

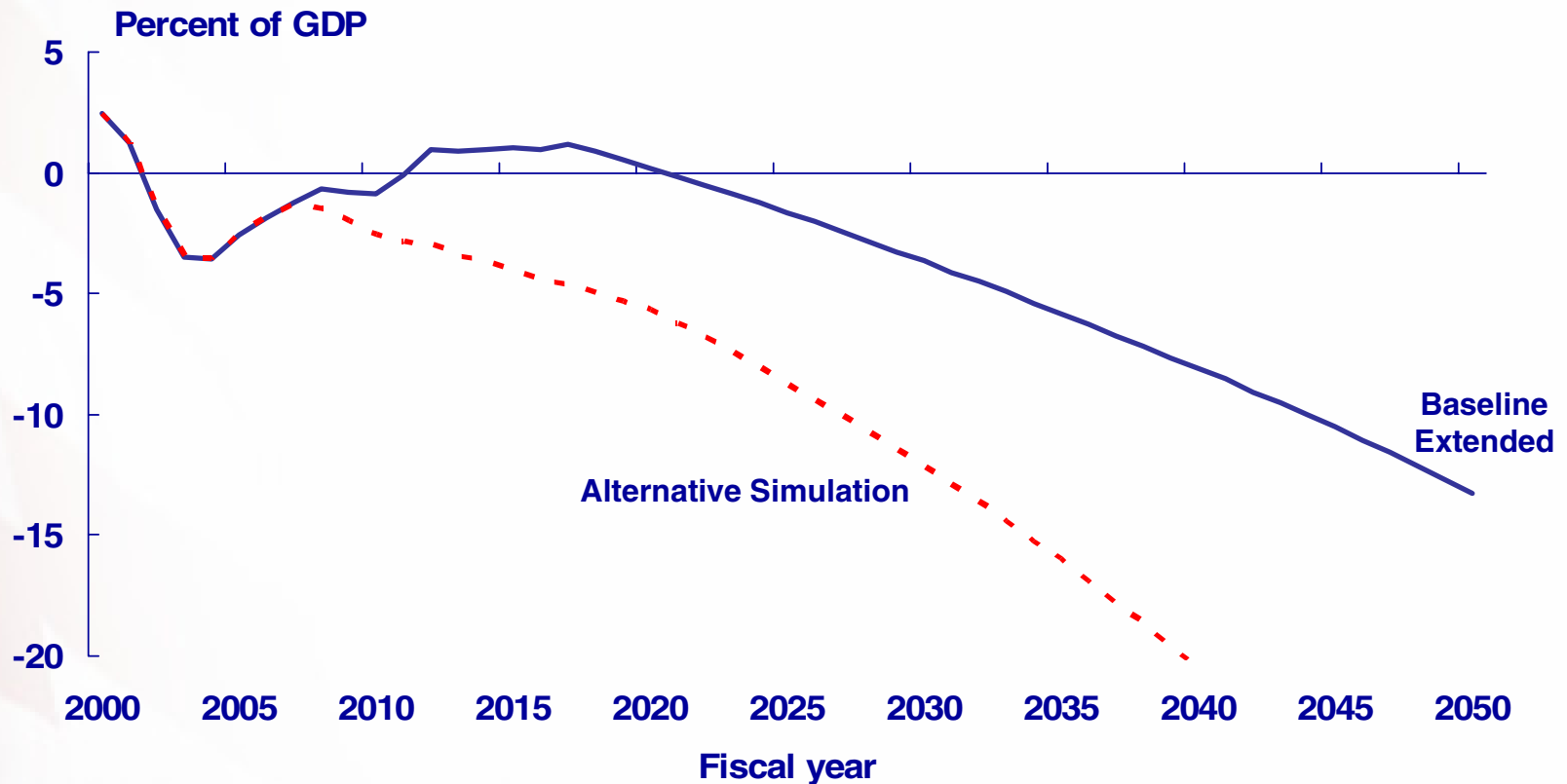
Interpreting Long-term Simulations

- Long-term simulations provide illustrations--not precise forecasts--of the relative fiscal and economic outcomes associated with alternative policy paths.
- Long-term simulations are useful for comparing the potential outcomes of alternative policies within a common economic framework over the long term.
 - Recognizing the inherent uncertainties of long-term simulations, we have generally chosen conservative assumptions, such as holding interest rates and total factor productivity growth constant. Variations in these assumptions generally would not affect the relative outcomes of alternative policies.
 - The model simulates the interrelationships between the budget and the economy over the long term and does not reflect their interaction during short-term business cycles.
- Long-term simulations are not predictions of what will happen in the future. In reality, policymakers likely would take action before the occurrence of the negative out-year fiscal and economic consequences reflected in some simulated fiscal policy paths.

