The Panic of 1796-1797

The first major financial crisis in the United States

What came to be later known as the Panic of 1796-1797 was a series of cross-Atlantic economic slumps which hit the United States and Great Britain. History records that the primary cause for the crisis was a land speculation bubble which burst in 1796. In the run up to the crisis, wealthy people had invested a lot of their money in real estate, only to end up incarcerated in debtors' prison after things went downhill. Perhaps the most prominent investor to meet this fate is Robert Morris Jr., a Founding Father and financier of American troops during the American War of Independence and a former U.S. Superintendent of Finance. A similar fall from grace as that of Morris came from another Founding Father, Henry Lee III, who, too, ended up in debtor's prison. James Wilson, also a Founding Father, was also briefly locked up, until his son paid his debt.

But luckily for Morris and Lee, they had friends in high circles, in the U.S. Congress. Both men were released under the Bankruptcy Act of 1800 that Congress passed, and repealed years later in 1803. Events such as these stimulated charges of nepotism and corruption in nascent U.S. politics.

The crisis worsened under the Bank Restriction Act of 1797 after the Bank of England suspended specie payments, thus placing the Bank of England under no obligation to convert depositors' banknotes into gold or silver coinage. This Act of Parliament had been necessitated because bank notes were overprinted, which goes to show the evils of fractional reserve lending. There was insufficient gold inside the bank vaults to pay the bearer on demand, and the currency subsequently collapsed. The confidence in the monetary system had waned, and the crisis deepened in Great Britain and abroad.

The underlying causes that brought on the Panic of 1796-1797 came off the backdrop of decades-long economic instability in America. Continental money had drastically depreciated in value during the Revolutionary War, which gave rise to saying: *"…not worth a continental!"*. With the U.S. lacking a stable currency, banks issued their own bespoke notes. To bring forth a uniform currency, the Bank of North America was set up in 1781 (the first central bank in the U.S.) under the Articles of Confederation. But this bank was a private business with ties to Robert Morris who, prior to the property bubble, had been a very wealthy man. Whilst Morris had made a name for himself as an important financier during the American Revolution, prominent revolutionists such as Thomas Paine, Henry Laurens, et cetera criticized him and his firm for alleged war profiteering. The Bank of North America soon acquired the reputation for serving no other purpose but that of avarice for reasons that (i) it was a private corporation acting as a quasi-public corporation; (ii) its incorporation set up a monopoly which benefited a few wealthy merchants and investors; (iii) it did not operate in the public interest.

After the adoption of the Constitution, the First Bank of the United States succeeded it in 1791 as a de facto central bank; but its charter was not attained without opposition. There was scant approval by Secretary of State Thomas Jefferson and Representative James Madison in admitting this bank bill. The bank had been proposed by Alexander Hamilton, the Secretary of the Treasury, as a way to establish a financial order, clarity and precedence, establish credit, and resolve the issue of the Continental currency.

President George Washington signed Hamilton's bank bill into law with reservations. Concerns remained, however, over the strength of public credit as unstable bank notes remained the medium of exchange. The dollar's weakness vis-à-vis the British pound also posed problems for overseas merchants in Great Britain whose produce, destined for American ports, had to be paid in the currency in which it was sold.

During this time, speculation was the investment of choice, leading to the two month long Panic of 1792. Former Continental Congressman and Founding Father, William Duer, raised large sums of money to invest in bank stock and government securities, novel and financially sophisticated assets whose risks many contemporaries failed to understand. Duer soon defaulted on his debts, destroying the savings of many middle- and working-class people. The ensuing panic caused riots and reignited Congressional debate over a bankruptcy law that would finally produce the Bankruptcy Act of 1800 after the Panic of 1796–1797.

Duer and other prominent financiers then sought to recover their fortunes by applying unprecedented scale to an old concept: land speculation. Desperate measures such as these set the stage for the bubble that burst in 1796, causing a ripple effect throughout.

American port cities suffered trade deficits in the aftermath of the Panic of 1796-1797 which did not relent until the turn of the 19th century. The panic also revealed to what extent the depletion of European resources can impact the U.S. economy, particularly so when foreign nations are embroiled in costly wars. The lessons learned during this crisis prompted Thomas Jefferson to sign into law the Embargo Act of 1807 whilst the United Kingdom and France were engaged in the Napoleonic Wars of 1803-1815.