a liaison among the parties and representing interests was formed with the name Bank Advisory Committee (BAC). The terms negotiated and offered by BAC were often accepted. But even though this solution allowed for banks to regain financial freedom to an extent, its effects were not as intended on the debtor countries and their citizens. The deadline of loans being extended meant that the countries were still obligated to pay off the interest in their loans, which resulted in those countries borrowing even more bridge loans. As they were crushed under heavier debt burdens, the living conditions for their citizens also deteriorated. Not only that, but many countries were unable to meet the rescheduled deadlines as well. In addition, the region experienced a decline in the GDP per capita and a surge in unemployment. *“While the Western banks were able to recoup their losses to some extent, it came at a terrible cost to the borrowing nations.”* (UPenn, 2024)

Brady Plan

It was clear that the solutions were not yielding the expected results and were causing even more harm to the economies of the debtor countries. They had no way of paying off their debt, or even the interests, and the bridge loans and extensions were no help to these countries, as they caused the debt burden to increase even further. Meanwhile, the economies were collapsing, people were falling into poverty, and the GDP per capita was falling. In addition, the debt restructuring efforts were problematic, as collaboration was weak, and the efforts were not coordinated. All these were signs showing that a new solution was necessary.

A new scheme was announced in 1989 by Nicholas Brady, the United States Secretary of Treasury at the time. This new scheme, later to be known as the “Brady Plan”, recognized the need for drastic measures and proposed the securitization of the loans. Following this plan, the debtor countries converted their debts into bonds backed by the U.S Treasury Bonds and these bonds were then offered to the public. With this, the debtor countries were able to pay off their debts with the money generated by the

sales, while the investors who purchased these bonds would receive periodic payments from a fund. With this, the banks were no longer under the risk of bankruptcy if the debtor countries were to default, as the debts were already paid. Not only the banks, but the debtor countries also benefited from this scheme, not only was there a discount issued by the bonds, but the payments to the investors had a longer maturity date, allowing the debtor countries to have more time to pay them off while rebuilding their economy. Many debtors converted their debts to Brady Bonds, and most of the debts were held in this form for a long period of time.

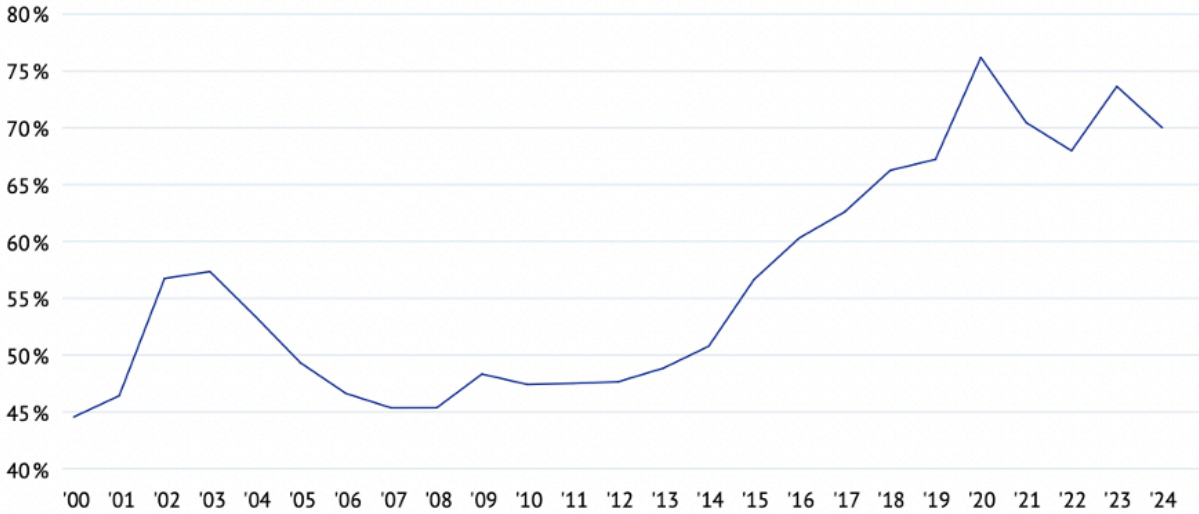
Exchange of Brady Bonds

In the following years, many debtor countries swapped out their Brady Bonds with other sources of debt or global bonds due to several economic reasons and advantages. This way, not only a portion of the money which would normally go to collateral is freed, allowing the debtor countries to put that money into use, but this also increased investor confidence, as investing in these types of bonds were safer for them. Additionally, this allowed the debtor countries to extend the maturity time of their debts, giving themselves even more time before the payments were due and a better chance to rebuild their economies. *“As of June 2001, the amount of Latin American sovereign debt held in the form of Brady bonds decreased from \$129 billion to \$63.5 billion.”* (UPenn)

The abandoning of the Brady Bonds was actually viewed as a positive development by many, including Nicholas Brady himself, when he stated he viewed this development as a sign of the Latin American economies gaining the ability to stand on their own.

