ONLY A BIPARTISAN EFFORT CAN FIX TAX SYSTEM

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There is a need for reform - but there is also a need for consensus to get this right

For the first time since 1998, the federal election is likely to be fought mainly on tax issues. Labor's grab bag of planned tax rises, from the reductions in the capital gains tax discount to making franking credits non-refundable, tap into a growing resentment.

The tax system is losing its credibility with the public. First, its growing complexity favours the better-off who can, quite reasonably, afford the advice to minimise their tax. Second, in a decade that's seen the biggest and quickest increase in wealth in history, the system increasingly ignores capacity to pay.

Even 18th-century Adam Smith, "the father of free market economics", said taxpayers should contribute "in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state".

That's happening less and less, with the system increasingly taxing wages and salaries very heavily (and property transactions) to avoid taxing big licks of investment income and large capital gains at all. When wages flatline, people stop and take a look around.

House prices in Sydney and Melbourne have roughly doubled since 2008, while the Australian stockmarket recently soared past previous records. Globally, the world's wealthiest 1 per cent now own more than half the world's assets, up from 43 per cent in 2010, according to Credit Suisse.

By slashing interest rates and artificially inflating asset prices, central banks have delivered a massive windfall to owners of assets, who tend to be older or already well-off. Assets can be cashed in, passed on or used to leverage up and buy more assets with barely any tax being paid.

For instance, any shares or property owned before 1985 won't incur a cent of tax when they're sold. Contributions to super before 1988 weren't taxed. And in 2006 the earnings of super funds for over 60s suddenly became taxfree — on top of a temporary $1 million cap for contributions, a move so generous that many retirees took out loans to meet it. Since 2000, the share of over-65s paying net tax has dropped from 24 per cent to 16 per cent.

By contrast, if you're working and trying to save what's left over after paying income tax, the Medicare and NDIS levies, the interest on your bank deposit is taxed at up to 48.5 per cent. In the wake of a property boom, the so-called family home isn't even part of the eligibility test for social security.

In this country one can enjoy very high incomes and assets by any conventional standard, pay no income tax and perhaps even receive a part-pension, subsidised medicines and transport — all while

the federal government's debt rockets past $600 billion.

Investors might say they deserve lower tax rates on capital gains or because they are "investing". Yet much of what passes for investment is better termed speculating. The word investment is bandied around a lot because it feels good: governments like to say they "invest" in health and education when waste is often a better description.

Households like to say they "invest" in shares and property. Sorry, buying a house that someone else built a long time ago in the expectation its price will rise isn't "investment", it's speculating that its price will rise over time.

Similarly, punting on shares in the secondary market is speculating. There's nothing wrong with these activities but let's not piously kid ourselves they are improving the nation's stock of machines, buildings and ideas, which might ultimately benefit everyone.

It's extraordinary how some of the finer distinctions of yesteryear have seeped almost entirely out of modern economic theory, which might explain some of the broader public's frustration. In the 19th century, liberal economist John Stuart Mill defined "unearned income" as that arising "without exertion or sacrifice", in effect what we would today call capital gains. He thought such income should be taxed more, not less.

The long shadows of Smith and Mill meant utilitarianism — trying to foster the greatest good for the greatest number — dominated tax policy until after WWII. Arch conservative Andrew Mellon, a billionaire US Treasury secretary, wrote in 1924: "The fairness of taxing more lightly incomes from wages, salaries and professional services than their incomes from business or from investments is beyond question."

It is now the very opposite that is "beyond question". Taxing capital less and labour and consumption income more is the conventional wisdom as the former is mobile. Money has other options. Yet supporters of this framework rarely advocate a shift to land tax, the least mobile factor. Nor do they advocate extending the GST to rent and imputed rent along with food, all of which a consistent consumption tax would include. No prizes for figuring out why.

Ordinarily reform happens from government but the Coalition's timidity on tax — championing an unpopular and modest cut in corporate tax as a solution to wage stagnation — has allowed Labor to start setting the tax reform agenda. In 1998 the Coalition squeezed back into power on the back of a bold, controversial goods and services tax that went towards reductions in income tax. It would have been an even better reform had Labor and the Greens scare campaign not forced Peter Costello to water it down.

Twenty years has taught us reform is impossible without agreement between the two major parties. The government should establish a parliamentary committee populated equally by Labor and Coalition backbenchers, with rolling instructions to recommend revenue neutral tax reforms.

The great challenge of tax policy is to raise a given sum while affecting incentives as little as possible, encouraging genuine thrift and an ingrained sense of fairness. As a country, we can definitely do better. But in a hysterical age when no one is allowed to lose $100 a year no matter their income or wealth, only through bipartisanship is there any hope.