Agriculture Energy Alliance

Representing agriculture as a producer and consumer of energy

November 4, 2005

Senate Committee on Agriculture, Nutrition and Forestry
328A Russell Senate Office Building
Washington, D.C. 20510

RE: Agriculture Energy Alliance
Before the Senate Committee on Agriculture, Nutrition and Forestry

Written Statement Submitted for the Record

The Agriculture Energy Alliance (AEA) appreciates the opportunity to submit written comments for the record on the impact of high natural gas prices on farmers.

The AEA represents a broad-based coalition of 100 farm organizations and agribusinesses facing a real crisis because of public policies that have created demand for natural gas while at the same time restricting access to supply sources. U.S. agriculture depends on natural gas for many very basic items in the food chain. Farmers and related agribusinesses use natural gas for irrigation, crop drying, food processing, crop protection, and nitrogen fertilizer production.

In the past two years, higher energy prices have slowed U.S. economic growth by 0.5-1.0 percent (based on pre-hurricane prices). More than 2.8 million U.S. manufacturing jobs have been lost since 2000. Since 2002, 36 percent of the U.S. nitrogen fertilizer industry – which uses natural gas as a raw material – has been shut down or mothballed. According to U.S. Department of Agriculture (USDA), farmers' fuel, oil, and electricity expenditures increased from $8.6 billion to $11.5 billion from 1999 to 2005. Over the same time period, fertilizer expenditures went from $9.9 billion to $11.5 billion. Combined, these expenditure increases represent a $4.5 billion decline in U.S. farmers' bottom line over a six year period. The U.S. chemical industry has been especially hard hit by high energy prices since natural gas is needed as a feedstock – its natural gas costs increased by $10 billion annually since 2003. And $40 billion in business has been lost to overseas competitors who pay less for natural gas. Chemical companies closed 70 facilities in the United States in 2004 and at least 40 more have been tagged for shutdown. Of the 120 chemical plants being built around the world with price tags of $1 billion or more, only one is in the U.S.

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Nitrogen

Nitrogen fertilizer is a key input required for the bountiful yields achieved by U.S. farmers. By far, the most intensive use of natural gas by the farm sector is in the production of nitrogen fertilizer, which is used on nearly every crop produced in this country. Retail prices for fertilizer – the prices paid by farmers – rise sharply when natural gas prices increase. Rising natural gas prices have contributed to the dramatic increase in the price to farmers for nitrogen fertilizers. According to the USDA, farm gate prices for fertilizer have jumped to record-high levels.

Anhydrous ammonia is a fertilizer itself and is a source of nearly all other nitrogen fertilizer produced in the world. Today, the cost of natural gas accounts for 90 percent of the production cost of ammonia for U.S. producers. Thus, when U.S. natural gas prices increased significantly beginning in the year 2000, the cost of domestically produced ammonia also rose, with average U.S. cash production costs more than doubling. Although natural gas prices eased in 2001 and the first half of 2002, natural gas cost, and therefore fertilizer production cost, once again began to escalate in September 2002 and have continued to rise ever since. More recently, natural gas prices have climbed to over $14 per MMBtu and have forced U.S. ammonia production cost to over $450 per ton – three to four times the historical norm. This has also driven up the cost of nitrogen fertilizers to the American farmer. According to the USDA, ammonia prices to farmers have jumped from $250 per ton in the spring of 2002 to $416 per ton in the spring of 2005 and to well over $500 per ton today. With U.S. farmers using approximately 12 million tons of nitrogen fertilizers per year, this increase translates into an estimated $3-4 billion tax on the farm economy.

While fertilizer producers can try to pass along these cost increases, the commodity nature of the business and competition from producers in nitrogen-exporting countries with access to lower priced gas limits this option. As a result, a rise in U.S. natural gas prices causes producer margins to shrink. Eventually, margins turn negative as gas prices continue to increase. Nitrogen fertilizer producers have no way of curtailing or reducing their demand for natural gas other than shutting down the production process itself. Consequently, companies are forced to reduce production, temporarily idle, or even permanently close plants, depending on the specific economic situation they face. This not only destroys their businesses, but it drives up fertilizer prices to the American farmer and food prices to the American consumer.