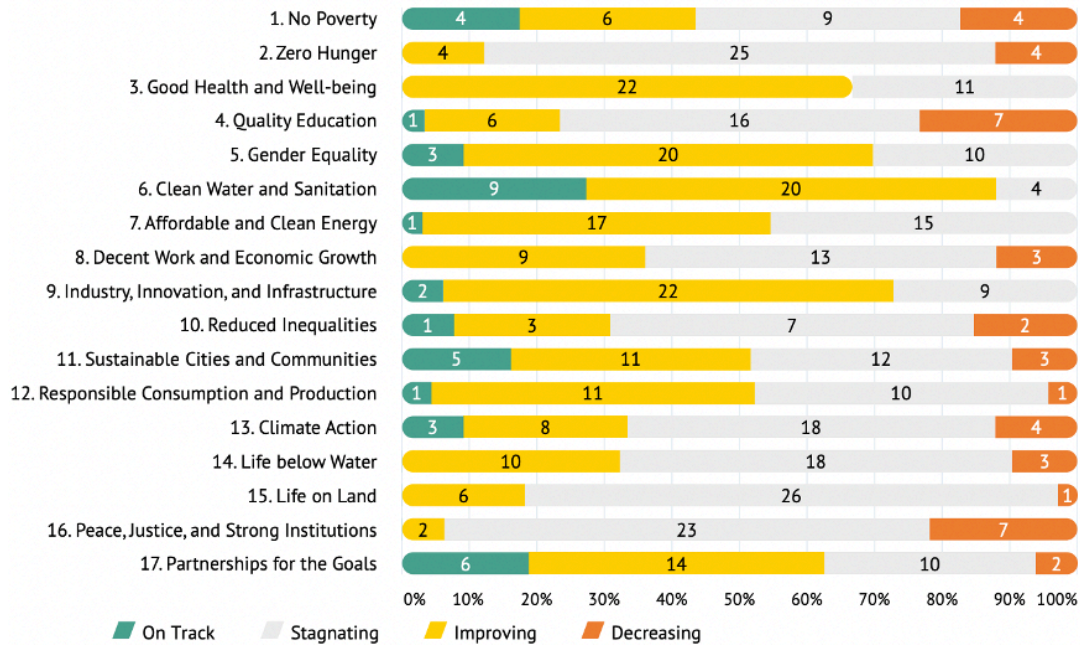
Latest Situation

However, even though the crisis was solved in the past, total regional economic stability is still not achieved. Between 2008 and 2023, the external debt of many Caribbean countries tripled, with a similar pattern also being present in Central and South America. The debt owed to bondholders rose from 222 billion USD to 543 USD between the same period. Not only the debt burden increased in numbers, but the depreciation of domestic currencies against the anchor currency, the USD, resulted in the increase of the cost of servicing the external debt, since the payments were done using the anchor currency.



A chart illustrating the debt-to-GDP ratio in Latin America and the Caribbean (Debt Relief for A Green & Inclusive Recovery)

The impacts of debt burden were not only international, but also internal. The high level of financial resources allocated to debt servicing was significantly straining the resources of the debtor countries. This limited the spending on social services such as healthcare and education. In addition, not only social services were affected, but many debtor countries faced significant challenges in reaching the sustainable development goals, as nearly none of them are on track of reaching the goals.



Number of Latin American and the Caribbean Countries to reach the sustainable development goals (Debt Relief for A Green & Inclusive Recovery)

In conclusion, it can be seen that the debt crisis has a long history with many causes and effects which needs to be addressed. The past solutions, although efficient for a period of time, were not able to offer permanent economic stability. Collaboration and mutual trust are essential for development in the region.

Major Parties Involved and Their Views

IMF

The IMF was founded with the Bretton Woods Agreement. Its aim was *“to grant loans to countries in order to forestall economic recessions”* (UPenn). It had strict prerequisites before giving out loans, and this was a reason why countries started to look for alternative financial sources.

Lenders

As many financial institutions received high amounts of credit and started to look for investment ground, the economically developing Latin American region was a target to them, as the countries were looking for alternative financial sources other than the IMF. When the debtor countries fell under the risk of defaulting, they fell under the risk of bankruptcy, as they had lent more money than what was available at their reserves. They were then engaged in debt restructuring talks and gave out bridge loans to prevent defaults from happening.

United States

The United States, although not being directly involved as a debtor or lender country, its actions were both critical in the formation of the crisis and the solutions to it. The Bretton Woods Agreement was signed in the United States, and the medium was the USD. The United States were also involved in the formation of the Brady Plan and the bonds were supported by the U.S. Treasury Bonds.

