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A Study on the Future of the Gasoline Tax – in light of the move toward abolishing the provisional tax rate in the ruling coalition's FY2025 Tax Reform (Proposals)

Junko Ogawa*
Executive Economist, Climate Change Group, Climate Change and Energy Efficiency Unit
The Institute of Energy Economics, Japan

On December 20, 2024, the Liberal Democratic Party (LDP) and Komeito published their outline of the FY2025 Tax Reform (Proposals).[i] This is an important document that indicates the direction of tax reform in the coming fiscal year and after, and it is published every December. The latest proposal incorporates[ii] a move toward abolishing the provisional tax rate for gasoline tax (also commonly known as local gasoline tax), which was agreed upon by the LDP, Komeito, and the Democratic Party for the People in December of the same year. This came as a big surprise for the author, who has been following the trends of energy-related taxes for many years. This is because of the perception that this provisional tax rate, the so-called "tax rate for the time being," while considered a temporary measure, had been implicitly understood to be effectively a permanent tax rate. Therefore, this decision can be regarded as one of the historical turning points in Japan's energy-related tax system. In this paper, I will look back on the history of the gasoline tax and consider the future of the gasoline tax.

Taxes on oil have been repeatedly introduced and abolished for various reasons since the Meiji era, but the original form of the current gasoline tax dates back to the gasoline tax (general account revenue) introduced 75 years ago in 1949. It was introduced for the purpose of supporting the nationwide construction of roads, which were a key infrastructure during the postwar reconstruction period, and in 1954 it was made a specific road-related revenue. The provisional tax rate was introduced in 1974 by Kakuei Tanaka's administration to compensate for the "Oil Shock," rising fiscal demand, and the shortage of funds for road development. Subsequently, after Japan had gone through a period of economic growth, this tax was raised in 1993 to the current rate of 48.6 yen per liter (statutory tax of 24.3 yen, provisional tax of 24.3 yen). In the interim, a consumption tax was introduced in 1989, and the consumption tax was levied on retail prices including the gasoline tax, resulting in a double taxation situation (so-called "tax on tax"). To summarize, the current burden associated with the gasoline tax per liter is 59.18 yen,[iii] consisting of the gasoline tax (48.6 yen) and the local gasoline tax (5.2 yen), as well as the consumption tax levied on these taxes (5.38 yen).

With regard to the provisional tax rate, discussions have been held in the past concerning the fact that road development has been completed to a certain degree and that other public investments with large multiplier effects (such as social security and measures to address the declining birthrate) should be made. There was a period when the provisional tax rate was abolished. Before the provisional tax rate extension measure expired at the end of March 2008, the Democratic Party (at the time) had announced the policy of abolishing the provisional tax rate, and the ordinary Diet session convened in January of the same year was described as the "Gasoline Diet session," with the ruling and opposition parties becoming embroiled in the debate. Taking advantage of the divided Diet at the time, in which the majority of the House of Representatives was the ruling party, and the majority of the House of Councillors was the opposition party, the Democratic Party brought about the revocation of the provisional tax rate. This created a situation in which the provisional tax rate was abolished for only one month, but Yasuo Fukuda's administration put to a second resolution and revived bills related to the provisional tax rate,[iv] alongside converting specific road-related revenue into general account revenue.[v] This also created a social phenomenon in which long snaking queues formed at gas stations in the city as people tried to purchase cheap gasoline before the time-limited abolition of the provisional tax rate came to an end. Although the provisional tax rate was abolished only for a short period of one month, it was sufficiently effective to make the public aware of the burden imposed by the gasoline tax. About a year after that, the Democratic Party came into power. While there were several factors underpinning this, including criticism of the LDP and the economic downturn caused by the "Lehman Shock," we can point to the Democratic Party's pledge to immediately abolish the provisional gasoline tax rate as one of the factors that boosted support for the party. However, the government under the Democratic Party ultimately failed to abolish the provisional gasoline tax rate. If the provisional tax rate were abolished, tax revenues were expected to decrease by approximately 2.5 trillion yen[vi] for both national and local governments combined, and there were concerns that this would increase the fiscal deficit and affect the funding of social security costs. Moreover, it was difficult to reconcile opinions within the party and with the relevant organizations (there was a mixture of opinions—those in favor of abolishing the provisional tax rate, and those opposing it due to concerns about the impact on finances and the environment). Consequently, the Democratic Party gave up on abolishing the provisional tax rate, which resulted in criticism that it had failed to keep its campaign promise.

