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INDEXING THE MILITARY STATE: THE THRIFT SAVINGS PLAN AS A LOW-COST INSTITUTIONAL INVESTOR

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ABSTRACT

The Thrift Savings Plan is the primary retirement investment vehicle for U.S. military personnel and federal employees, offering participants access to one of the world's largest institutional investment platforms. Built on a low-cost, passive indexing philosophy, the TSP achieves exceptional efficiency through scale, minimizing expenses while providing diversified market exposure. Its governance structure ensures stability and neutrality, positioning it as a key player in global capital markets. While its current investment policy excludes explicit Environmental, Social, and Governance (ESG) criteria, this absence raises important questions for future policy, balancing fiduciary duty, political context, and evolving standards in public pension management.

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INTRODUCTION

The Thrift Savings Plan (TSP) constitutes the principal defined-contribution retirement scheme for members of the United States Armed Forces and federal employees. Instituted in the late 1980s through the Federal Employees' Retirement System Act (FERSA) of 1986, it was designed to provide a supplementary savings and investment vehicle aimed at reinforcing future retirement income (U.S. Office of Personnel Management, 2022). Historically, the establishment of the TSP marked a shift away from exclusively defined-benefit systems toward a hybrid model, in which long-term financial security depends not only on government-provided benefits but also on the investment performance of individual accounts (Clark, Craig & Wilson, 2003). Following the reforms introduced by the Blended Retirement System (BRS) in 2018, the TSP became a central pillar of the military retirement framework, incorporating service members into a mixed regime of social security entitlements and contributory investment mechanisms (Asch *et al.*, 2019). As a large-scale institutional investor, the TSP manages assets exceeding 800 billion dollars, ranking it among the largest pension funds worldwide (Federal Retirement Thrift Investment Board, 2023). Its investment strategies and returns affect not only the well-being of millions of participants but also the broader U.S. capital market. Nevertheless, the existing literature has focused primarily on the reform of federal

retirement schemes, while paying comparatively less attention to the military dimension and to the role of the TSP as a powerful institutional investor (Duflo & Saez, 2004; Ippolito, 2012). The research question posed, therefore, is how the TSP, as a mechanism of military and federal savings, balances its role as an instrument of social security with its mission as an actor in the global investment arena. This article seeks to address this gap through a combination of historical, institutional, and investment analysis, contributing to the broader debate at the intersection of defense, social policy, and financial markets.

Institutional Framework of the TSP: The TSP operates within a clearly defined institutional framework that combines legal provisions, administrative structures, and organizational oversight. Its legal foundation is established by the Federal Employees' Retirement System Act of 1986, which set forth its creation and core operational principles (U.S. Congress, 1986), as well as by subsequent amendments that incorporated specific provisions for members of the Armed Forces, particularly following the implementation of the Blended Retirement System (BRS) in 2018 (Department of Defense, 2017). The administrative and operational oversight of the TSP is exercised by the Federal Retirement Thrift Investment Board (FRTIB), an independent federal agency established to manage the funds and safeguard the interests of participants (FRTIB, 2023), which is responsible for:

- Formulating of investment policy and selecting management strategies,
- Ensuring compliance with the institutional and regulatory framework,
- Ensuring transparency and accountability,
- Safeguarding the interests of participants (GAO, 2020).

Within the federal-military retirement system, the TSP operates as a complement to the defined-benefit schemes, namely the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) for federal employees (U.S. Office of Personnel Management, 2022), as well as the military Blended Retirement System (BRS). The linkage with the BRS is particularly significant. The TSP functions as the principal mechanism of capital-based savings, into which the Department of Defense contributes a percentage of service members' basic pay, while also allowing for additional voluntary contributions from participants (Department of Defense, 2017). In this way, the TSP becomes organically embedded within the retirement 'package' of active-duty and retired military personnel, enhancing both long-term financial security and the strategic objective of force retention (Asch, Mattock, & Hosek, 2019). This institutional and administrative framework ensures that the TSP is not merely an investment account, but rather an organization with a clear mission, robust oversight, and a close connection to the national strategy for the welfare of federal and military employees."

DISCUSSION

The institutional architecture of the TSP, in conjunction with its integration into the federal-military retirement system, represents a characteristic case of 'financial state incorporation,' in which stable public contributions are transformed into capital markets through indexing mechanisms (Clark, Dixon, & Monk, 2013). This model raises research questions regarding the balance between financial efficiency, systemic stability, and institutional accountability, which become particularly salient in the analysis of the TSP's low-cost passive investment model that follows.