Debtor Countries

Many of the Latin American countries were in a period of economic growth in the 2nd half of the 20th century. As they looked for alternative financial sources than the restricted loans of the IMF, they turned to banks and other financial organizations. As they took more and more loans from these other financial organizations, their debts piled up. Combined with the oil crisis, high operation costs of economies and increased interests, many were unable to pay their debts off, and fell under the risk of

defaulting. With solutions such as the Brady Bonds, the issue was fixed for some time until the countries fell under heavy debt burden created by international bonds once again.

Small Island Developing States

Among the debtor countries are many Small Island Developing States (SIDS). Due to their small size, economy and population, they are especially vulnerable to the debt crisis. Some of them have debts that are over 100% of their entire GDP's.

Timeline of Events

1944	The IMF was founded with the Bretton Woods Agreement.
1960s	The Bretton Woods System is a major source of funding for countries that are looking for loans.
1970s	<ul style="list-style-type: none">- Many financial institutions receive massive amounts of money and look to invest.- Latin American countries turn to these financial institutions for loans instead of the IMF.
1982	Mexico is the first country to announce that it will not be able to pay off its debt, followed by many other countries in the region. Debt crisis begins.
1980s	Debt restructuring takes place.
1989	Nicholas Brady announces the "Brady Plan"

1996	Mexico exchanges an amount of its debt from Brady Bonds to global bonds
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UN Involvement

The UN was involved in this issue mainly through the IMF. The IMF has been giving out loans to Latin American countries. After the countries stopped seeing the IMF as a viable option because of its perquisites and started to drown under the debt burden, there was no additional action taken. The issue was solved mainly through multilateral agreements to restructure debt and the Brady Plan, UN impact was minimal other than the loans given out by the IMF.

Treaties and Events

Bretton Woods Agreement

Signed in Bretton Woods, New Hampshire, in 1944, the Bretton Woods Agreement led to the formation of the IMF and the emergence of a new international monetary system. It facilitated countries to take out loans whenever they needed to support their economy.

The Brady Plan

Proposed by Nicholas Brady, the United States Secretary of Treasury in 1989, the Brady Plan proposed the exchange of foreign debt with bonds to save countries from the debt burden they were being crushed under. The bonds were then offered to the public and were backed by the U.S Treasury Bonds. The payments to the investors were done from a fund set up for this purpose. Many of these bonds were later swapped with international bonds.

Evaluation of Previous Attempts to Resolve the Issue

Bridge Loans

Although being efficient in the short-term for avoiding defaulting and bankruptcy, the bridge loans did not help any country to save themselves from the debt burden. In contrast, these loans caused them to be under even more serious debt crises.

Debt Restructuring

It was an efficient solution to give more time to debtor countries and to sometimes decrease the burden on them, but as many of these restructurings were ill-coordinated and were not done collaboratively and extensively, it only managed to fix a small portion of the issue. In addition, the countries that are not able to finance their debt in the extended time faced even more interest and had to take out even more loans.

Formation of the BAC

By forming an advisory committee as primary liaison among the creditors and the debtors, and negotiating agreements, it was possible for the debt restructuring agreements to go smoothly. However, the issue still persisted.

The Brady Bonds

As a part of the plan proposed by Nicholas Brady, the debtor countries converted their loans into bonds and offered them to the public. From the revenue generated from the selling of these bonds, the countries were able to pay off their debts.

However, as the Brady Bonds were replaced with international bonds in the following years and although this was seen as a positive development at first glance, many of the modern problems emerged from this action. Many countries in the region are once again crushed under their debt to the bondholders as the interest of the bonds are more than what they are capable of paying.

Possible Solutions

Support in Economic Development

The primary issue with the debt crisis is the fact that the countries are locked in a state where they cannot generate any additional revenue other than what they have to pay to the bondholders. First thing that needs to be done to solve the issue is to support the economies of the Latin American and Caribbean countries. With the help of the international community and several UN bodies, investment and economic aid needs to be done in the region to support the economy. This would help the countries to stand up by themselves.

Lessons from the Past

The debt crisis was once solved. Although not being a permanent solution, it is a solution to be improved on. With protection from inflation and high interest rates, a program similar to the Brady Plan could be put in action. However, this plan needs to protect both sides.

Notes from the Chair

Since there are multiple sides in this issue, solutions need to address the needs of all the parties. In the past, issues regarding the restructuring of the debt were present, since no plan satisfied every party. As the region is currently in another debt crisis, different from the one in the 20th century, the conditions and reasons are different. While solving this issue, mutual trust and collaboration is needed to save the region from economic collapse.

Here are some links that would be helpful for delegates.

- <https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1305&context=jil>
- <https://www.investopedia.com/terms/b/bradybonds.asp>

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