

The Return of Business Dynamism: Declining Market Concentration and Rising Labor Market Reallocation in Israel

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Motivation: Decline in Business Dynamics in Advance Economies

Figure 1: Cumulative Growth of Labor Productivity in Israel vs. G7 Countries, 1981 = 0 (log scale)

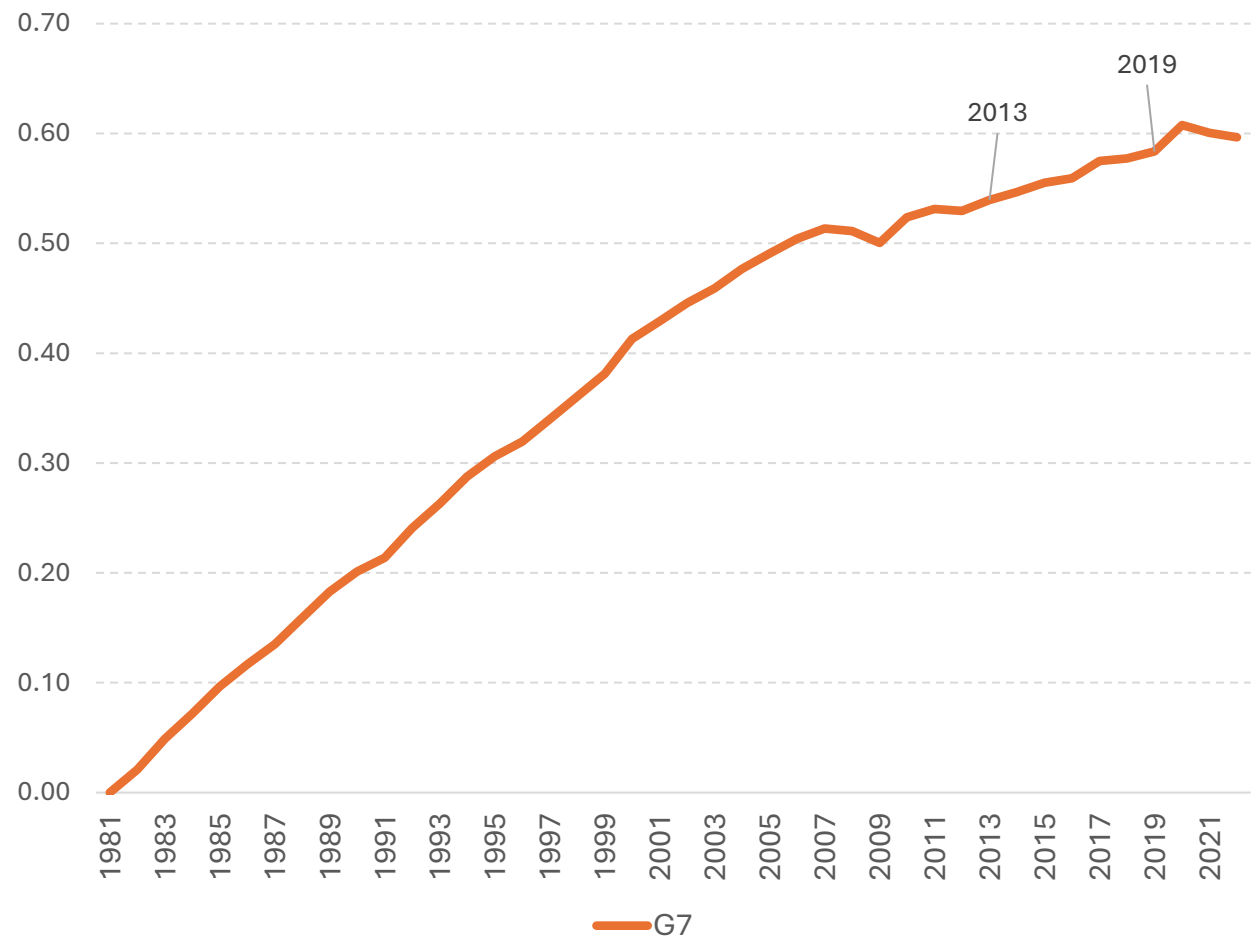
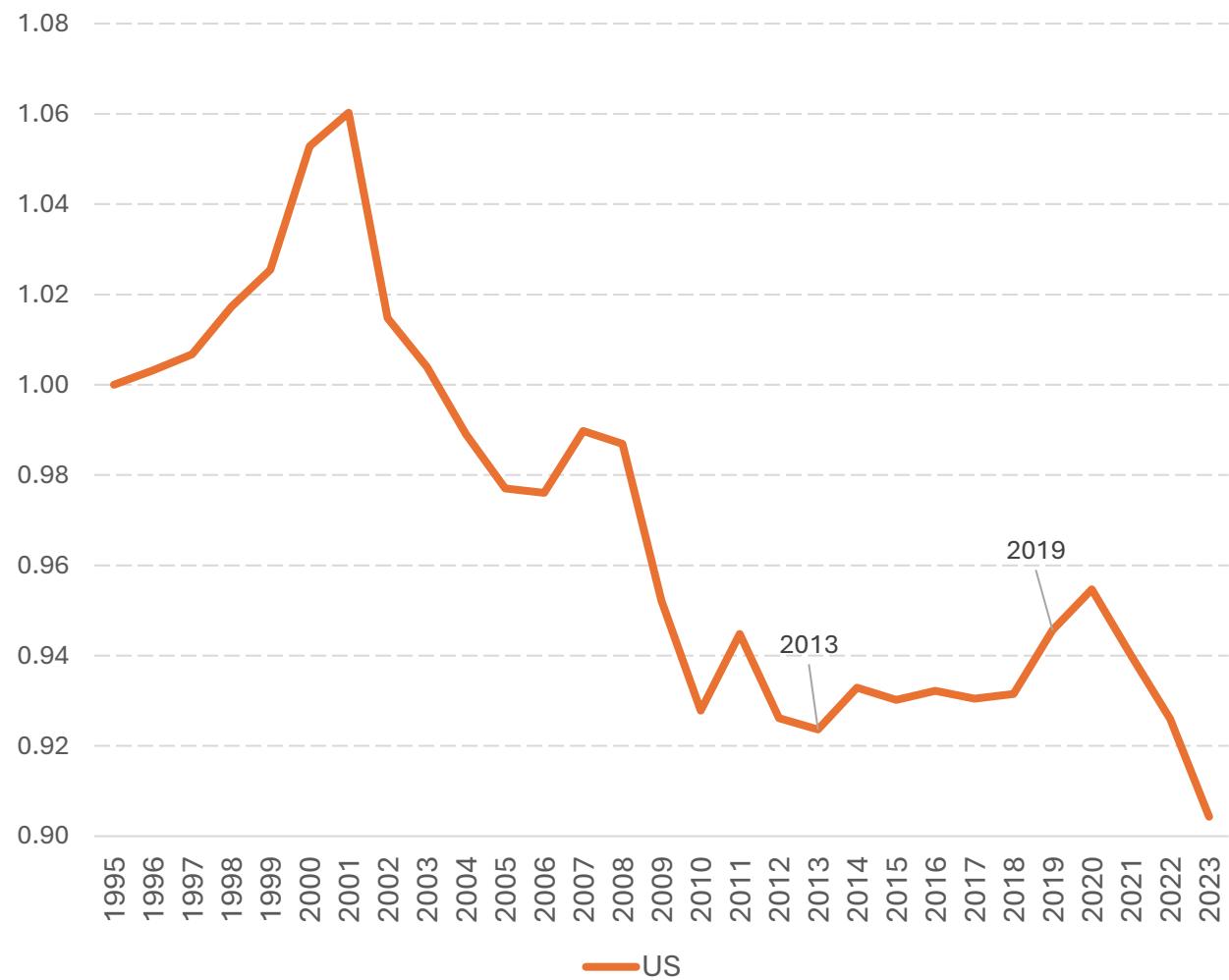


