

**The Title:** Reconsidering the Market Size Effect in Innovation and Growth

**Abstract:**

In the standard R&D-based endogenous growth model, a larger country innovates more and grows faster. Because of the homotheticity of preferences, however, it does not matter whether the large market size is due to a large population size or a high per-capita expenditure. In this paper, we develop a balanced growth model of innovation with nonhomothetic preferences, containing the standard model as a limit case. We show, among others, that, holding the aggregate market size fixed, a country with higher per capita expenditure and a smaller population size innovates more and grows faster under the empirically relevant cases.

**Keywords:** Horizontal Innovation, Endogenous Growth, Balanced Growth, Nonhomothetic Preferences, Demand Composition

JEL classification: O11, O31, O33

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