Alternative Fiscal Policy Simulations

- **Baseline extended** follows CBO's January 2007 10-year baseline projections which assume that discretionary spending authority grows with inflation and tax provisions scheduled to expire will actually do so including the temporary increase in the alternative minimum tax (AMT) exemption amount. After 2017, discretionary spending is assumed to grow with the economy, and revenue is held constant as a share of GDP at the 2017 level of 20.1 percent—implicitly assuming that action is taken to offset increased revenue from real bracket creep, the AMT, and tax-deferred retirement accounts. Medicare spending is based on the 2007 Trustees' intermediate projections that assume the continuation of current law under which fees for physicians treating Medicare patients would be cut in future years.
- **Alternative Simulation** follows CBO's January 2007 10-year baseline projections except that discretionary spending grows with the economy after 2007 and all expiring tax provisions are extended including the 2006 AMT exemption amount. After 2017, revenue returns to its 40-year historical average level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts. Throughout the simulation period, Medicare spending is based on the April 2007 Trustee's intermediate projections adjusted for CMS's alternative assumption that physician payments are not reduced as required under current law.
- After the first 10 years, in both simulations
 - Social Security spending is based on the April 2007 Trustees' intermediate projections. Medicaid spending is based on CBO's December 2005 long-term projections under mid-range assumptions.
 - Social Security and Medicare benefits are paid in full after the trust funds are exhausted through borrowing from the general fund to meet any payroll tax shortfall.
 - Other mandatory spending is held constant as a share of GDP at the 2017 level.

Unified Surpluses and Deficits as a Share of GDP Under Alternative Fiscal Policy Simulations



Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's April 2007 analysis.

Total Federal Revenue and Discretionary Spending as Shares of GDP: Historical Averages and GAO's Simulations after 2017

