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Xiaojun Shi, Zhu Yan

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Urbanization and risk preference in China: A decomposition of self-selection and assimilation effects*

Xiaojun Shi ^{† ‡} and Zhu Yan [§]

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Abstract

This paper posits that urbanization reshapes individuals' risk preference by exerting self-selection and assimilation effects. Taking advantage of the unique Hukou system in China, we innovate a quasi-experiment method to elicit the two effects, employing the 2013 wave dataset of the Chinese General Social Survey (CGSS). We find strong evidence supporting our two-effect theory, and the magnitudes of both effects are sizable and similar in scale. The assimilation effect reduces the migrant's risk aversion measurement by 0.606, while the self-selection effect reduces it by 0.715 on average. Overall, urbanization improves migrants' risk appetite, and mediated by this improvement, migrants are more likely than their rural peers to engage in economic activities under uncertainty, as indicated by the evidence that presents when we apply the two-effect theory to investigate how a household decides on risky financial asset investment.

Keywords: Risk aversion; Migration; Urbanization; Assimilation; Self-selection

JEL Classification: P25 R23 D1 J61 Q5

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[†]China Financial Policy Research Center, School of Finance, Renmin University of China, Beijing, 100872, P.R.China. TEL: +86 (10) 8250 0642 and E-mail: sxjstein@gmail.com; sxjstein@126.com.

[‡]Corresponding author.

[§]School of Finance, Renmin University of China, Beijing, 100872, P.R.China. E-mail: yanzhuruc@163.com.

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