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From the Sublime to the Ridiculous - The Canadian Tobacco Transition Program: Canadian Agriculture Deserves Better Policy Than This

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Executive Summary

Over the past month, the federal government did an about-face on rules regarding how farmers who used to hold tobacco quota could use their production and capital assets. These rule changes occurred after decisions were made by growers to participate in the government's Tobacco Transition Program (TTP). In other words, the rules were changed in the middle of the game. Decisions made by farmers to participate in the program also meant decisions were made by new entrants to produce tobacco this year. But the new entrants are now effectively barred by the change in rules, even though they have already begun investing in a crop for this year.

This is not just a tobacco issue. It has implications for family farms and family businesses, and is not a precedent that should be set in this context. It bars families from renting their land to their children, lending them money to start into production, or guaranteeing their loans.

The policy also impedes the ability of these farms to diversify into other types of production because of the restrictions it places on farm assets and resources. This is the antithesis of the stated intent of the policy.

The policy also largely destroys the opportunity for 60 - 80 million dollars of annual economic activity in a region that faces rapidly declining employment in manufacturing.

This is bad policy. Its negative effects can be reversed if the Minister of Agriculture makes a quick and simple decision based on principle, originally set out by the Minister and accepted by the Tobacco Board. The principle is that no program participant can in any way hold direct liability for loss or direct potential for gain from the production of tobacco. If this principle is adopted, the Minister has two courses of action that will have a much more positive outcome. One is to agree that the program rules conveyed in March, on which producers made their decisions, are in alignment with the principle. The second is to use them for this year and work to ensure that consistent regulations are put in place before the 2010 crop.

Introduction

Over the past two years, the George Morris Centre has released a series of papers (Mussell and Martin, Martin) that addressed the on-going saga of Canadian tobacco policy. Its evolution has been a study in how to do things as inefficiently and ineffectively as possible, perhaps especially in the past three months. This paper documents the latest machinations and the potentially devastating consequences it will have on a region and many farm families within it.

The Recent Progression of Tobacco "Policy"

On February 18, 2009 the Federal government unveiled its Tobacco Transition Program (TTP). The proposal clearly altered the Ontario Flue-Cured Tobacco Grower Marketing Board's original proposal from a tobacco exit program to a transition program. The objectives of the TTP were as follows[2]:

- "Assist in the repositioning of the Canadian tobacco growing industry."
- "Allow for an easier transition of BPQ (Basic Production Quota) holders out of the Tobacco industry."
- "Allow producers who stay in the sector full flexibility to maximize use of their resources, while maintaining the regulations that are necessary."
- "The presentation spoke to opportunities for TTP participants to "rent their land and equipment to a tobacco producer who [obtains] a license to grow other crops on [their] land."

During the government's information session, many questions were posed by quota holders, their accountants, and their lawyers. A conference call was also held February 24, 2009 with solicitors and accountants requiring further clarification. On March 3, 2009 Agriculture and Agri-Food Canada released a TTP fact sheet which put in writing responses to frequently asked questions[3].

The responses to the questions clearly indicated that anyone could obtain a license to produce tobacco in the future, except those who participate in the transition program and their spouses or dependent children. The response went on to indicate that a "non-dependant child who is not a principal of the farm or entity holding quota will be allowed to enter the tobacco industry". It also indicated that "sharegrowers not holding BPQ are not affected by the program and will be allowed to continuing producing and seeking a license". A further question was asked about whether a TTP participant could become an employee of another tobacco farm. The response indicated that "a TTP participant can become an employee of another tobacco business entity if he does not have any direct or indirect interest in the ownership of this business entity for which he/she will be working".

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[2] Tobacco Transition Program (TTP) Information Session – Delhi, Ontario, February 18, 2009 slide presentation. Source: Agriculture and Agri-Food Canada

[3] Tobacco Transition Program (TTP) Fact Sheet. Source: Agriculture and Agri-Food Canada, distributed by the Ontario Flue-Cured Tobacco Growers' Marketing Board on March 3, 2009.

Specific questions were asked of Agriculture Canada officials both prior to and after March 23, 2009 by the Ontario Flue-Cured Tobacco Growers' Marketing Board on behalf of individual growers and their unique farming operation situations. Verbal responses received indicated that as long as the TTP participant or its shareholders (defined as “exceeding 10% ownership share”) do not share in any way in the revenues or profits generated by the tobacco licensee, that commercially justifiable and suitable arrangements could be made to share labour, flow through some costs, and provide financing support in the form of loans to the licensee or through co-signing arrangements with banks.

