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## *Road Improvement Revenue Sources Should be Transferred to Local Governments: Allow Them to Decide Whether to Categorize as General Revenue*

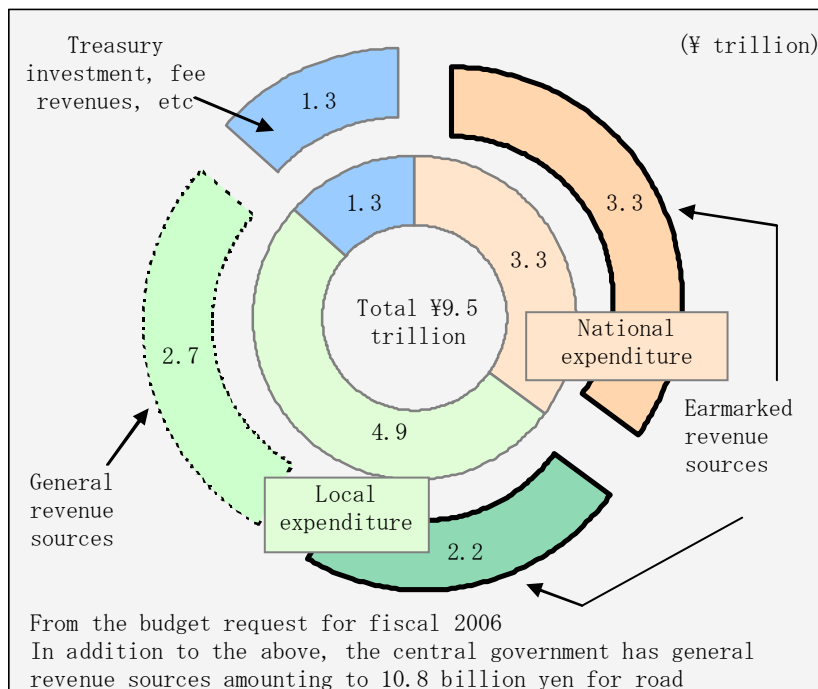
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The transfer of revenue sources earmarked for road improvements into the general revenue category is likely to become one of the focuses of tax reform debates in fiscal 2007. The argument in favor of allocating earmarked revenue sources to the general revenue category has surfaced whenever the government is faced with difficult financial conditions. Each time, conclusions have been postponed. However, this time, the debate has passed the stage of whether or not the earmarked revenue sources should be re-allocated, to reach the stage of “how,” because the basic policy of allocating them to the general revenue category was incorporated in the budget compilation for fiscal 2006, and amid the current wave of structural reforms, this matter is likely to become the last major job for Prime Minister Junichiro Koizumi during the remainder of his term in office. Rather than solving the puzzle of the allocation of road revenue sources to the general revenue category, (all the while keeping them as national taxes,) this writer would like to propose a third way, namely a “full-scale transfer of the revenue sources for road improvements to local governments,” as a part of devolution.

**Exhibit 1. A Total of Six Revenue Sources Earmarked for Road Improvements**

	National tax	Local tax	Main rule tax rate (A)	Present tax rate	
					% of (A)
Gasoline tax	○		¥24.3/lit.	¥48.6/lit.	200%
Local road tax		○	¥4.4/lit.	¥5.2/lit.	120%
Light oil delivery tax		○	¥15.0/lit.	¥32.1/lit.	210%
LPG tax	○	○	¥17.5/lit.	¥17.5/lit.	100%
Automobile acquisition tax		○	3%	5%	170%
Automobile tonnage tax	○	○	¥2,500/0.5t	¥6,300/0.5t	250%

**Exhibit 2. Revenue Sources Earmarked for Road Improvements Exceed 5 Trillion Yen: A Breakdown of Revenue Sources for Investment in Roads (Based on fiscal 2006 budget request)**



Revenue sources for road improvements expanded in step with the First Road Improvement Plan, which was launched in 1954. In addition to gasoline tax, which was already in existence, local road tax, light oil delivery tax, LPG tax, automobile acquisition tax and automobile tonnage tax were designated as earmarked revenue sources one after another. In order to flexibly cope with fluctuations in road investments, provisional tax rates were applied to some of these taxes. Although the tax rates were originally intended as a temporary measure (for five years), they have nonetheless been re-introduced every time the period expired (Exhibit 1).

A breakdown of revenue sources in the fiscal 2006 budget request for road improvements shows that, on the basis of national taxes alone, earmarked revenue sources exceed 3 trillion yen. When local expenditure is included, such revenue sources top 5 trillion yen a year (Exhibit 2). These are very large revenue sources, which are equivalent to revenues from a consumption tax rate of 2 percent. So far, the argument in favor of their review has been shelved de facto due to resistance from Diet members of the “road tribe” and the Ministry of Land, Infrastructure and Transport. However, because Prime Minister Koizumi, emboldened by his landslide victory in the last general election, instructed bureaucrats to formulate a basic policy before the end of 2005, to see if the road improvement revenue sources might not be allocated to the general revenue category with the provisional tax rates intact, this matter has been suddenly thrown into the limelight.