Figure 2: Normalized Labor Share in GDP: Israel vs. U.S. (1995–2023, 1995 = 1)



Motivation: Israel's Unique Patterns Between 2013-2019

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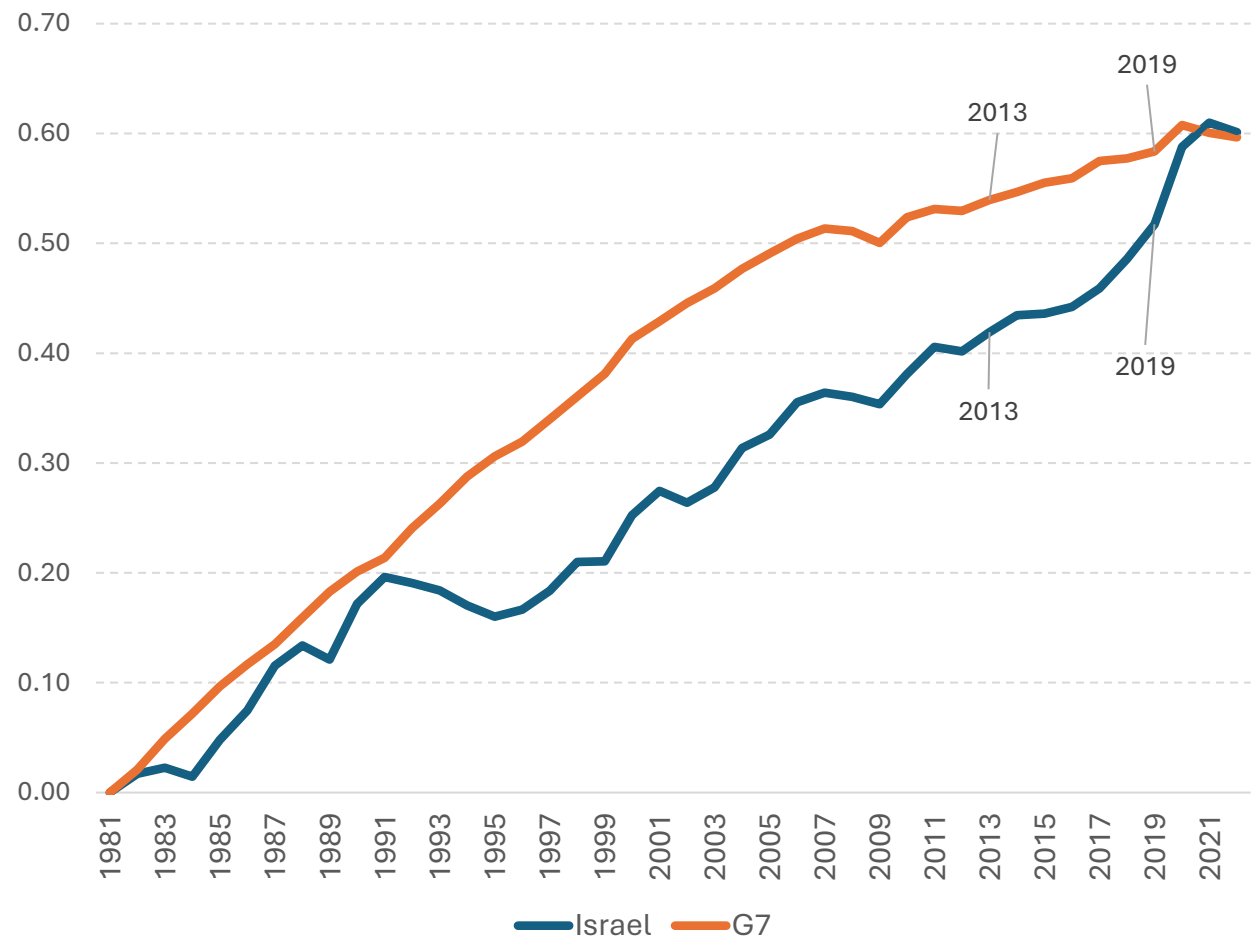
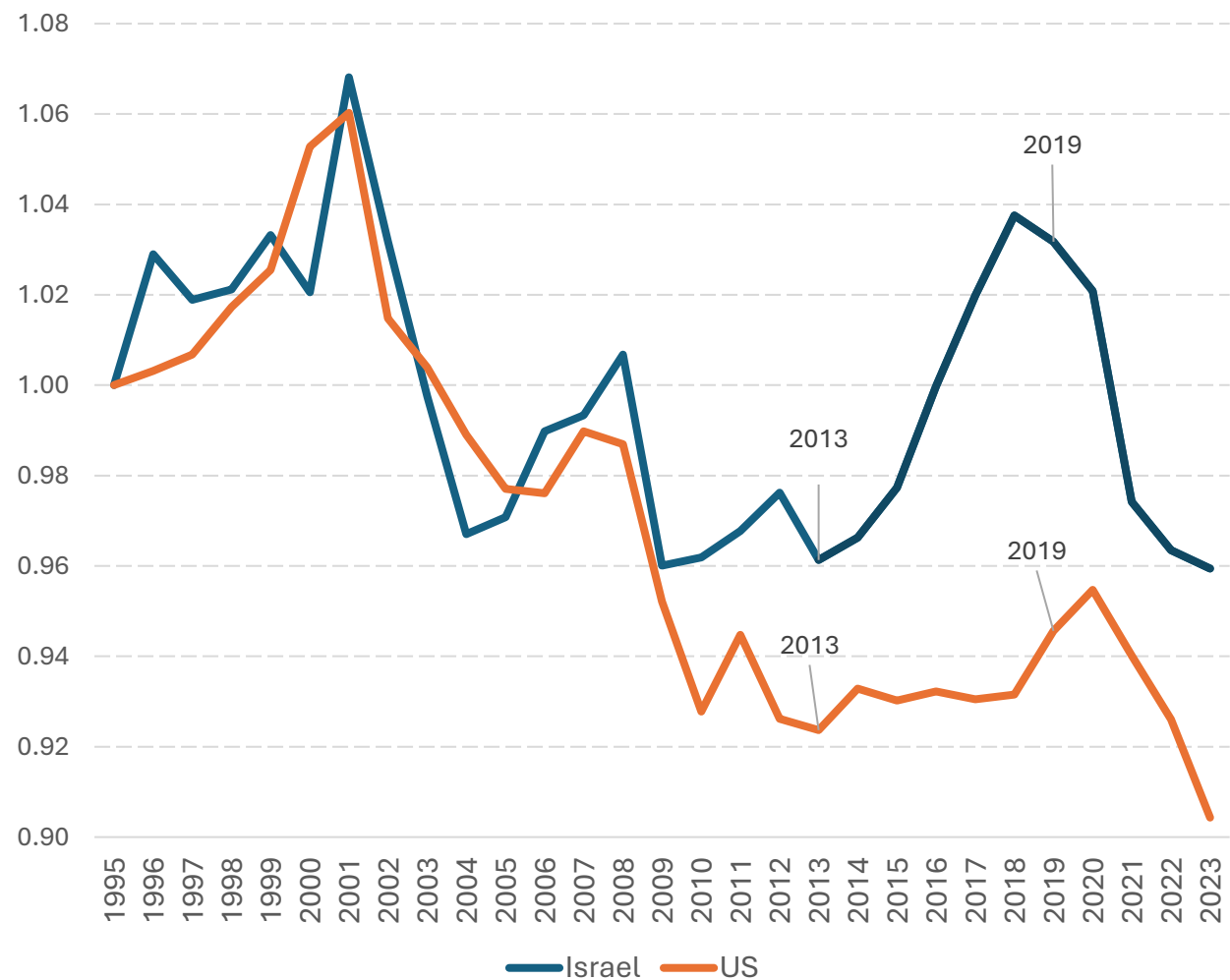
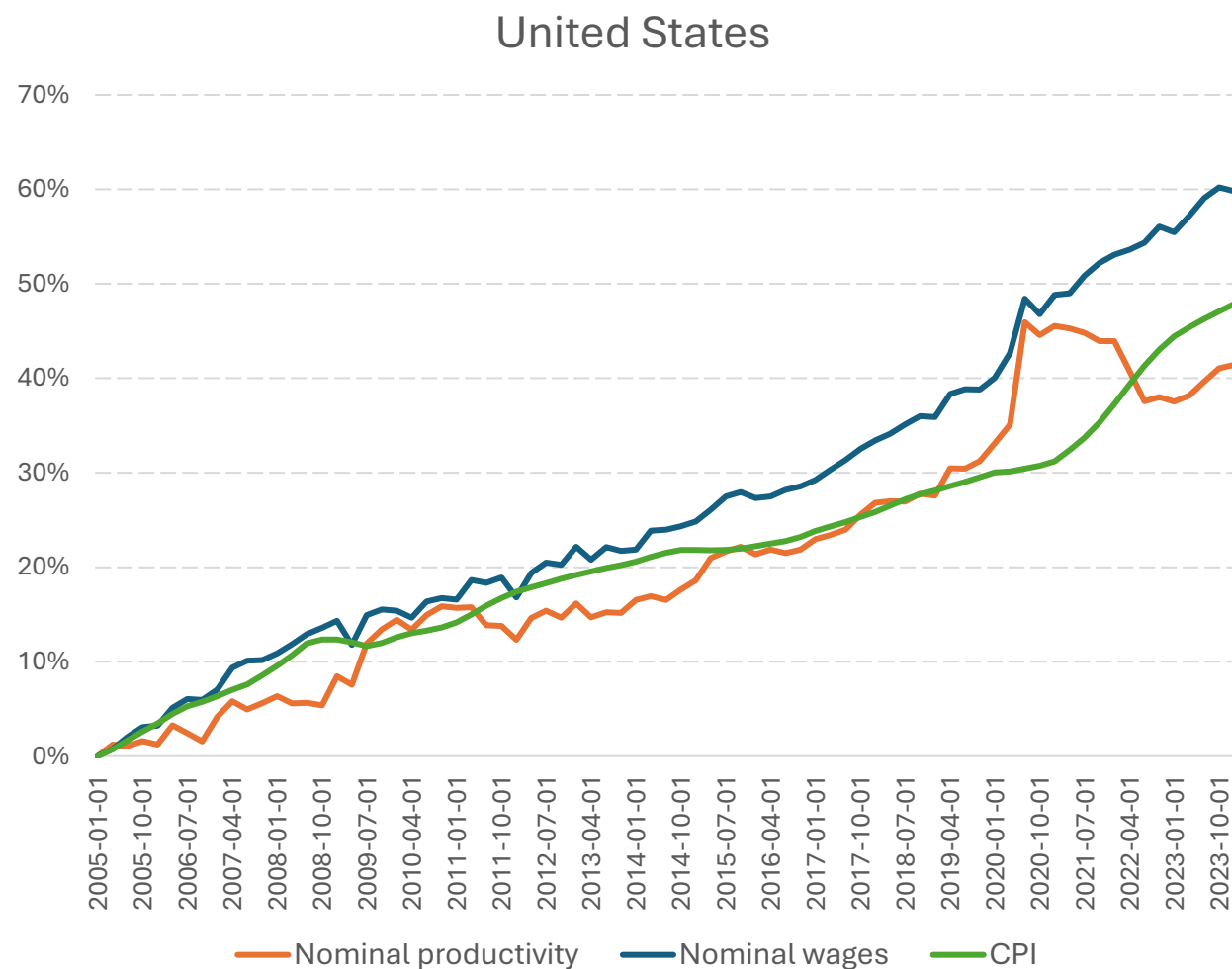