Based on this information, BPQ holders made their decisions about whether to participate in the TTP program by the end of March deadline for entering the program, a non-reversible decision.

However, when the Ontario Flue-Cured Tobacco Growers' Marketing Board asked for these responses in writing to ease the minds of growers, there was a long lag and then a complete change in the rules. On April 14, 2009 the Marketing Board released the newly received written responses to questions asked by producers[4]. Producers then learned the following had changed:

- TTP participants can no longer pay any day-to-day tobacco operation expenses such as labour for a licensee who has rented out his land and infrastructure, even with a legal agreement documenting the reimbursement of such costs because it is now deemed “contrary to the intents and purposes of the TTP”.
- It was also stated “to ensure that the intent of the TTP is not undermined, license holders cannot rent the land of a family member, who participated in TTP or of a business entity in which he/she previously had an ownership relationship with and which participated in the TTP”. Sons/daughters are not able to rent their parents’ land and infrastructure, even with commercially fair rental agreements.
- That a TTP participant can not work as an employee for a licensee who has rented his land and equipment, despite not having any ownership interest in this business entity in which he/she will be working. So a farmer who rents his land is not allowed to be paid $15/hour to drive a tractor on it.
- That a TTP recipient can not loan money to a licensee in order to “ensure that the intent of the TTP is not undermined”, despite the loan being reasonable under commercially viable practices, legally documented as such, and repaid under the terms of the agreement. So, a farmer can neither rent his land to his son or daughter nor offer to finance the offspring’s new tobacco venture on a neighbor’s farm
- That a TTP recipient can not co-sign at the bank for a loan to a licensee.

Implications of the Altered Rules

These rules, in addition to being diametrically opposed to what was said two weeks earlier when growers were deciding whether to participate in the program, have tremendous implications. The implications are not just for the tobacco industry, but for agriculture in general because they

[4] Letter from Greg Meredith, Assistant Deputy Minister of Agriculture and Agri-Food Canada.

affect succession planning, diversification by both TTP participants and their families, and the very structure of the family enterprise.

Effects on Family Succession

Due to the tremendous investment in infrastructure that tobacco requires (kilns, specialized equipment, specialized labour), tobacco can only be produced on current tobacco farms. Due to the unique expertise involved, new entrants into tobacco cannot do so without the help of a former grower who is leaving the industry. Based on land, infrastructure, and knowledge requirements, the most likely candidate to be a new tobacco entrant is an individual who grew up on the family farm.

This is consistent with the nature of Canadian agriculture: business succession for Canadian farm families consists of one generation helping the next by loaning funds, making loan guarantees and renting the land. To exclude tobacco farm families from this process seems to go against the very principles of Canadian family enterprise. No other Canadian farmers or small businesses are limited from assisting their children to continue their parents' farming businesses.

Due to these changes in the rules, many next-generation farmers are unable to produce in the emerging system of contracting because of the restrictions on renting family land and/or the lending restrictions. In most cases, these new potential tobacco licensees never owned quota, and in some cases people chose to forgo TTP dollars in order to maintain their eligibility to grow. Also, there are opportunities for a child that a parent would be willing to undertake that a stranger would not, such as rent-to-own. In the same vein, any farm with a parent/offspring succession plan in place is automatically denied any opportunity to grow tobacco no matter who held the quota in the past.

The policy also restricts both family and non-family licensees (former employees or sharegrowers are good examples of potential candidates) due to the restrictions on lending. Third party lending to licensees is blocked by lack of assets (mainly land), which in any other circumstances could be accomplished by loan guarantees.

Effects on Diversification

The policy also restricts its announced purpose to help diversify away from tobacco. Transition is a process that takes time. Restrictions on lending and land rentals to family unnecessarily cause the promised "full flexibility to maximize use of their resources" to be impeded. The restrictions have the likely outcome of no longer making those assets viable. What value does a tobacco kiln have in producing grain, livestock or vegetables?
Revenues from the rental of tobacco assets are very likely needed by those TTP participants who are trying to transition out of tobacco, whether to retirement, an alternate career, or another crop. Funds from the TTP, in many cases, service debt from the tobacco operation and again, in many cases, little is left to sustain normal expenses while retraining or launching a new enterprise. New enterprises, whether they be in agriculture or not, do not blossom into profitability over night.

