**Student's name:** ⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯⎯ Nº USP: ⎯⎯⎯⎯⎯⎯⎯

Instructions: The exam is **individual**. Students can check their hand-written notes written in **their personal and identified** colored paper, anything else is forbidden. It is strictly forbidden to share notes. The exam is worth 9 points. The time allotted to completing the exam is **1 hour and 40 minutes**. All answers to be valid need to be well explained, but answers that do not respond the *exact* statement of the exam question will be ignored. **Answers should be based on the course content.** The maximum *suggested* answer size for each question is *half a page*. The exam should be answered **entirely in pen**, either in English or in Portuguese.

1. (1 point) In an editorial article by the outlet *The Economist* on October 2nd, 2025, titled "Don't tax wealth", the outlet states:

   "Some economists object to their colleagues' advocacy of wealth taxes on procedural grounds. "In my view", wrote John Cochrane of Stanford University, "economists should analyse tax policy based on incentives, not moral sentiments, where we have little comparative advantage." Leave politics to the politicians, in other words."

   Explain what Cochrane means, using the concepts of **positive and normative economics**, and discuss whether that argument makes sense, considering what we learned about social welfare.

2. (1 point) In the beginning of this year became viral the following claim, posted in the front of a restaurant in São Paulo, that states: "Dear clientes, please be patient, the people of Bolsa Família and the beer do not want to work, we have a severe shortage of labor. Thank you." (As seen in a BBC article of April 15, 2025, "Is Bolsa Família guilty for the difficulty of companies to hire?".)
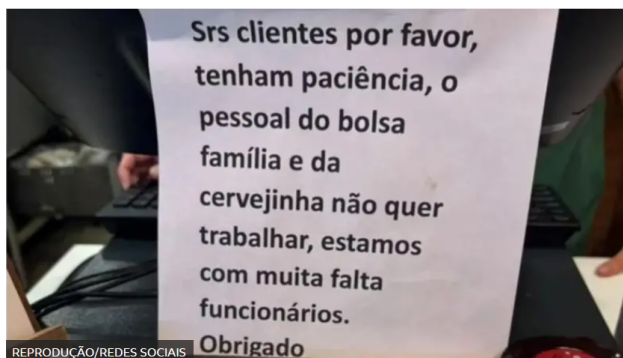
   Considering what we know about the **labor supply model**, does this claim make sense? Would this be an argument for reducing Programa Bolsa Família?

3. (2 points) In November 12, 2025, a news report by Reuters titled "Trump is committed to a $2,000 dividend to Americans using tariff income, says White House" stated that Donald Trump was planning on using the government revenue from tariffs and redistributing it evenly among Americans.

   (a) Using what we know about **tax incidence**, what can you predict about the economic incidence of the import tariffs implemented by the United States?

   (b) Even disregarding the distributional effects of that policy within Americans and assuming that all revenue is distributed, would a policy like that make Americans indifferent between having these tariffs implemented or not? Answer in a precise way using the concept of **compensating variation** (or its sister concept, equivalent variation).

4. (1 point) Last week (26/11/2025) the president Lula sanctioned the law change that establishes exemption from labor income tax (IRPF) for people earning up to R$ 5,000 per month, and a discount for incomes up to R$ 7,350. Explain the effect of this tax change on the labor supply of someone earning, say, R$ 10,000 per month, being clear and precise on the size and direction of both the **income and substitution effects**.

5. (1 point) As of November 2025, the Brazilian real interest rate is at 9.74%, the second highest in the world. Should we expect that people would save more, since the interest rate is higher? Explain using the concepts of **income and substitution effects** in a life-cycle savings model.

6. (2 points) The aforementioned The Economist editorial "Don't tax wealth" states:

   "(...) Many wealth-tax advocates almost certainly see a levy of 2% as just the start. While helping Bernie Sanders's presidential campaign in 2019-20, Mr Zucman seemed to favour a tax of 8% on America's biggest fortunes. And observe Thomas Piketty, Mr Zucman's mentor, who has gone in the past decade from advocating mild wealth taxes to ones that would confiscate 90% of the biggest fortunes."

   (a) Explain the relationship between **wealth taxes** (stock) and **taxes on capital income** (flow). Assume the usual rate of return in the economy is 5%. How large would a weath tax need to be to "confiscate 90% [of the capital return] of the biggest fortunes"? *Explain precisely why.*

   (b) Now explain *precisely* the differences between these two tax instruments.

7. (1 point) In Brazil, the Lei do Bem (Lei nº 11.196/2005) is the main instrument to incentivize investment in research and development in Brazil. One of its main provisions is to allow **immediate deduction** (*expensing*) of investments in R&D from IRPJ (corporate income tax). Explain what that means and why it constitutes a tax benefit.