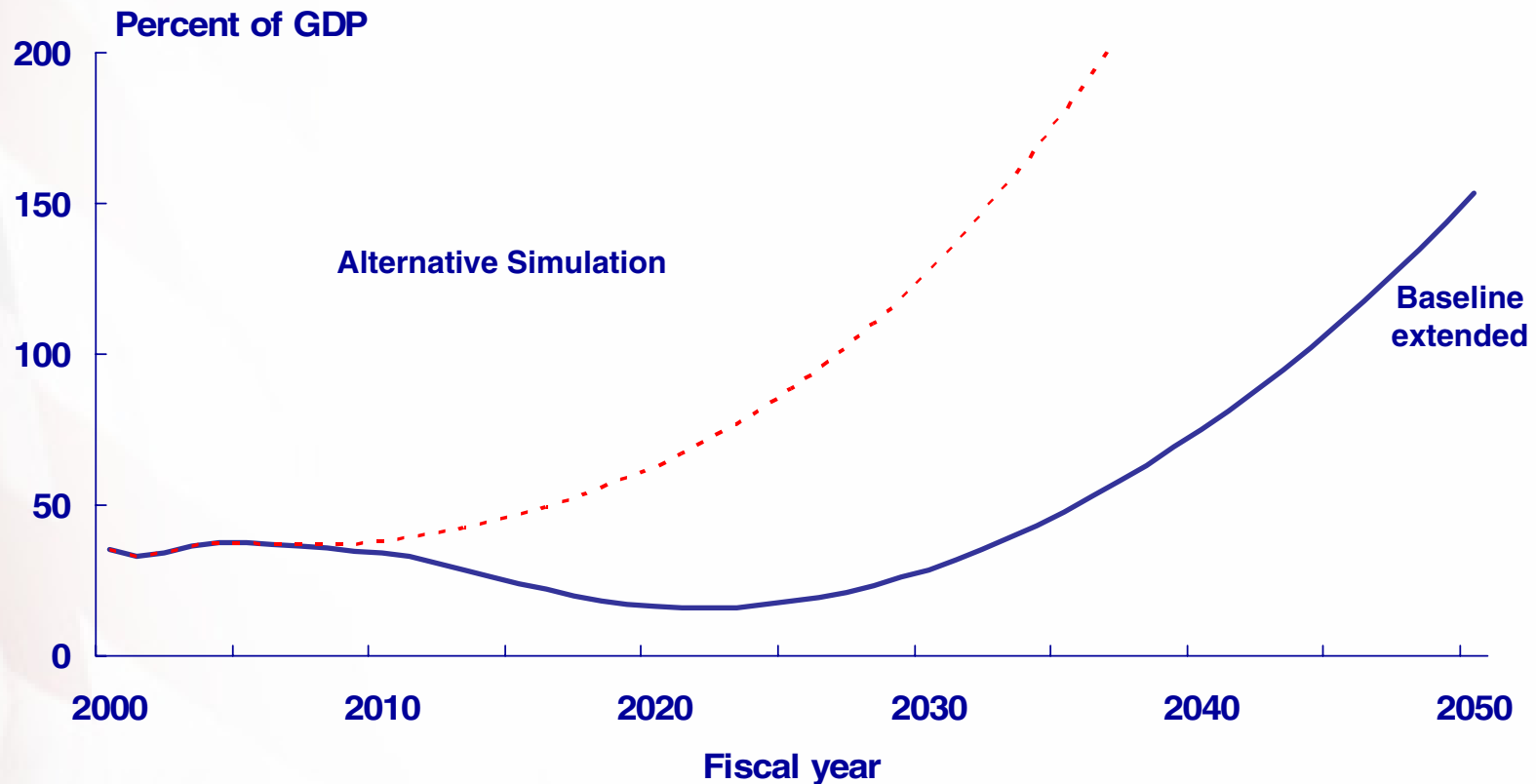
(percent)	20-year historical average	40-year historical average	GAO's Baseline Extended Simulation	GAO's Alternative Simulation
Total Revenue	18.4	18.3	20.1	18.4 -18.6 ^a
Discretionary spending	7.7	9.2	5.8	7.5

Notes: Simulation values represent GAO's ultimate assumptions (year 10 and beyond).