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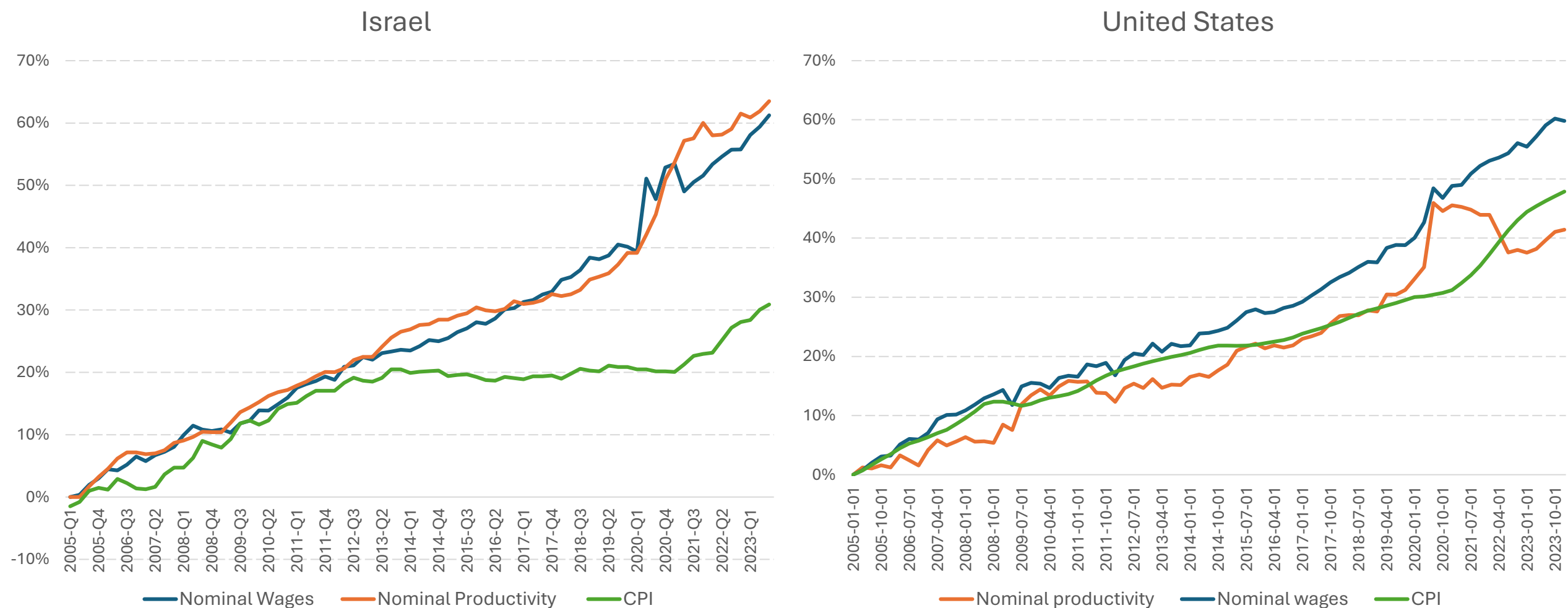
Motivation: Israel's Unique Patterns Between 2013-2019

Cumulative Changes in Consumer Prices, Nominal Wages, and Nominal Productivity in Israel and the United States, 2005–2023, 2005Q1 = 0 (log scale)



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These Patterns Coincides With Increase in Business Dynamism

Israel's unique macroeconomic trajectory between 2013 and 2019—marked by rising real wages, productivity, and labor share—coincides with a notable rise in business dynamism – the reallocation of resources toward more productive firms, driven by innovation and competitive pressure.

Two core indicators support this interpretation:

- 1. A sharp decline in market concentration**
- 2. Reallocation of workers toward more productive firms**

We use administrative data from the Israeli Tax Authority, including:

1. Firm-level data (2005–2022): annual reports and ownership structure
2. Worker-level employment records (2003–2022)
3. Linked employer–employee panel (2010–2022)
4. IVC High-Tech definition

Market Concentration:

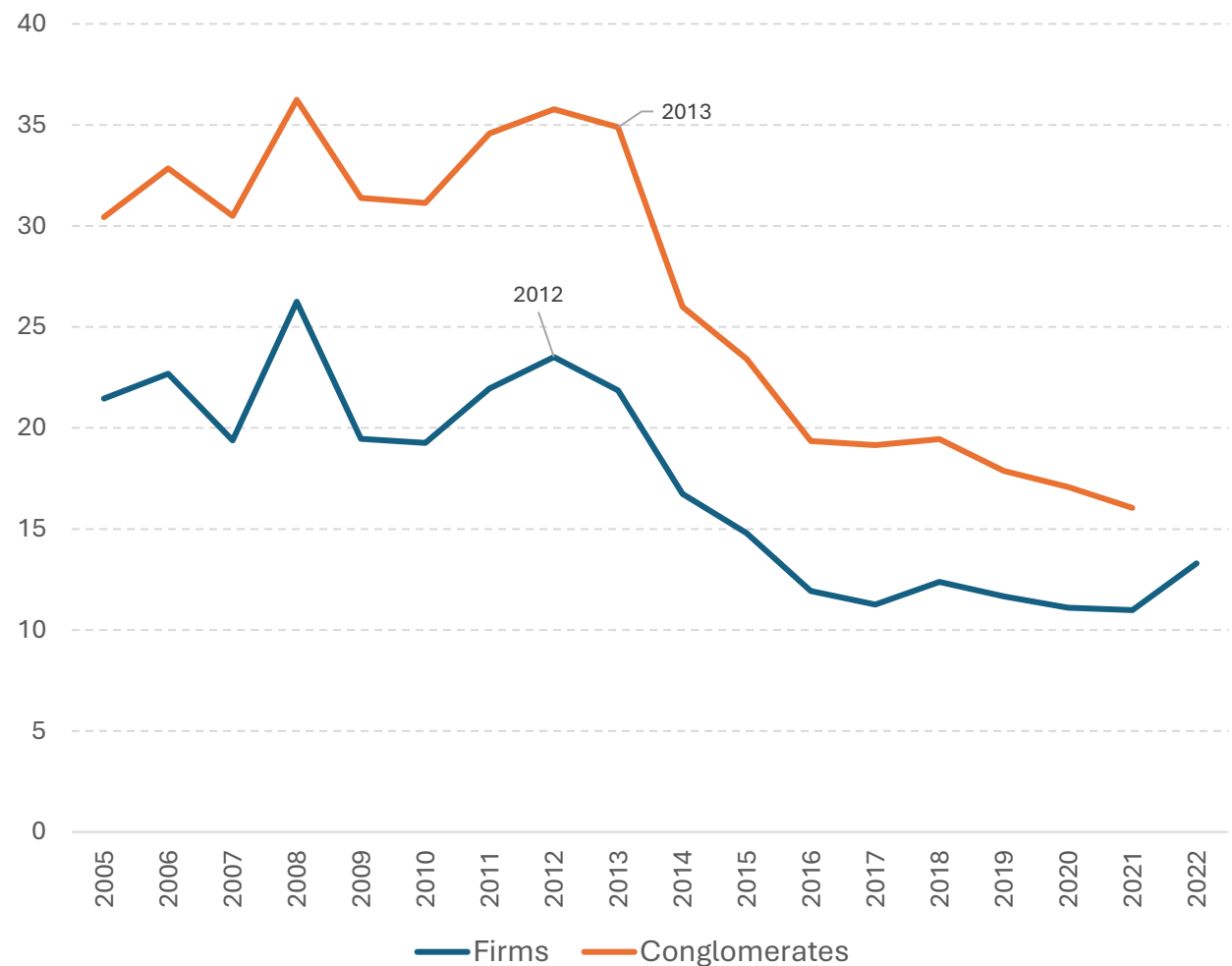
We use standard concentration measures—CR(X), HHI, and Pareto tail —based on firm revenues and employment

