Globalization and Synchronization of Innovation Cycles

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We propose and analyze a two-country model of endogenous innovation cycles. In autarky, innovation fluctuations in the two countries are decoupled. As the trade costs fall and intra-industry trade rises, they become synchronized. This is because globalization leads to the alignment of innovation incentives across firms based in different countries, as they operate in the increasingly global (hence common) market environment. Furthermore, synchronization occurs faster (i.e., with a smaller reduction in trade costs) when the country sizes are more unequal, and it is the larger country that dictates the tempo of global innovation cycles with the smaller country adjusting its rhythm to the rhythm of the larger country. These results suggest that adding endogenous sources of productivity fluctuations might help improve our understanding of why countries that trade more with each other have more synchronized business cycles.