Bastiat's "What is Seen and What is Not Seen"
The Effect of Excess Money on Income Inequality
An Austrian Perspective
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Frederic Bastiat was a 19th century French theorist who wrote extensively on economic matters. One of his insights was the notion of "what is seen and what is not seen." Today, the concept is more popularly known as "the law of unintended consequences." Bastiat used the broken window as an example. If a business has a broken window, and a glazier is hired to repair the window, what is seen is the hiring of the glazier and the repair of the broken window. The glazier is economically better off for having gotten the extra business. What is not seen is what the shopkeeper might have done with the money if the window hadn't been broken. The repair only brings things back to their prior state. The thing "not seen" might have been another machine to help the shop owner be more productive or the purchase of more product with which to sell.

The same situation exists with money. This blog post was born from an article in the June 2014 issue of the Harvard Business Review titled "The Capitalist's Dilemma." Without getting into the weeds, the premise of the article was that the old fashioned concept of money being labeled a scarce resource is true. Since organizations are awash in cash (nearly two-trillion dollars), and – I'm adding logically to the story – with fractional banking laws, the notion of money being scarce is almost risible. Throw caution to the wind and begin spending that money on innovation, hire skilled labor to do the innovating. It's a nice idea, but it fails to address the ramifications of releasing all the money into the economy. We see the hiring. We see the drive to innovate. The company is apparently better, but for how long? What we don't see is what happens when nearly two trillion dollars spills out into the economy. Prices for goods rise. The rich get richer; the poor get poorer.

When the Federal Reserve adopts a policy of easy money, which it's been doing since 2010 (I'm not even counting the 800 billion stimulus that opened the Obama presidency), the purpose of which is ostensibly to stimulate production, the banks must necessarily lower interest rates, now less than three percent, to encourage access to the money. And, with its system of fractional banking, banks can lend out as much as 10 times (I'm being generous) as much capital as it has in reserve! Truly, money is no longer a "scarce resource." It's not a real problem for the banks. FDIC insurance and the "lender of last resort (the Fed)," banks give little thought to being overleveraged.

With such low lending rates by the banks, consumers with savings accounts in those banks have seen interest on their accounts lowered to less than one percent! To someone trying to save some money, a savings account is generally all that's available for the prudent student. So, a $100 balance yields a whopping 95 cents interest!

The upper income earners have many more investment opportunities, so a savings account with such a low rate of interest will not appeal to them. This explains why the stock market seems to have become untethered from the economy. It's the only place that offers the potential for a much more substantial investment profit. In fact, the average stock market yield since 1987 has been over 10 percent. The rich are getting richer. The fear of inflation explains why the stock market seems to be sputtering these days. Janet Yellen has promised to stop quantitative easing. This is partly done by raising lending rates. These rates will then become more attractive to investors, and money will begin to flow away from the market and back into those vehicles. The stock market suffers.

So, in one respect easy money exacerbates income inequality. But, inflation works in another way, too, and it's much more "unseen," and much more insidious.

Money, while being a medium of exchange, is still like any other good. It has value. When we had commodity money -- a piece of gold, silver, copper, etc, the value of money related directly to the weight of the commodity. When it was replaced by what we now call fiat money – paper backed by a promise by the Fed, it still has a perceived value. Without the promise by the Fed to make good on the dollar, the paper money would have no value whatsoever.

When the money supply becomes too abundant, it loses value. Much like an overabundance of diamonds will lower the value of a diamond, an overabundance of laptop computers will likewise make the computer less costly, even an abundant crop yield of apples will make apples cheaper. An excess of money will make the money less valuable. So, more money will be needed to purchase economic goods. When food and gas prices rise, there is usually an inflation component. Obviously, other factors contribute as well. Weather can affect supply and so, too, can the impact of geopolitical factors. For example, reparations imposed on Germany after World War I, caused hyperinflation in the Weimar Republic during the 1920s -- arguably the cause of World War II.

When the Fed opens the money spigots – to expand, invest in plant expansion, increase research and development, whatever, organizations seek out new employees. Now that organizations are engaged in the search for skilled labor, wages will be bid up. And, it's not a problem for them, because money is no longer scarce. With the organizations hiring all the new employees at the increased salaries, costs of those payments has to be reflected in higher prices for the goods produced. The poor can no longer afford some of those higher priced goods. They are poorer.

Inflation and easy money were the precipitating reason for the 2007 recession. As no money down and subprime mortgages created an asset bubble and a highly over leveraged consumer, inflation caused housing prices to rise at an unsustainable rate. Home shoppers, with access to easy money, bid up home prices. It wasn't a problem until the bubble burst and many lost all they owned. The poor over leveraged home owner lost everything. They got poorer. But, to the rescue of the rich came TARP (Toxic Asset Relief Program), and bailed out the over leveraged banks.

The simple fact is that businesses are holding on to their money because of great uncertainty – fiscal policy, monetary policy, regulatory policy, volatile global issues, etc. And, because businesses are afraid to expand, there are fewer opportunities for the new college grad, for example, to get onto the career path for which they've studied so hard. Without job opportunities, the poor (and the middle class, too) get poorer.