TTP participants very likely can use funds from infrastructure rentals to cover overheads or investments into diversifications during their starting phase. They may also find it beneficial to work with a licensed renter of their land and/or infrastructure to ensure maximum efficiencies in terms of labour or other input costs. This is likely necessary for both operations to work in terms of economic viability. For instance, new businesses cannot guarantee sufficient hours to labour as they are just building their customer base. However, if they are able to share employees with the licensor renting their land, this may work to attract and retain sufficient human resources. There seems to be no reason why this should not be allowed, as long as proper functions are put in place to ensure that the costs are being allocated properly.

Further, TTP participants are even limited in what employment they are allowed to seek out (e.g., the retiring farmer who can't drive a tractor on his own leased farm). Again, as long as proper pay amounts are made, this appears to be unreasonable and too restrictive, and certainly different from the information on which program participants made their decisions to join the TTP before the end of March.

Regarding TTP participant family members or former employees/share growers seeking to become licensees in the new tobacco environment, the rules restrict opportunities to improve the economics of the business. The day of the tobacco farmer is over. The day of a farmer who grows tobacco is not. The next generation may be transitioning into other crops, and needs to be able to produce tobacco as well to cover overheads or meet labour needs.

Effects on the Local Economy

This all comes at a time when the tobacco processing industry has shown an interest of 15,000 to 20,000 acres of flue-cured tobacco at a potential farm gate value of $60-80 million. Tobacco is grown in a region that has recently lost large amounts of economic activity because of its reliance on automobile and other manufacturing. This policy threatens the region's obvious source of income and the opportunity to transition to better diversification.

It follows that these effects are not just on farmers and tobacco companies. Tobacco production and processing is very labour intensive. If these restrictive measures prevent a large number of farmers from growing tobacco, a much larger number of people in the region will lose some or all of their livelihoods.

Why Has This Policy Occurred?

Only the federal Minister of Agriculture can answer that because it is his policy. One can only surmise that it has something to do with "evil tobacco". People in the region surmise that someone on high has decided that totally destroying the local tobacco industry will somehow reduce smoking. If so, this is a lame argument. As we have addressed in our previous two papers, the policy to date has promoted illegal black market tobacco consumption at the expense of the local industry. It is also clear that by following the licensing rules that were in place before the sudden change in early April, local contraband production can be stopped.

The vast majority of the true contraband is from illegal imports. Destroying the local industry, as this policy threatens to do, will be another advantage for illegal imports.

More fundamentally, it's not good enough to excuse governments from making poor policy choices on a product that is unpopular; policy choices that restrict rights and fly in the face of family business practices. It's a slippery slope – where is the line that limits the right of governments to arbitrarily limit the rights of their citizens? This is no way to set a precedent for the nature of family business. What if the next capricious and whimsical decision of government is that they don't like supply-managed products, or red meat products, or….? Others in agriculture and small business should not be complacent because this is "only tobacco".

Alternatives

We are told that, as a result of this change in policy, the federal government is going to face legal action. This is not surprising, given the draconian nature of the change, especially when people made their decisions to participate in the TTP Program under one set of rules and then found that those rules had changed totally.

However, as this is written, it is almost the end of April and tobacco seedlings have been planted in greenhouses. Decisions were made to produce tobacco this year before the about-face in policy. Waiting for legal action to come to fruition will jeopardize this year's crop. There are two alternatives for proceeding quickly to undo the damage. Both are based on the principle that no TTP program participant can in any way hold direct liability for loss or direct potential for gain from the production of tobacco. If this is the principle, it should not prevent a program participant from renting land and equipment to a child, making a loan to a child, or guaranteeing a loan for a child so long as the participant had no direct interest in the production itself.

If this is the principle, which seems to have been the original intent of the policy, then a tobacco crop can be produced this year if the Minister does one of two things:

- Accept that the rules set out by Agriculture and Agri-food Canada in March are compliant with the principle and return to them, or
- Accept those rules for this year without precedent for subsequent years and work to improve them, in time for next year's crop.

If the Minister does not act quickly, there will be almost no crop this year. This will put one more stake in the heart of a processing industry that has been withdrawing from Canada. It will also be one more signal to industry that this is really not a good country in which to invest.