Reallocation of workers toward more productive firms

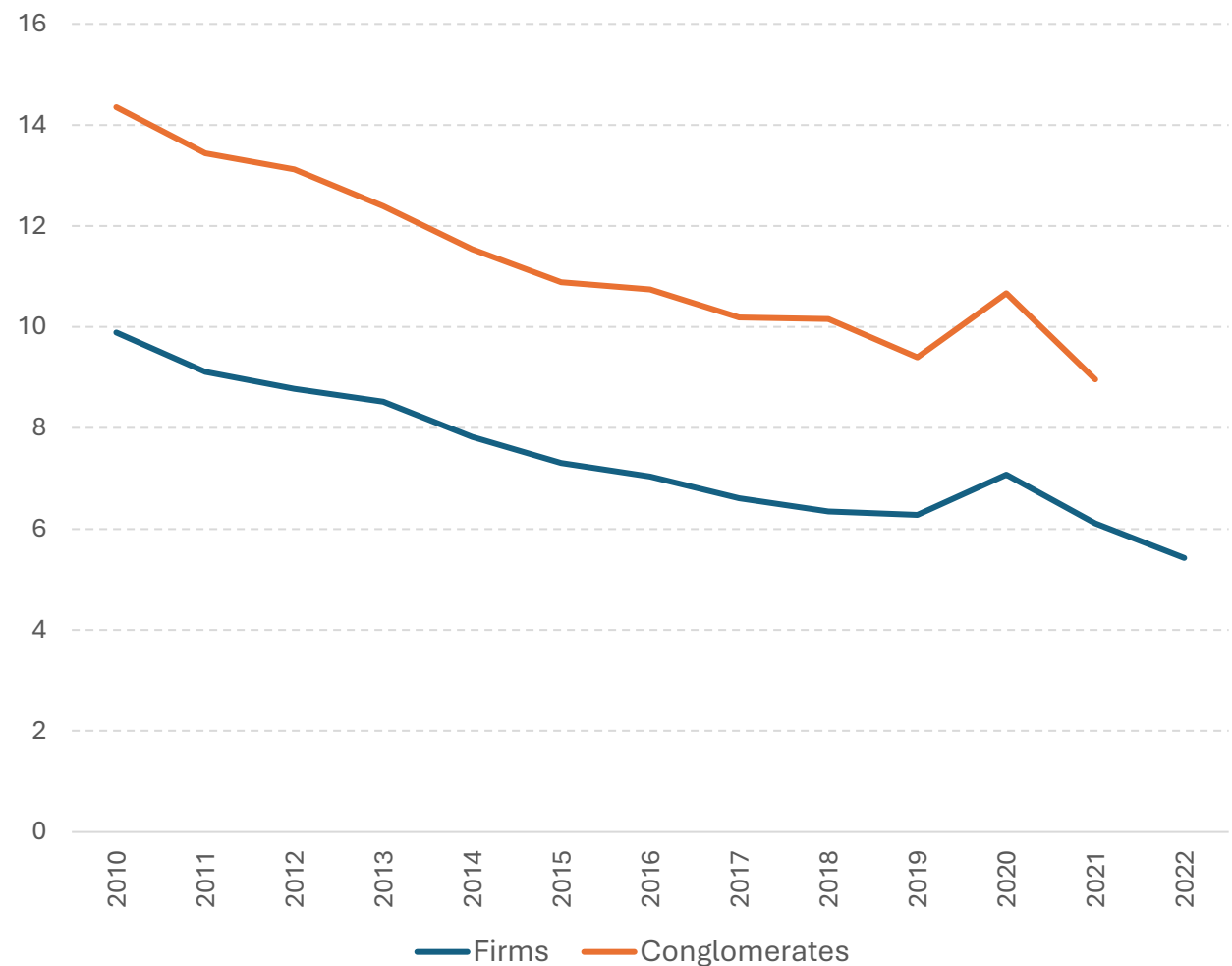
1. We proxy firm productivity and apply Grim and Haltiwanger (2016) decomposition to estimate labor reallocation effects on aggregate productivity
2. We further use the AKM framework to analyze worker–firm sorting over time