### *A Review of the Need for Road Improvements Has Yet to be Made*

The present system contains the following problems. (1) The “road tribe,” a special interest group, has for its own benefit, been controlling earmarked revenue sources in a special account, which is separate from the general account and which typically lacks transparency, and has managed to build unnecessary roads one after another. As a result, the public works budget has become rigid. (2) Today, because most families own automobiles, it is safe to assume that everyone is a beneficiary of road improvements. Also, given the large impact of automobiles on society, automobile-related taxes should be used for society as a whole. It is not rational to limit the applications of revenues from these taxes. (3) Automobile users are benefiting from the consumption of fossil fuels, but they are putting a load on the Earth’s environment by emitting carbon dioxide into the atmosphere. The present system is not equipped to have automobile users shoulder these costs.

Opponents of these views argue as follows. (1) These revenue sources are earmarked taxes and when their objects are lost (when they are attained), they should be repealed. The allocation of these revenue sources to the general revenue category amounts to nothing but tax increases for those who pay these taxes. (2) The applications of these tax revenues, (when they are categorized as general revenue) which are now being considered are urban development and the protection of the environment, both of which are measures affecting big cities. In the sense that the revenue sources earmarked for road improvements will be used to develop large cities, this is equal to an income transfer from provincial areas to large cities.

Both arguments present perspectives warranting further discussion. However, looking at the current direction of a series of discussions, this writer is puzzled by the fact that it is not the result of a thorough review of the need for roads, such as whether there is still a shortage of roads or which roads are called for as a minimum necessity. The policy-making mechanism, which is conducive to collusive bidding and interventions by the “road tribe” Diet members, is a hotbed of swelling project costs. However, there is not even a sign of this problem being corrected. In the Liberal Democratic Party, there are moves to transfer the earmarked revenue sources into the general revenue category but these moves merely aim to do the “homework” assigned by the Prime Minister. They fail to spell out how the funds in question should be used.

### *Allow Local Governments to Raise Tax Rates at Their Discretion*

Even if the earmarked revenue sources are eliminated, there will still be a need for road maintenance and repair. During the first half of the 1980s, major cities in the United States were on the brink of bankruptcy due to a plunge in tax revenues, which resulted from a decline in the competitiveness of their industries. They were unable to finance the maintenance and repair of existing road networks, not to mention the construction of new ones. Because highways were dotted with potholes everywhere,

the function of the road as a major infrastructure for the movement of people and for physical distribution was badly impaired. As this example shows, with the passage of time, infrastructures need maintenance. The question is whether the central government should continue to shoulder the burden of road projects, whose emphasis will shift from the construction of new roads to the maintenance and management of existing ones.

Hence, this writer proposes a “full-scale transfer of the revenue sources reserved for road improvements to local governments,” a move which would also be consistent with the current trend of devolution. Specifically, he proposes (1) to make these taxes local taxes and transfer the responsibility of tax collecting to local governments, and (2) to authorize local governments to allocate at their discretion the revenues from these taxes to uses other than roads.

The first proposal is more in line with the “benefit principle” than the present practice. At present, the tax money paid by drivers in large cities is invested in local roads which most of them will probably never use. The present proposal would solve the problem of this “mismatch.” It would allow local governments, which decide that they need more road improvements, to raise the tax rates. As subsidies from the national treasury to local governments would be reduced with the transfer of tax sources to them, the impact of this system on the fiscal balances of the national and local governments should be basically neutral. Some analyses by experts show that automobile-related taxes, along with local consumption taxes, have small regional discrepancies in terms of per capita tax revenue, and that fluctuations due to business conditions are relatively small.

It can be said that the so-called “trinity reform” (to revise tax and fiscal relations between the central and local governments) has been more or less executed, since the goal of abolishing, or reducing by 4 trillion yen the subsidies from the national treasury to local governments, while transferring tax sources worth approximately 3 trillion yen to local governments, was achieved recently. However, merely reducing the ratio of the central government’s burden, which comprised the main measure for abolishing or reducing the subsidies, does not directly lead to an expansion of local autonomy, which is the main objective of the reform. The top-down structure will remain, in which local governments will abide by the decisions made by the central government. In this respect, an attempt to transfer revenue sources for road improvements to local governments would also be consistent with the spirit of the reform.

With respect to the second proposal, if tax hikes through local ordinances or other measures were allowed with the approval of the local assembly, local governments would be able to invest in priority areas other than road improvements depending on local needs. Of course, they might continue to invest the money in road-related areas, or they might choose to allocate it to the general revenue category, which entails no

constraints, and apply it to other government services. This step should automatically answer questions concerning the actual need for roads and the order of priority vis-à-vis other government services—questions, which everyone has raised but no one has answered thus far.

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