Low-Cost Investing Model: The TSP has developed one of the most distinctive models of passive investment strategy within the field of institutional investing, with the primary objective of ensuring low costs for participants and long-term return stability. This philosophy is grounded in the extensive academic and empirical evidence supporting the superiority of passive index-based strategies over many active management approaches, particularly across multi-year investment horizons (Fama & French, 2004; Malkiel, 2019).

Passive Investment Strategy: The TSP invests primarily through funds that track specific market indices, with the objective of replicating rather than outperforming the returns of the underlying markets. This approach drastically reduces transaction and management costs, while simultaneously aligning with the academic underpinnings of the 'Efficient Market Hypothesis' (Sharpe, 1991; Jensen, 1968).

Investment Fund Options: The participants have access to five core funds, each linked to a different benchmark index:

- **C Fund:** Tracks the **S&P 500 Index**, which represents a capitalization-weighted index of large U.S. companies. Historically, it has delivered an average annual return of approximately 10% over the long term, with a standard deviation of about 15% (Dimson, Marsh, & Staunton, 2021).
- **S Fund:** It is linked to the Dow Jones U.S. Completion Total Stock Market Index, which comprises mid- and small-capitalization companies, providing greater diversification and potentially higher volatility.
- **I Fund:** Tracks the **MSCI EAFE Index**, which encompasses developed markets outside North America, primarily Europe, Australia, and the Far East. Historically, it has exhibited lower

correlation with the S&P 500, thereby enhancing the benefits of international diversification (Solnik & McLeavey, 2009).

- **G Fund:** Invests in special-issue U.S. government securities issued exclusively for the TSP, with principal guaranteed and returns tied to the weighted average yield of all outstanding U.S. Treasury securities, with principal guaranteed.
- **F Fund:** Tracks the Bloomberg U.S. Aggregate Bond Index, offering exposure to the U.S. investment-grade bond market. Historically, it has provided an average return of approximately 4–5% with lower standard deviation compared to equity markets (Fabozzi, 2016).

Cost Indicators and Control Mechanisms: The TSP is internationally recognized for its exceptionally low expense ratios¹, which in 2023 stood at approximately 0.043% (FRTIB, 2023), compared to an average of around 0.20% for U.S. index mutual funds and above 0.60% for actively managed funds (Investment Company Institute, 2023). This cost differential has significant cumulative effects on net returns over the long term, as demonstrated by compound return models (Sharpe, 1991)

The cost control mechanisms include:

- Economies of scale² arising from the vast volume of assets under management.
- Passive management,³ which reduces transaction costs.
- Centralized management by the FRTIB⁴, without retail distribution intermediaries.

Comparison with Other Pension Funds: By comparison, large institutional investors such as CalPERS or the Norwegian Government Pension Fund Global exhibit higher overall costs due to mixed (passive-active) strategies, although in some cases they record excess returns through alternative investments. However, long-term research indicates that the TSP's low-cost passive strategy delivers competitive net returns, particularly for investors with horizons exceeding 20 years (Bogle, 2017).

Market Role and Strategic Positioning: The TSP holds a prominent position in global capital markets due to the scale of its assets under management and its distinctive status as an institutional investor directly tied to U.S. federal and military personnel. With assets exceeding \$800 billion (FRTIB, 2023), the TSP ranks among the largest passive investment institutions worldwide, exerting significant influence on the valuation and liquidity of financial markets.

Influence on Capital Markets

The indexing strategy implies that capital inflows and outflows primarily follow the capitalization of the underlying indices. This contributes to increased demand for large-cap securities (C Fund – S&P 500) and enhanced liquidity in both international and domestic

¹ They measure the annual cost of managing an investment product as a percentage of the fund's assets. This includes management and operational expenses as well as fixed costs, but excludes commissions or taxes. A low expense ratio translates into higher returns for the investor, whereas a high expense ratio reflects greater costs. Passive ETFs typically exhibit low expense ratios (0.05%–0.3%), while actively managed mutual funds carry higher ones (1%–2%+).

² Because the TSP manages vast amounts of assets on behalf of millions of participants, the operating cost per investor is drastically reduced.

³ Passive management means that most of the funds' investments do not seek to 'beat' the market through active security selection, but rather track benchmark indices. Consequently, there is no need for an expensive team of analysts to conduct continuous trading, which keeps management costs significantly lower. The objective is to replicate the index's performance, not to surpass it.