Overall, 19 ammonia plants have closed permanently since 1998 primarily as a result of the increase in natural gas prices. As a result, U.S. ammonia production fell by over 6 million tons or 34 percent in only 5 years. The U.S. agriculture which typically obtained 85 percent of their domestic needs from U.S.-based production during the 1990's, now relies on imports for nearly 45 percent of nitrogen supplies.

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Farmers face higher nitrogen fertilizer prices and the prospect that there might not be an adequate supply of nitrogen fertilizer to satisfy farmers' demands at any price. Unfortunately, these high and volatile prices are expected to continue. Tight supplies and increasing demand will continue to pressure producers' margins and profitability, as farmers do not have the ability to pass on these increased costs. In addition, the prices of farm machinery, seed, and wage rates were up 62-71 percent, while fuel costs more than doubled over their 1990-92 level.

Congressional Action Needed

Our nation's current natural gas crisis has two solutions: increase supply and reduce demand. The 109th Congress is facing the daunting task of finding ways to balance our nation's dwindling available supply of and rising demand for natural gas. Additional supply is available from three primary sources: onshore and offshore production, and liquefied natural gas. While there is considerable activity underway in each of these areas, Congress can do more to facilitate the timely development of these critical supply sources. To promote additional production, for example, Congress can adopt measures to ensure that potential federal lands and Outer Continental Shelf (OCS) areas are open for leasing, that leases and permits are issued promptly, that the appropriate tax and royalty policies are in place, and that the necessary pipeline infrastructure is available to bring supplies to market while leaving behind as small an environmental footprint as possible. [1]

The AEA urges Congress to pass legislation that would allow natural gas exploration and production in the OCS. Development of offshore natural gas reserves is crucial for both homeowners and manufacturers that use natural gas as a feedstock, such as nitrogen fertilizer producers. At today's natural gas price levels, the U.S. can expect continued demand destruction in the manufacturing sector, along with the loss of good jobs. The Ocean State Option Act (OSOA) language that was included in the House Resources Committee's budget reconciliation package can reduce dependence on imported energy and help maintain a competitive domestic manufacturing base through provisions for states to opt out of the current moratorium on development of natural gas supplies in the OCS. The OSOA provisions will provide an enhanced role for development of offshore energy resources to create additional supplies of natural gas and to diversify the nation's energy supply.[1]

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[1] Please note a December 2004 Argonne National Laboratory report entitled, *"Environmental Policy and Regulatory Constraints to Natural Gas Production,"* which outlines more than thirty environmental policy and regulatory impediments to natural gas production. The information presented is a virtual road map of suggestions for decision makers to consider to address policy changes to help increase the supply of natural gas. http://www.pi.energy.gov/pdf/library/NaturalGasFinal.pdf

Alaska's North Slope is one area with significant potential reserves that can be unlocked in this way. Alaska's North Slope is believed to hold as much as 100 trillion cubic feet of natural gas, making it the largest reserve in North America. The natural gas industry anticipates the need for more than $60 billion of infrastructure investment over the next fifteen years just to keep pace with demand, including liquefied natural gas terminals, pipelines, and storage facilities. The construction of new pipelines, such as a pipeline to bring Alaska's North Slope natural gas to domestic markets, cannot be further delayed.

Congress must also support efforts to ensure that new coal and nuclear facilities are constructed, such as federal loan guarantees and other incentives for the retrofitting of existing natural gas-fired facilities with new integrated gasification combined-cycle and next-generation nuclear technologies. The loan guarantee program recently enacted as part of the "Energy Policy Act of 2005" would provide an immediate benefit to the nitrogen fertilizer industry, which uses natural gas as its feedstock. With the ability to utilize proven gasification technologies, U.S. fertilizer producers could shift to coal or petroleum coke and would, therefore, make more gas available for other applications. The availability of these additional supplies should help to moderate natural gas prices throughout the economy. Without these incentive packages in place to jump start the deployment of coal gasification technologies for these applications, damage to American industries will continue and farmers will be left paying skyrocketing prices for fertilizer. We hope that the U.S. Department of Energy will provide funding for the industrial gasification loan guarantee program in its FY 2007 budget. We also urge the DOE to promulgate rules for this important provision as quickly as possible.

