Bond refunding in postbellum New Orleans: The premium bond plan

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When the Civil War broke out, New Orleans was the leading city in the South. By 1875, New Orleans definitely was not. Like so many other Southern cities, it had fallen victim to the ravages of war and changes in patterns of trade—in this case due to the construction of a national railroad system and the subsequent decline in traffic along the Mississippi River. The assessed value of real and personal property in the City (its tax base) amounted to $125,192,403 in 1861 (City of New Orleans, 1865, p. 18). By 1864, this amount had fallen to $98,788,325 (Ibid, p. 19), a loss of 21% in four years of wartime inflation. Eleven years later, it had only risen to $119,288,504 (Phillips, p. 24).

While part of the above decrease was due to the reduced valuation of real estate, the major portion was due to losses of personal property. For example, when the slaves were declared free, property assessed at $6,609,210 was removed from the City’s tax rolls at one stroke (Ibid, p. 18).

These numbers do not fully reflect the magnitude of the decline. From the following statement made in 1868 by then mayor of New Orleans, Edward Heath, it can be inferred that the dollars shown in the city’s records are not federal dollars, but a form of local currency—which must have depreciated significantly during and after the Civil War. According to Mayor Heath,

“The City currency is a subject

which has painfully occupied a good deal of our attention of late. It is a paper currency which represents not precious metals, but rests solely on the credit of the city. The present city government is not responsible for its introduction. We found it in circulation when we came into office. It was the offspring of the war. It originated with the Council of 1861. It had its precedent—not a venerable one, though rather time-worn, in the shinplasters of 1836-37—a convenient kind of money, but which soon flooded the community in such quantity that the Legislature was compelled to intervene and prohibit the overissue of it.”

(Report to the Common Council of New Orleans, 1868)

Regretably, the expenses of running the city did not decrease, and by 1875, the bonded indebtedness of New Orleans had reached $22,041,379 (Phillips, p. 24). The rate of taxation, which had been 15 mills in 1861, was 30 mills (Ibid, p. 4), and it was felt that in order to run the city and service this debt, a tax rate of 50 mills would be necessary (La. Laws, 1876, Act 31, Preamble)—in a city whose economy had never really recovered from the...
devastation of the Civil War or the excesses of the Reconstruction.

This state of affairs did not pass unnoticed by the financial community. While the bonds issued at this time by governmental units in the Northern part of the United States typically paid interest at the rate of 5% (New York Times, 1876), those issued by the City of New Orleans paid interest at rates ranging from 7 to 10% (Hecht, p. 5). To save the City from bankruptcy, drastic measures were necessary.

THE PREMIUM BOND PLAN

The plan put forth by the City's Administrator of Finance, Mr. D.H. Adler, was known as the "Premium Bond Plan" and was designed to liquidate the City's bonded indebtedness over a 50-year period. Under this plan, which was adopted by the City Council on May 25, 1875 (New Orleans City Ordinance 3130) and ratified by the Louisiana Legislature on March 6, 1876 (La. Laws 1876, Act 31), existing bonds, whose coupon rates averaged 7 1/2% (Phillips, p. 5), would be converted into 5% Premium Bonds—redeemable from one to fifty years in the future. One million bonds, of $20 denomination, would be issued in 10,000 series of 100 bonds each.

To determine which bonds were to be redeemed, numbers representing each series of outstanding bonds were placed in a wheel. Four times a year, on January 31st, April 15th, July 31st and October 15th, fifty numbers, representing 50 series of bonds, were drawn from this wheel by a blindfolded orphan boy. Twice a year, on January 15th and July 15th, holders of bonds of the series drawn participated in a premium distribution (another drawing) at which 1,176 premiums, ranging from $20 to $5,000 (and totaling $50,000), were distributed. All bonds which did not win any premium were paid at their par value, plus simple interest at the rate of 5% from July 15th, 1875.

To service the bonds and finance the premiums, the City Council was authorized by the Legislature to levy a tax of one and one-half percent (15 mills) on all assessed property within the corporate limits of the City. The proceeds of this tax were to be placed into a special fund "to be used for no other purpose than the payment of said bonds and interest on the said premiums comprised in said allotments, and the funds so raised shall be placed to the credit of an account to be called the premium bond account, and no money from said fund shall be paid out except of the joint authority of the commissioners of the consolidated debt. The said tax shall be denominated the premium bond tax, and shall be separately mentioned in the tax rolls and receipts." (La. Laws, 1876, Act 31, Sec. 6.)

The Premium Bond Plan was a mixed success. As is the case today, New Orleanians love a game of chance. Here was a way to enter an honest lottery (the Louisiana lottery at this time definitely wasn't) and to perform a civic duty without losing one's investment. Many bondholders jumped at this opportunity and exchanged their old bonds, at par, for this new form of security.

Other bondholders, however, did not wish (or could not afford) to exchange securities with a high yield, which gave them income semiannually, for lower-yielding ones—on which interest would not be paid until redemption, which could be as long as 50 years in the future. The end result was that premium bonds with a face value of about $13.5 million continued on page 26
were issued, while almost $10 million of the old high-interest bonds remained outstanding (Phillips, p. 6).

The price of the premium bonds varied over the years. Although they were originally issued at par, their value fell to 25 cents on the dollar (or $5 for a $20 bond) when the constitutionality of the Premium Bond Act was questioned (Hecht, p. 9). After the Louisiana Supreme Court upheld the legality of the act by a 3 to 2 decision (Docket #7907, 32 LA. Ann 726), the price of the bonds increased rapidly.

While the Premium Bond Plan was being challenged, the City took advantage of the depressed prices of these bonds and, using monies received from the sale of certain street railway franchises, purchased over 3.5 million dollars of them on the open market—at a price averaging one-third of their par value (Hecht, p. 9). Since these bonds continued to participate in the premium drawings, the City occasionally won some of its own prizes.

Over the next five decades, the premium bonds were gradually retired. Although most of the other debts of the city were consolidated and refinanced with lower-interest securities (the "Constitutional 4's" of 1892), the premium bonds remained outstanding. In 1925, the last series of this bond issue was retired, and a unique form of financing was relegated to the annals of history.

CONCLUSION

New Orleans is still facing a financial crisis—this time because of the collapse of oil prices. Its bonds are barely investment grade, and its citizens are unwilling and/or unable to pay more property, income or sales taxes. The local desire to engage in games of chance, however, is as strong as ever. Bingo games and off-track betting thrive, and casinos and a lottery

have been major political issues for the past several years.

Why not revive the Premium Bond Plan? Here is a way to raise money for various worthy causes (e.g., teachers' salaries and a new prison) and to provide a constructive outlet for more affluent citizens' gambling instincts. Since the only "loss" to the bondholders would be a lower rate of interest, the usual arguments against lotteries would not apply (poor people don't ordinarily buy bonds). In today's environment, such a plan would be bound to succeed.

REFERENCES:


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