⁴ Federal Retirement Thrift Investment Board: A unified independent federal agency responsible for the administration, oversight, and operation of the program. This structure avoids cost and process fragmentation, ensures the formulation of a unified strategy, risk control, and large-scale contract negotiation, while also securing stability and transparency in investment management.

markets (I Fund – MSCI EAFE, F Fund – Bloomberg U.S. Aggregate Bond Index). At the same time, the steady stream of contributions from millions of participants provides a countercyclical dimension to allocations, mitigating the likelihood of severe disruptions from short-term market movements (Greenwood & Vayanos, 2014).

Role in Market Stability: The long-term nature of TSP investments, combined with the absence of pressure for active reallocation, acts as a stabilizing factor in financial markets. Research has shown that large institutional investors with a passive orientation contribute to reduced volatility and enhanced market efficiency (Appel, Gormley, & Keim, 2016). In the case of the TSP, this stabilizing role is reinforced by the fiscal reliability of its contributions, as they are sourced from the payrolls of federal and military employees, ensuring predictable cash flows.

“Indexing the Military State”: The notion of *Indexing the Military State* can be described as the institutional integration of the armed forces and federal personnel into capital markets through indexing mechanisms⁵. In the case of the TSP, military and federal civilian labor is translated into funds that are automatically invested in stock market indices, creating a direct linkage between the 'military-state' system and private capital markets. This structure has been interpreted as an example of the 'financialization of the state' (Clark, Dixon, & Monk, 2013), in which the public sector and the military are not merely regulators but active participants in the investment process." Moreover, the continuous accumulation of capital in passive portfolios links the financial well-being of millions of participants to the stability and performance of the markets. This creates a feedback loop: the market affects pensions, while pensions themselves, through the TSP's assets, exert influence on the market."

ESG Considerations as a Policy Question: In recent years, the integration of Environmental, Social, and Governance (ESG) criteria into investment strategies has become a central issue for many public and pension funds worldwide. Major institutional investors, such as the Norwegian Government Pension Fund Global and the Canada Pension Plan Investment Board, have adopted ESG policies that include company exclusions, active engagement with corporate management, and investments in green or socially responsible initiatives (Clark, Dixon, & Monk, 2013; Richardson, 2021). This trend reflects the growing recognition that ESG factors can influence long-term returns and risk (Friede, Busch, & Bassen, 2015).

Global Trends in Public Pension Funds: The majority of large public pension funds worldwide have adopted ESG policies, often in conjunction with the United Nations' Principles for Responsible Investment (PRI). The adoption of ESG is associated with:

- Reduction of regulatory and legal risks.
- Adaptation to climate and social transitions.
- Strengthening the social legitimacy of pension funds (Gunn, 2020).

Absence of ESG in the TSP: The TSP does not implement ESG-screened investment options. The reasons for this absence include:

- Legal constraints: The FRTIB is required to invest solely on the basis of maximizing financial returns for participants, in accordance with the fiduciary duty established by FERSA (U.S. Congress, 1986).
- Political sensitivities: The selection of specific ESG criteria may be perceived as politically charged, particularly in an environment with diverse ideological orientations.
- Portfolio structure: The strict indexing to widely accepted market benchmarks limits the ability to apply exclusions without altering the underlying index.

Potential Implications: The absence of an ESG strategy:

- In the short term, it allows the TSP to focus exclusively on financial returns, avoiding the costs associated with portfolio restructuring.
- In the long term, it increases exposure to risks related to climate change, social inequalities, and corporate governance, while foregoing international best practices (Sullivan & Mackenzie, 2017).

The debate over the integration of ESG into the TSP remains politically charged and is intertwined with the broader question of the role of a state-military pension fund as an investor in global capital markets.

CONCLUSION

The TSP represents an institutional investor of unique character, as it combines three features that are rare on a global scale: (a) the scale of asset management, which places it among the largest pension funds worldwide; (b) a strict commitment to low-cost passive indexing; and (c) its institutional linkage to U.S. federal and military personnel. As a result, it functions as a stabilizing mechanism in capital markets while simultaneously highlighting their active role in the global investment arena. In the realm of institutional investing, the TSP offers a distinctive case study that combines efficiency (of investments) and security (of government-backed cash flows), raising questions about the 'indexing of the state' and its implications. The absence of an ESG strategy opens a critical debate on whether and how public pension funds should integrate responsible investment criteria without undermining their fundamental investment purpose. Future directions could include a comparative analysis of the TSP with international funds that have incorporated ESG practices, a quantitative assessment of its contribution to market stability, as well as an evaluation of the long-term investment outcomes of the passive strategy in environments of heightened volatility or geopolitical disruptions.

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⁵Passive investment strategies, which replicate the returns of stock market indices by investing in the same or equivalent assets in identical proportions.

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