One of the reasons for the then-Democratic Party's failure to abolish the provisional tax rate is, as mentioned above, the characteristic of gasoline as a highly taxable commodity from the perspective of securing tax revenue. Gasoline has low price elasticity (details on the price elasticity of energy are covered in the September 2024 issue), and demand is unlikely to fall significantly even if the tax rate were increased; this means that stable tax revenue can be secured. In addition, gasoline is an essential energy source that supports daily life and logistics, and is used by a wide range of consumer groups, creating a broad tax base. On the other hand, it also offers the advantage of low tax collection costs as the tax is paid by importers and refiners. Due to these characteristics that make it an excellent taxable commodity, gasoline boasts the highest tax revenue of all individual commodity taxes in Japan and has long supported Japan's finances.

As described above, in light of the difficulty of abolishing the provisional gasoline tax rate due to the fiscal and political implications, we can liken the recent decision to the act of moving a massive rock in Japan's energy-related tax system. It is also highly significant as it highlights the need to review the energy tax system in tandem with the changing times. For example, the bill[vii] on the abolition of the provisional tax rate, dated December 24 and currently being deliberated in the plenary sitting of the House of Representatives, states its purpose as follows: "[Previous section omitted] In light of the significant changes in the socio-economic situation since the establishment of the special tax rate in question, the bill provides for the abolition of the special tax rate in question and measures to establish a tax system that contributes to the realization of a decarbonized society." As this purpose suggests, in order to drive forward the transition to a decarbonized society, in the next stage, it may be necessary to take the abolition of the provisional tax rate as an opportunity to reconsider the statutory tax on gasoline itself. For example, from the perspective of realizing a decarbonized society, as set forth in the abovementioned purpose, it is possible to consider changing the basis for taxation from conventional kiloliters (KL) to carbon content. If we were to calculate the statutory tax portion (24,300 yen/KL) based on carbon dioxide emissions, it would be 10,611 yen/t-CO2[viii] (12,533 yen/t-CO2 if the statutory tax for a local gasoline tax of 4,400 yen/KL were included); this is a high taxation level that is comparable to global standards. As of 2024, for instance, there are only seven countries in the world with a carbon tax rate exceeding 10,000 yen/t-CO2, and the price of emissions rights under the EU Emissions Trading System (EU ETS) is below 10,000 yen.[ix]

This proposal also offers another significant advantage, in that it can clearly present carbon prices to consumers without changing the way in which consumers shoulder the burden. There are also similar cases overseas, including Sweden reducing energy tax by 50% while simultaneously introducing a carbon tax,[x] and Finland ensuring fiscal neutrality by replacing energy tax with a carbon tax.[xi] Of course, there are also challenges, such as verification from the taxation perspective of whether the basis for taxation can be changed in light of the purpose of the gasoline tax law, how the use will be affected by changing to a carbon content basis, and how to address the issue of consistency with other domestic carbon price levels in the future.[xii] However, even when taking these points into account, there is much room for the reevaluation and reconstruction of existing energy-related taxes when considering measures toward decarbonization. In particular, the change in the basis for taxation from KL to t-CO2 discussed in this paper will make it possible to visualize carbon prices without significantly changing both the revenue scale and burden of the gasoline tax. In addition, in recent years, there have been moves to impose additional tariffs on countries with insufficient carbon costs, such as the EU's Carbon Border Adjustment Measures (CBAM). Generally speaking, presenting the existing energy taxes on the basis of carbon content could potentially strengthen the ability to respond to such measures.