1. Decline in Market Concentration

Herfindahl-Hirschman Index (HHI) for
Revenue Concentration

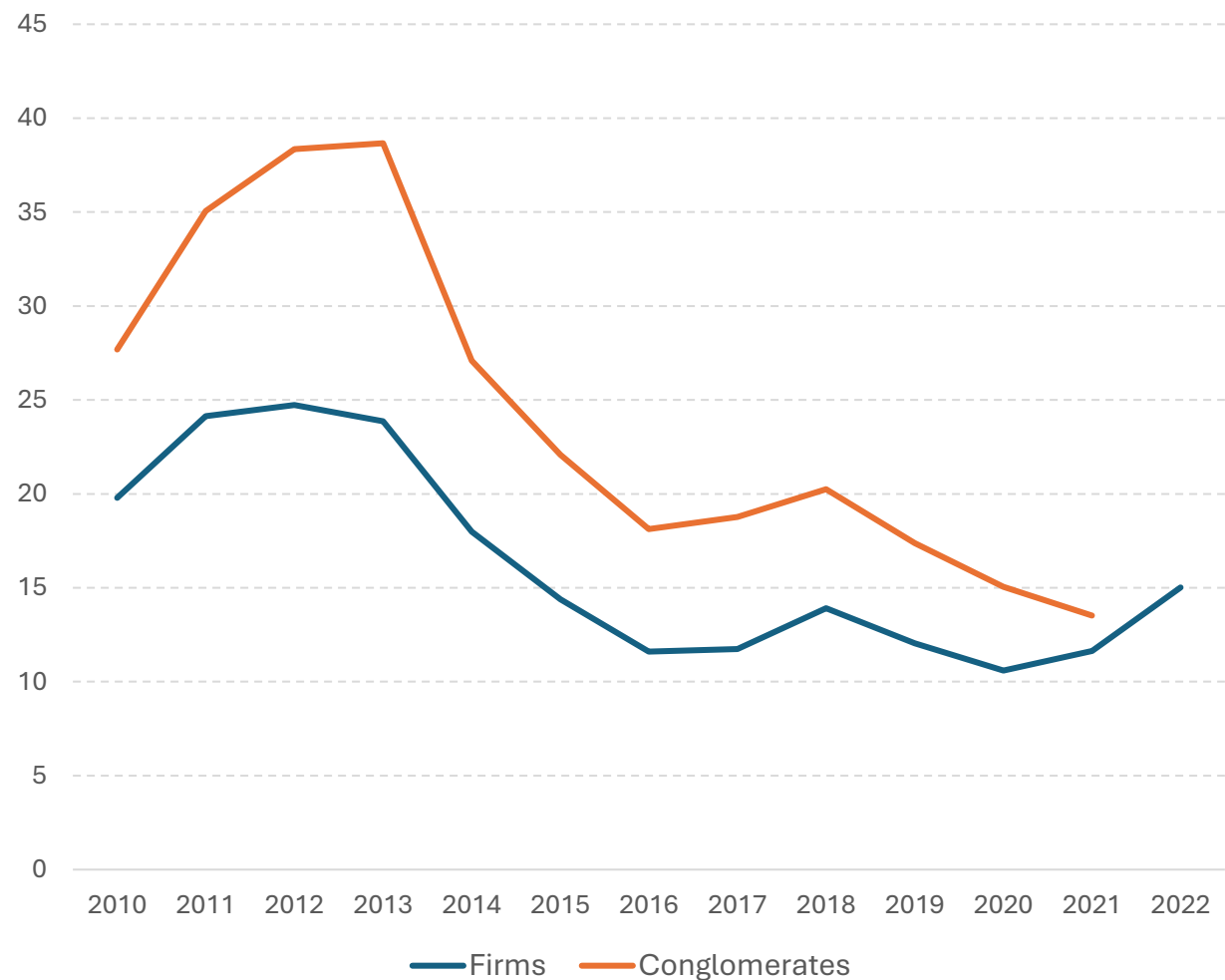


Herfindahl-Hirschman Index (HHI) for
Employment Concentration

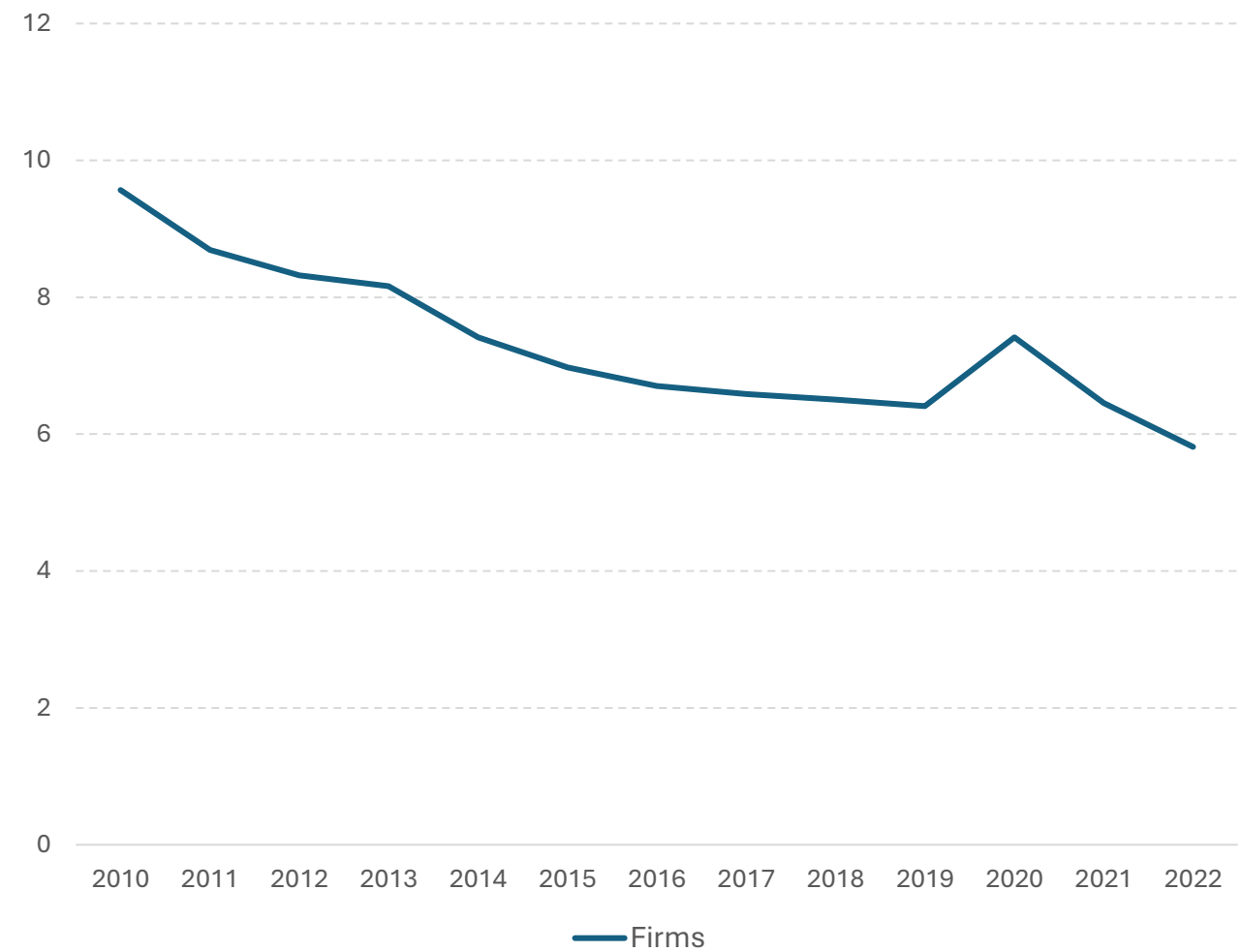


1. Decline in Market Concentration – Excluding High-Tech

Herfindahl-Hirschman Index (HHI) for
Revenue excluding High-Tech

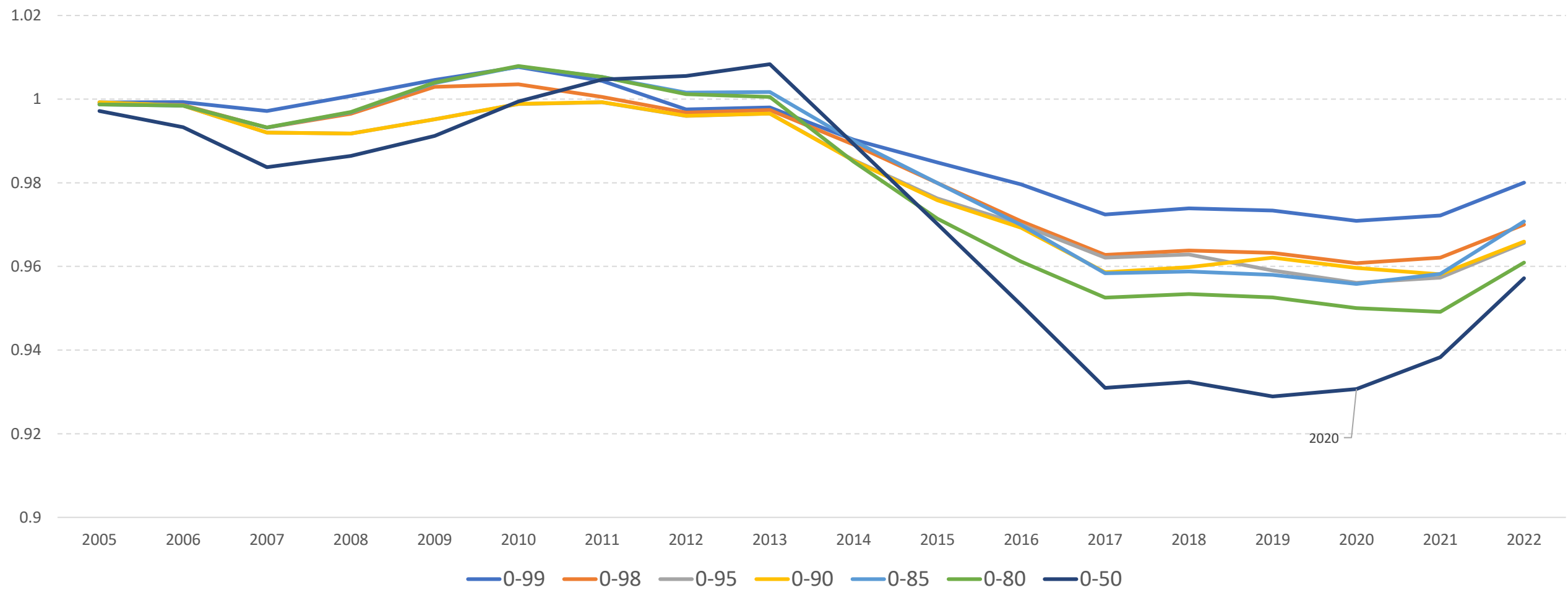


Herfindahl-Hirschman Index (HHI) for
Employment excluding High-Tech



1. Decline in Market Concentration

