Life cycle hypothesis

Business

Introduction Individuals have a saving pattern that follows a certain process in their life time. The case study is an example of a sampling of the many theories that have been developed based on individual consumption patterns.

The most common is the Keynesian theory referred to as the life cycle theory. Others include the permanent income and the relative income hypotheses. This paper will analyze the life cycle theory, the pattern of an individual's lifetime savings and the impact of that pattern to the overall economy of a country. Saving Pattern An individual has a particular saving pattern they follow in their lifetime. According to the life cycle theory a person who has a source of income that is huge and hence is considered rich saves more than a person who has small income. This is because the rich one has the capacity to use and save without a problem.

According to this hypothesis, young people tend to involve themselves in debt at the early age to meet lifetime big goals and obligations such as owning a house and education. This debt is paid off in the middle age as the person saves some and during the sunset years the individual starts dissaving either for the kids orfor self use. This person might die with so much in their bank accounts because their time of death is not definite (Browning and Crossley, 2001). The most obvious reason people follow this type of a model in their saving is because of the difference between income and consumption needs in the various stages in life. Young people have consumption needs that exceed their income and older people have income that exceeds their consumption levels.

This makes it hard for a young person to save and very easy for an old person to save. It is not necessarily true that a person saves when in the middle age or old because some commitments may vary but the general pattern is applicable to most people. Also many people may die broke bringing to conclusion that old people don't necessarily dissave but they can dissave badly to their detriment (Browning and Crossley, 2001). Impact on Saving Rate The overall saving rate of an economy depends on the level of saving and consumption in terms of dissaving that is there. This is directly proportional to the net saving of an individual and it is also dependent on many other factors. This includes the cost of the most basic purchases such as houses and the tax treatment on savings in an economy.

It iis also dependent on the culture of saving of individuals in the country and the policies that guide saving institutions, their reliability, trustworthiness and the convenience these institutions such as banks. This if translated means that richer economies will save more than poorer economies but that is not always the case. It is also logical to argue that as economies grow they will save more of their disposable income and hence grow richer. Japan is an example of how policies in a country can be used to grow an economy. Their post offices double up as convenience saving accounts that are spread all over the country and to buy a house one must save considerable amount of money as deposit to the bank making it almost mandatory to save (Browning and Crossley, 2001). Conclusion A country's saving rate is a reflection of the individual saving of disposable incomes in the country.

It is dependent on many factors apart from the saving and dissaving levels of the people. Individual saving patterns are on the other hand influenced by

the level the person is in life as suggested by the life cycle hypothesis. The culture of saving and a good policy approach towards saving is the cornerstone of an economy expansion from that angle.