The ideas presented in this paper are based on the perspective of a researcher who has studied energy-related taxes primarily from the perspectives of climate change and energy policy. As explained above, there is a broad range of issues that should be considered, including the perspective of the taxation system and giving consideration to stakeholders who are impacted. However, I believe that the reexamination of these existing policies is worthy of consideration in advancing Japan's future decarbonization policies.

Contact: report@tky.ieej.or.jp

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*The views presented in this paper are the personal views of the author and do not necessarily represent the views of the institution that the author is affiliated with.

[i] LDP/Komeito, FY2025 Tax Reform (Proposals), December 20, 2024.
https://storage2.jimin.jp/pdf/news/policy/zeisi_2025.pdf

[ii] The FY2025 Tax Reform (Proposals) sets out the following in the section "1. Basic Stance on FY2025 Tax Reform," which describes the overall approach to the tax reform.
"In preparation for the vote on the FY2024 supplementary budget in the House of Representatives, the following agreement was reached between the Secretaries-General of the Liberal Democratic Party, Komeito, and the Democratic Party for the People on December 11, 2024:

> "One, that the so-called '1.03 million yen barrier' shall be increased from next year, aiming for the 1.78 million yen that the Democratic Party for the People has called for.
> One, that the so-called 'provisional gasoline tax rate' shall be abolished."
> The relevant parties shall continue to engage in candid discussions regarding the specific implementation methods for each of the abovementioned items.
> The Liberal Democratic Party and Komeito shall continue to engage in sincere discussions."

[iii] Apart from the gasoline tax, tariffs and petroleum and coal tax are also levied on gasoline.

[iv] Act on Special Measures Concerning Taxation, Article 88, Paragraph 8

[v] Act on State's Special Financial Measures on Road Construction and Improvement Projects

[vi] Materials from the Ministry of Internal Affairs and Communications (2009),
https://www.soumu.go.jp/main_content/000050381.pdf

[vii] Bill on the implementation of measures to suspend special tax rates on gasoline, etc., when gasoline prices rise, abolishing special tax rates on gasoline, etc., and establishing a tax system that contributes to the realization of a decarbonized society (Under closed session deliberations as of December 24, 2024)
https://www.sangiin.go.jp/japanese/joho1/kousei/gian/216/pdf/t0902160032160.pdf

[viii] Estimated by the author based on Ministry of the Environment, "Greenhouse gas emissions calculation, reporting and disclosure system: Calculation methods and emission coefficients" (https://ghg-santeikohyo.env.go.jp/files/calc/itiran_2023_rev4.pdf) and Ministry of Finance, "Overview of Vehicle-related Taxes and Energy-related Taxes (National Taxes)" (https://www.mof.go.jp/tax_policy/summary/consumption/d10.htm).

[ix] World Bank, Stata and Trends of Carbon Pricing 2024
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Yen conversion is based on exchange rates as of December 26, 2024.

[x]Folke Bohlin, The Swedish carbon dioxide tax: effects on biofuel use and carbon dioxide emissions, *Biomass and Bioenergy*, Volume 15, Issues 4–5, 1998 https://www.sciencedirect.com/science/article/pii/S0961953498000361

[xi] Finland Prime Minister's Office, Environmental and Energy Taxation in Finland- Preparing for the Kyoto Challenge Summary of the Working Group Report, Prime Minister's Office Publication Series, 2000 https://valtioneuvosto.fi/documents/10616/622996/J0400_Environmental+and+Energy+Taxation+in+Finland.pdf/bf880b78-6d64-461e-92c1-c823904bbb94

[xii] In Japan, there are plans to implement a series of growth-oriented carbon pricing systems, including strengthening GXETS discipline in FY2026, introducing a fossil fuel surcharge in FY2028, and introducing specific business contributions in FY2033.