Abstract:

One of the key stylized facts of macroeconomics has been the stability of the labor share of income over time. There have been numerous recent studies, however, that have documented that the labor share has significantly declined since the early 1980s around the globe. In this paper, we analyze the implications of the decline in labor share for optimal taxation of capital and labor income. Our main finding is that the optimal tax implications of the decline in labor share depend on the mechanism responsible for the decline. In particular, if the decline in labor share is matched with a rise in profit share as some economists argue, then optimal tax rate on capital income should increase over the transition where labor share is declining and should be positive in the long run.