^a Represents a return to 40-year historical average level of revenue of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts.

Source: GAO.

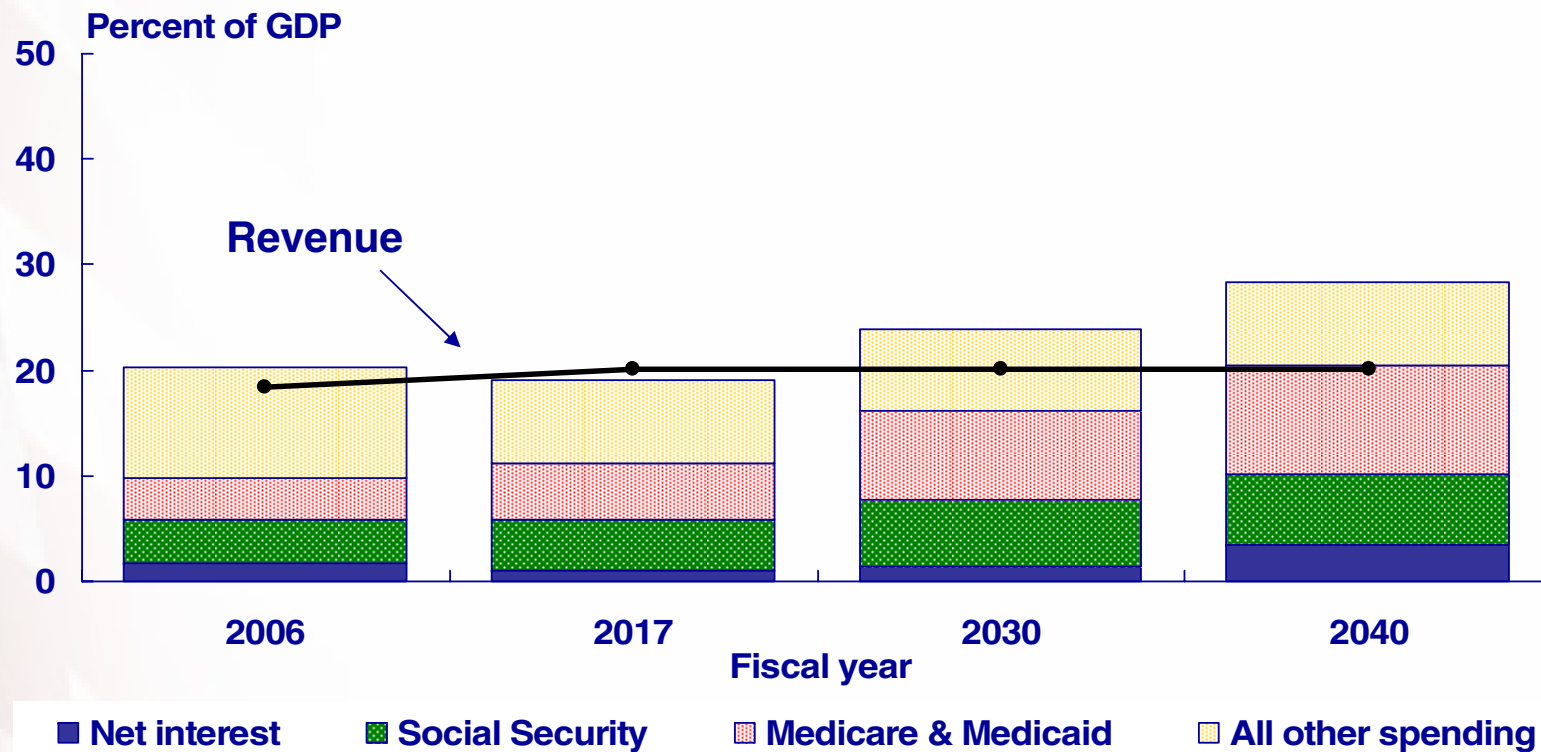
Debt Held by the Public as a Share of GDP Under Alternative Fiscal Policy Simulations



Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's April 2007 analysis.

Potential Fiscal Outcomes Under Baseline Extended Revenues and Composition of Spending as a Share of GDP

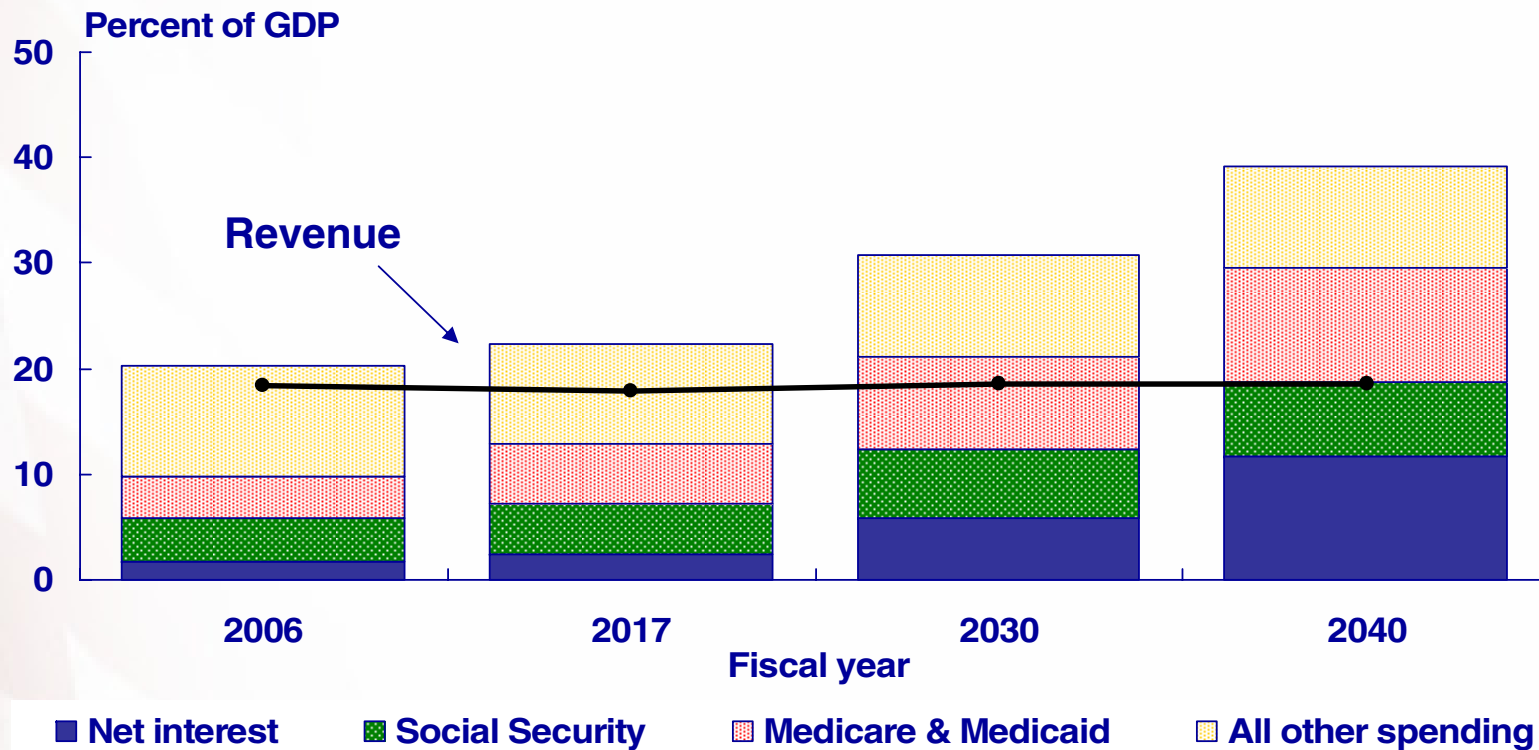


Source: GAO's April 2007 analysis.

Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2017 mainly due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2017, revenue as a share of GDP is held constant—implicitly assuming that action is taken to offset increased revenue from real bracket creep, the AMT, and tax-deferred retirement accounts.

Potential Fiscal Outcomes Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP



Source: GAO's April 2007 analysis.

Notes: AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from 7 retirement accounts.

Key Model Assumptions Under Baseline Extended

Model inputs	Assumptions
Surplus/deficit	CBO's January 2007 baseline through 2017; GAO simulations thereafter
Social Security spending (OASDI)	CBO's January 2007 baseline through 2017; thereafter based on 2007 Social Security Trustees' intermediate projections
Medicare spending	CBO's January 2007 baseline through 2017; thereafter based on 2007 Medicare Trustees' intermediate projections that assume per enrollee Medicare spending gradually slows from 1.4 percent faster than GDP per capita in 2030 to about the same rate as GDP per capita by 2080.
Medicaid spending	CBO's January 2007 baseline through 2017; thereafter based on CBO's December 2005 long-term projections under Scenario 2 that assume per enrollee Medicaid spending grows with GDP per capita plus 1 percent over the long term.
Other mandatory spending	CBO's January 2007 baseline through 2017; thereafter increases at the rate of economic growth (i.e., remains constant as a share of GDP)
Discretionary spending	CBO's January 2007 baseline through 2017; thereafter increases at the rate of economic growth
Revenue	CBO's January 2007 baseline through 2017; thereafter remains constant at 20.1 percent of GDP (CBO's projection in 2017)
Nonfederal saving: gross saving of the private sector and state and local government sector	Increases gradually over the first 10 years to 18.5 percent of GDP (the average nonfederal saving rate from 1950-2006)
Current account balance (percent of GDP)	From 2006-2017, 2006 share of GDP plus one-third of any change in gross national saving from 2006; thereafter equal to 2017 nominal level plus one-third of any change in gross national saving from 2006
Labor: growth in hours worked	2007 Social Security Trustees' intermediate projections
Total factor productivity growth	1.4 percent through 2017 (CBO's January 2007 short-term assumption); 1.4 percent thereafter (long-term average from 1950-2005)
Inflation (percent change in GDP price index)	CBO January 2007 baseline through 2017; 1.8 percent thereafter (CBO's projection in 2017)
Interest rate (on publicly held debt)	Rate implied by CBO's January 2007 baseline net interest payment projections through 2017; 5.0 percent thereafter (the rate implied in 2017)

Notes: These assumptions apply to our base simulation, Baseline Extended. For alternative fiscal policy simulations, certain assumptions are varied, which are noted in the discussion of the alternative paths.

Source: GAO's April 2007 analysis.