Market Share of Top 1% Firms by Revenue, Normalized to 2005=1, Across Firm Percentile Cutoffs



2. Labor reallocation : Abowd, Kramarz, and Margolis (1999)

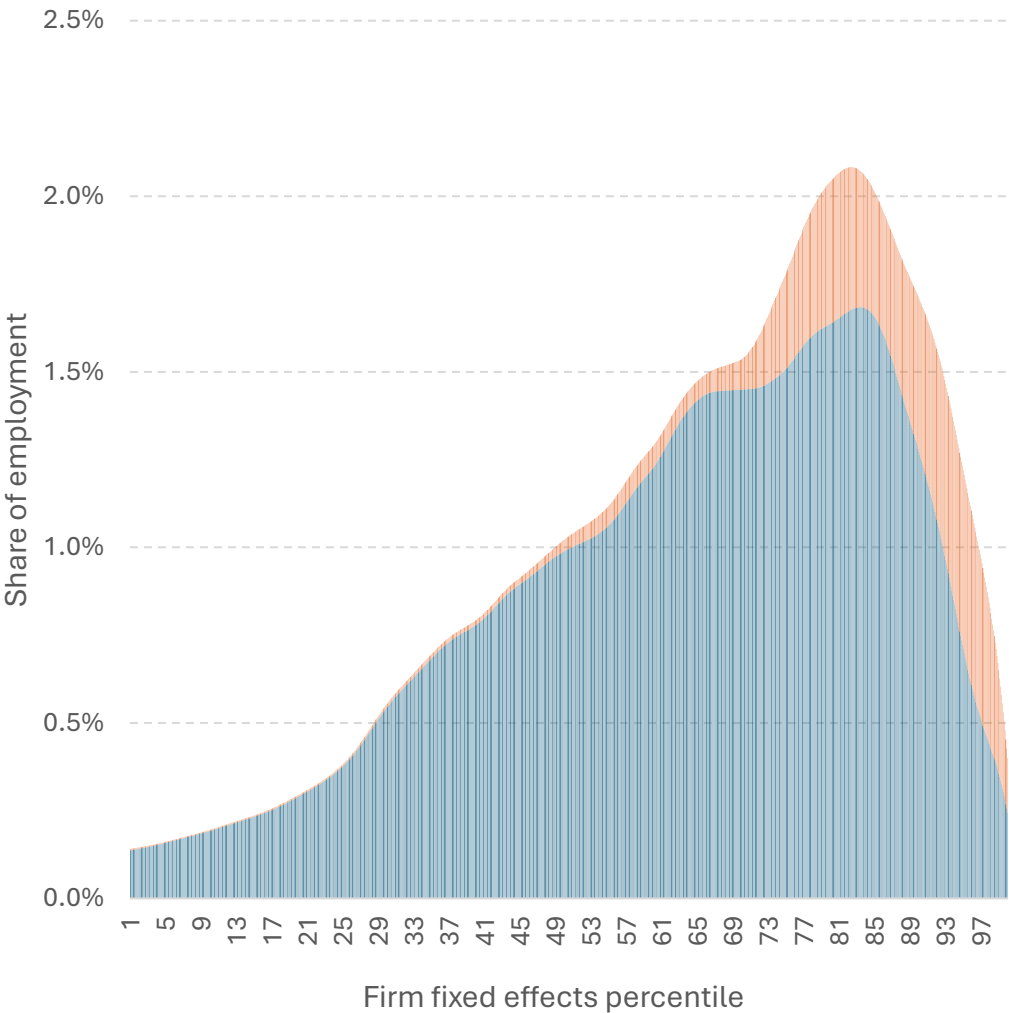
Estimation equation

$$\begin{array}{ccccccc} \log(\text{wage}) & & & & (age - 40)^2 + (age - 40)^3 & & \\ \uparrow & & & & \uparrow & & \\ \mathbf{w}_{i,t} = \alpha_i + \psi_{j(i,t)} + \beta \bar{x}_t + \delta t + \varepsilon_{i,t} & & & & & & \\ \downarrow & & \downarrow & & & \downarrow & \\ \text{Worker FE} & & \text{Firm FE} & & & \text{Linear time trend} & \end{array}$$

