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A DOUBLE-EDGED PENSION REFORM

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Chile moved forward —in the dead of night— with one of the most ambitious pension reforms in its history. Yet far from offering clarity and confidence, the final design blends elements that raise as many answers as questions. The stated goal is to improve pensions, reduce inequality, and address gender-based longevity gaps. In practice, the reform introduces mechanisms that could compromise both efficiency and long-term sustainability.

The approved pension reform brings structural changes: a social insurance fund financed by employers, a progressive increase in mandatory contributions from 10% to 18.5%, and a mixed system combining individual savings, redistribution, and solidarity.

At the heart of this design is an additional 8.5% employer contribution, allocated as follows: 4.5% to individual capitalization accounts, 2.5% assigned to a redistributive social insurance component (which is in fact an additional tax), and a 1.5% contribution assigned to a government-backed bond with protected returns. This last element deserves scrutiny. The Autonomous Pension Protection Fund (FAPP) will issue bonds guaranteed by the State, but without any real investment in the market which is a notional performance. In essence, this contribution becomes a forced loan to the government. The result? A form of disguised pay-as-you-go financing, nominally profitable, but one that could place growing pressure on public finances.

Another major element of the reform is the adoption of generational funds, aligned with the affiliate's age, aiming to mirror international models. However, the evidence on generational funds remains inconclusive. Mexico has shown positive outcomes, but not necessarily due to the model itself. Costa Rica's case, in contrast, illustrates the rigidity caused by strict age segmentation. Without a flexible "glide path"—an adaptable investment trajectory responsive to individual risk and market conditions—this model may fall short. Chile's reform offers no guarantees of such flexibility.

Additionally, every two years, a 10% of the total stock of affiliates will be randomly reallocated across pension fund administrators (AFPs). This innovation—moving beyond the existing tender process for new entrants—is intended to boost competition and reduce fees. But it may backfire. It disrupts long-term investment strategies, introduces operational volatility, and may discourage investment in illiquid, high-return assets in favor of more conservative, lower-yield portfolios. Ironically, a mechanism meant to maximize returns could undermine them.

In short, what was once a clear, individual account-based system will be gradually replaced with a hybrid, bureaucratic structure that multiplies actors: AFPs, the IPS, the FAPP, a forthcoming public investment manager, and a new institution for social insurance. This fragmentation increases administrative costs and opens the door to inefficiencies and political capture.

Moreover, the government plans to finance the reform with additional tax revenue equal to 1.5% of GDP via a tax compliance law. But if revenue falls short—as recent history suggests it might—part of the new contributions may end up being used indirectly to keep the fiscal deficit in check. In that sense, this pension reform could quietly function as a stealth tax reform.

Will this reform improve pensions? Probably yes. But it also increases system complexity and erodes coherence. AFPs are weakened and partially replaced by a model that isn't necessarily more efficient—but certainly more regulated, costly, and uncertain. What's urgent now is to monitor the implementation closely, ensure incentives remain aligned, and protect the core of the system: the affiliate's pension.