

B. The Role of Natural Gas in Fertilizer Prices

1. Deregulation of Natural Gas Prices

As the industry pointed out to the Committee in its brief, because of the large capital investment in basic nitrogen and phosphate plants and potash mines, producers have historically tended to keep operating until variable costs exceed net selling prices. When this point is reached and cash costs exceed unit selling prices, plants have been shut down on a temporary or permanent basis which is presently the case.

For the nitrogen fertilizers like urea, ammonium nitrate, ammonium sulphate and other derivatives, natural gas is the feedstock and makes up 30% to 50% of these variable production costs. In 1985, approximately 10% of the natural gas consumed in Canada was used in the production of basic fertilizer materials. The nitrogen segment of the industry is very dependent on the cost advantage of its natural gas supplies to remain competitive. Alberta has 70% of Canada's nitrogen fertilizer capacity, with other facilities in B.C., Manitoba and Ontario.

Historically, Alberta producers have had a production cost advantage over U.S. producers and eastern Canadian producers because they have been able to negotiate favourable long-term discount contracts for natural gas, at prices lower than U.S. gas prices. Since the mid-1970s, before deregulation changed the whole pricing structure, fertilizer manufacturers were also guaranteed a price on natural gas by the Government of Alberta under the *Natural Gas Rebates Act*, that would be no more than 65% of the border price.

This advantageous position was eroded, however, when U.S. prices were deregulated just before the Western Accord introduced a market-oriented pricing regime and relaxed export controls. Coupled with gas surpluses in the U.S. which may last into the early 1990s, lower prices there have limited the Canadian competitive position.

Deregulation has been particularly beneficial to the eastern fertilizer producers who are no longer held to the Toronto reference price and who now negotiate directly with western Canadian natural gas producers for their gas.

Deregulation has in fact contributed to a 25% reduction in the export price of Canadian natural gas over the past year; however, this price is still 35% higher than the U.S. Texas Gulf price. This means that while Canada's natural gas price is down, the impact has not been enough to offer a cost advantage over Canada's fertilizer competitors. Just how natural gas prices affect fertilizer prices raised questions before the Committee: "I guess the comparison I would have to make is to say that the price of gas went down and the price of fertilizer should have gone down and it did. But if the price of natural gas were to go down to a producer east of Alberta today, I expect the price of fertilizer to go down would be like saying that if the price of diesel fuel to the farmer goes down today, the price of grain should go down. We are in the same situation. We are producing a product from which we cannot recover our full costs. Reductions in the price of gas due to deregulation was simply a saviour when it came along. I think testimony to the fact that it was needed is that a couple of producers outside of Alberta subsequent to deregulation have stopped producing fertilizer. So the deregulatory effect was not enough to underpin the industry" (Issue 23:15,16, 29-4-87).

The industry told the Committee that in the past year: "... export markets have reached the point where we (the fertilizer industry) could not, in fact recover our cash costs. We did not make the number of sales simply because it would have cost money. It would have realized a cash loss" (Issue 23:23, 29-4-87).