

Discrete Choice, Complete Markets, and Equilibrium

Simon Mongey

Federal Reserve Bank of Minneapolis and NBER

Michael E. Waugh

Federal Reserve Bank of Minneapolis and NBER

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ABSTRACT

This paper characterizes the allocations that emerge in general equilibrium economies populated by households with preferences of the additive random utility type and making discrete choices across products, employment, or locations. We consider a framework with complete markets where households can, ex-ante, trade claims contingent upon the realizations of their preference shocks. We establish a first and second welfare theorem and illustrate that in the absence of complete markets these economies are generically inefficient. We illustrate the relevance of these results when measuring how welfare changes in response to productivity shocks.

Email: michael.e.waugh@gmail.com. The views expressed herein are those of the authors and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.