Division of Labor and Common Currency

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Very preliminary and incomplete. Please do not circulate.

Abstract

This paper analyzes an economy in which workers are divided into multiple sectors due to sector-specific skills. If employers pay wages by IOUs that promises to deliver their own products, then workers cannot share risk to their consumption due to a shock to the relative prices of goods between different sectors. In contrast, if employers pay wages by common currency issued by the central bank, then workers can share consumption risk among them as the relative-price shock does not affect the relative wealth distribution among them. This result explains why currency is necessary despite the availability of credit, and also why common currency must be the sole medium of exchange, or the unit of account.

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