A Theory of Economic Growth: Dynamics and Policy in Overlapping Generations. By DAVID DE LA CROIX and PHILIPPE MICHEL. Cambridge University Press, Cambridge. 2002. xvii+378 pp. d20.95 paperback.

This is an excellent book which I am sure will become a well-thumbed friend on the bookshelves of many students and researchers in the field of dynamic macroeconomic policy analysis. The book is based for the most part on the Diamond (one-sector, two-factor, two-period lives) overlapping generations model, and it concentrates on the policy areas for which this model is the most appropriate: the analysis of the optimality of equilibrium under perfect markets, public debt and public spending, optimal second best taxation rules for financing public spending, and pensions policy. It also covers more briefly other important policy areas, such as human capital accumulation and the relative benefits of public and private education, intergenerational bequests and taste externalities. The strength and distinguishing feature of this book lies in the depth and detail of the analysis. Results are derived from first principles, yet the analysis is still highly accessible. The level of detail is such that there are no jumps between lines, so that the detail has the effect of demystifying the analysis.

The analysis of ponzi schemes and public debt gives a good illustration of the nature of the book. Not only is the standard analysis presented, in which ponzi debt schemes (where the level of debt in each year is at least as high as the level of last year's debt plus interest payments) are not feasible when the rate of interest is greater than the rate of population growth, if debt repayments are paid for by taxes on only one generation; but also, it is shown that, if the government can tax both generations, then there is no restriction on the level of government borrowing, since the government can simply take away with one hand what it is repaying with the other. Thus, the old generation may be repaid an amount greater than the level of GDP, since this repayment is then taxed back and given to the young generation, which allows them to purchase the large level of debt. The implication of this for policy analysis is clear. Government is much less restricted in its actions than one would suppose from analysing models where the government must rely on only one tax instrument.

The great detail and depth of the book comes at the cost of breadth. Although the book is called A Theory of Economic Growth rather than Theories of Economic Growth, I am sure that many readers might expect some coverage of issues such as endogenous technological progress, endogenous fertility and the break-out from the Malthusian trap, and the impact of the international environment on growth (technological diffusion, international capital flows and international trade). Some might also be expecting more than a couple of pages on the empirics of long-run income levels and economic growth, and the effects of income inequality on growth.
Clearly, given the choice between covering all the bases to some degree and concentrating on a subset of growth theory in depth and detail, Professors de la Croix and Michel have chosen the latter. In so doing, they have provided us with an excellent teaching tool and reference book on the important issues of public debt, optimal taxation, public pensions and the optimality of equilibrium under perfect markets and complete information.

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