Congress must act expeditiously to promote the development of domestic energy resources to help secure future economic growth for our nation. Congress needs to enact a comprehensive energy policy ***now*** that provides further development of environmentally sensitive production of adequate domestic supplies of natural gas and all energy resources for a more diverse portfolio.

Conclusion

There are many indications that our nation's economy and energy security are being seriously impacted by inaction at expanding all sources of domestic energy to feed our country's growing demand. Our ability to produce food and fuel for our nation and the world depends on a sound energy policy. Simply, farmers need access to reliable sources of energy and raw materials so they can continue to use the fertilizers necessary to produce an abundant, affordable, and healthy food supply.

Agribusiness Association of Iowa
Agribusiness Council of Indiana
Agricultural Council of California
Agricultural Retailers Assn.
Agriliance, LLC
Agrium Inc.
Alabama Crop Management Assn.
American Farm Bureau Federation
American Plant Food Corporation
American Soybean Assn.
Arkansas Plant Food Assn.
Ben-Trei Ltd.
Brandt Consolidated
CF Industries
CHS Inc.

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California League of Food Processors
Chemical Industry Council of Illinois
CoBank (CO)
Colorado Grain & Feed Assn.
Crop Production Services
CropLife America
D.B. Western, Inc.—Texas
Delaware Maryland Agribusiness Assn.
Diamond of California
Far West Agribusiness Assn. (WA)
Florida Fertilizer & Agrichemical Assn.
Georgia Agribusiness Council, Inc.
Georgia Feed & Grain Assn., Inc.
GROWMARK, Inc.
Hartung Brothers, Inc.
Hawaiian Alliance for Responsible Technology & Science
Helena Chemical Company
Illinois Fertilizer & Chemical Assn.
Indiana Grain & Feed Association
Indiana Plant Food & Ag Chemicals Assn.
Intermountain Farmers Assn.
International Chemical Corporation
International Commodities Export Corp.
International Raw Materials Ltd.
Iowa Institute for Cooperatives
JR Simplot Company
Jim Hicks & Company
Johnston Seed Company
Kansas Agribusiness Retailers Assn.
Kansas Grain and Feed Assn.
Land O' Lakes, Inc.
Louisiana Ammonia Producers
MFA Incorporated
Mayo Fertilizer Inc.
Michigan Agri-Business Assn.
Minnesota Agri-Growth Council
Minnesota Crop Production Retailers
Missouri Ag Industries Council, Inc.
Montana Agricultural Business Assn.
National Association of Wheat Growers
National Barley Growers Assn.
National Chicken Council
National Corn Growers Assn.
National Council of Farmer Cooperatives
National Sorghum Producers
National Grange
National Renderers Association, Inc.
National Sunflower Assn.
National Turkey Federation
Nebraska Agri-Business Assn.
North Dakota Agricultural Assn.
Northern Ag Suppliers, Inc.
Oklahoma Ag Retailers
Oregon Wheat Growers League
Plant Food Association of North Carolina, Inc.
PotashCorp
Rocky Mountain Agri-Business Assn.
Society of American Florists
South Carolina Fertilizer and Agrichemical Assn.
South Dakota Agri-Business Assn.
Southern Crop Production Assn. (GA)
Southern States Cooperative, Inc.
Tennessee Agricultural Production Assn.
Tennessee Farmers Cooperative
Terra Industries
Texas Ag Industries Assn.
Texas Agricultural Cooperative Council
The Andersons, Inc.
The Fertilizer Institute
The McGregor Company (WA)
The Mosaic Company
3-D Fertilizer
U.S. Canola Assn.
USA Rice Federation
United Suppliers, Inc.
Virginia Crop Production Assn.
Virginia Poultry Federation, Inc.
W.B. Johnston Grain Company
Washington State Council of Farmer Cooperatives
West Central Inc.
Western Peanut Growers Association (TX)
Western Plant Health Association (CA)
Wheeler Bros. Grain and Fertilizer Co.
Willard Agri-Service of Frederick, Inc. (MD)
Wisconsin Fertilizer and Chemical Assn.