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The Welfare Economics of a Biofuel Tax Credit and the Interaction Effects with Price Contingent Farm Subsidies

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Harry de Gorter, David R. Just

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Abstract

A framework is developed to analyze the effects of a biofuel consumer tax exemption and the interaction effects with a price contingent farm subsidy. Ethanol prices rise above the gasoline price by the amount of the tax credit. Corn farmers gain directly while gasoline consumers only gain from any reduction in world oil prices due to the extra ethanol production. Domestic oil producers lose. Historically, the intercept of the ethanol supply curve is above the gasoline price. Hence, part of the tax credit is redundant and represents "rectangular" deadweight costs that dwarf triangular deadweight cost measures of traditional farm subsidies.

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