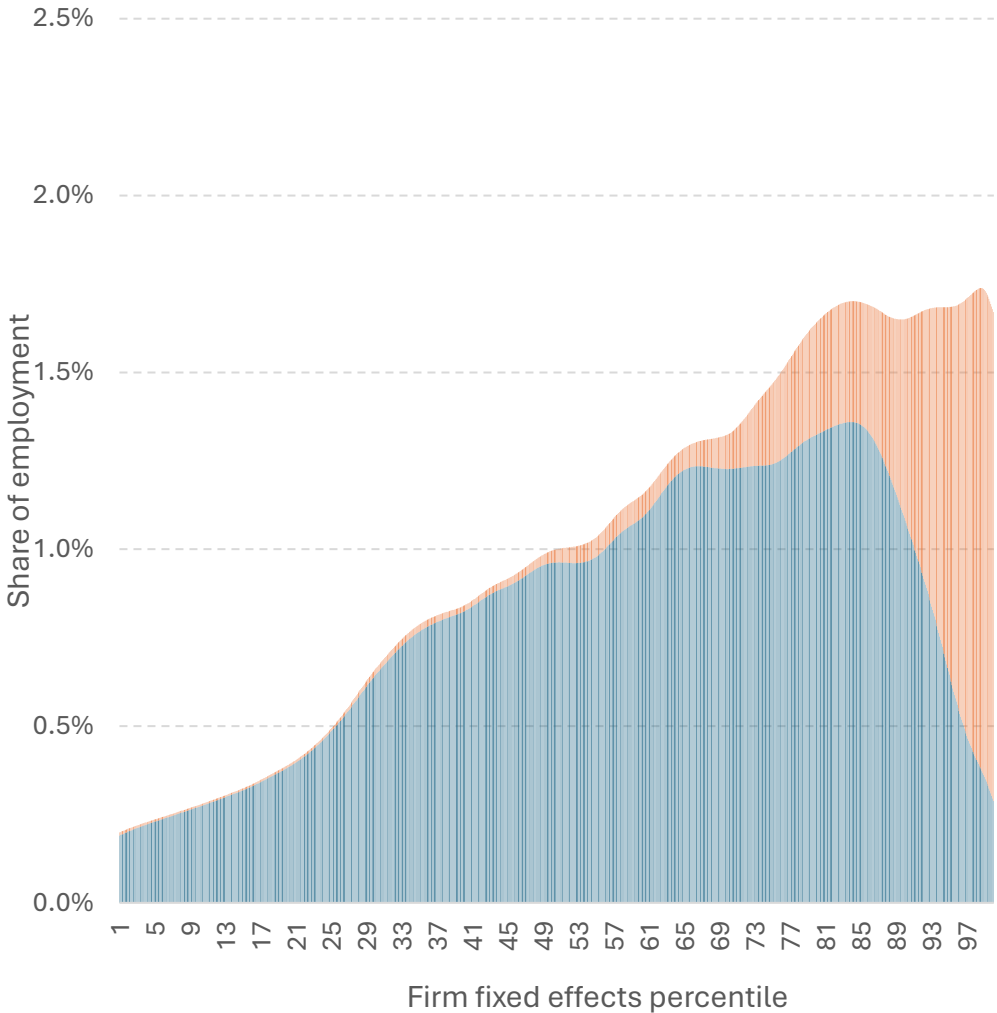
* Based on the AKM (Abowd, Kramarz, and Margolis, 1999) with subsequent adaptations

2. Labor reallocation : Abowd, Kramarz, and Margolis (1999)

2010

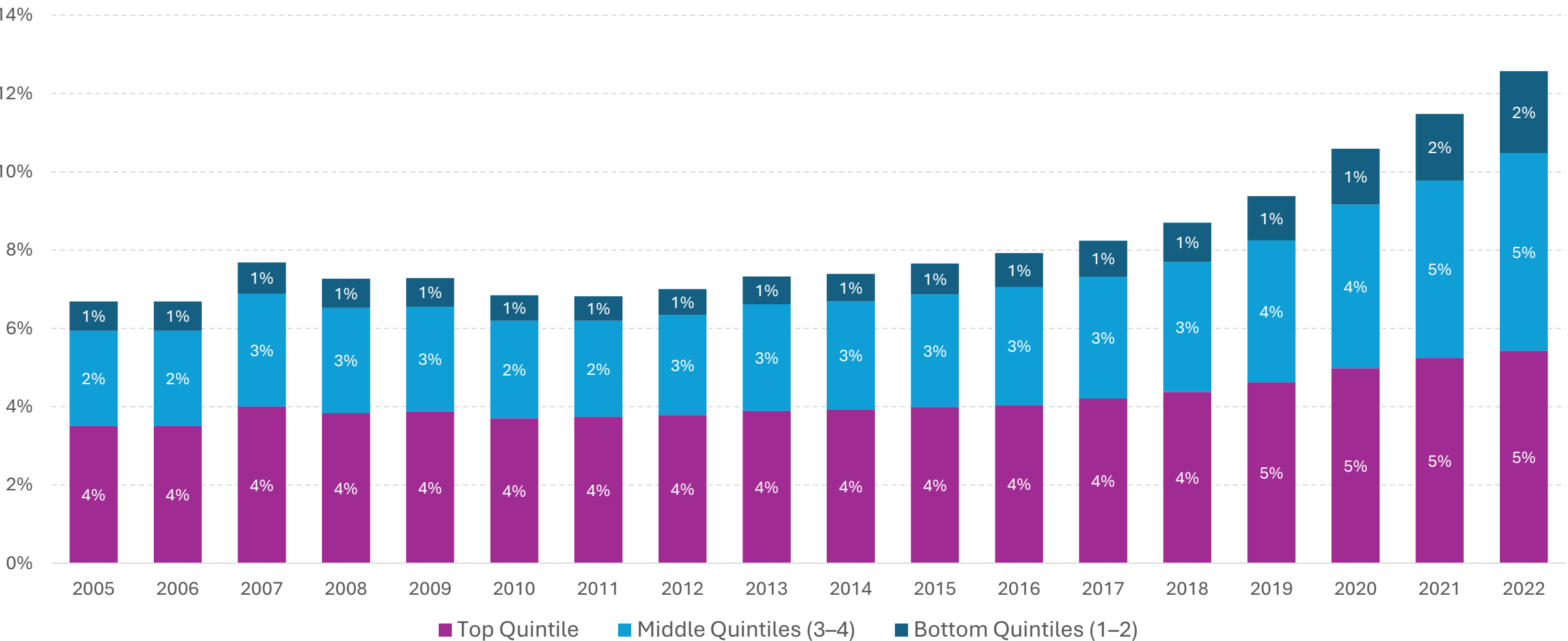


2022



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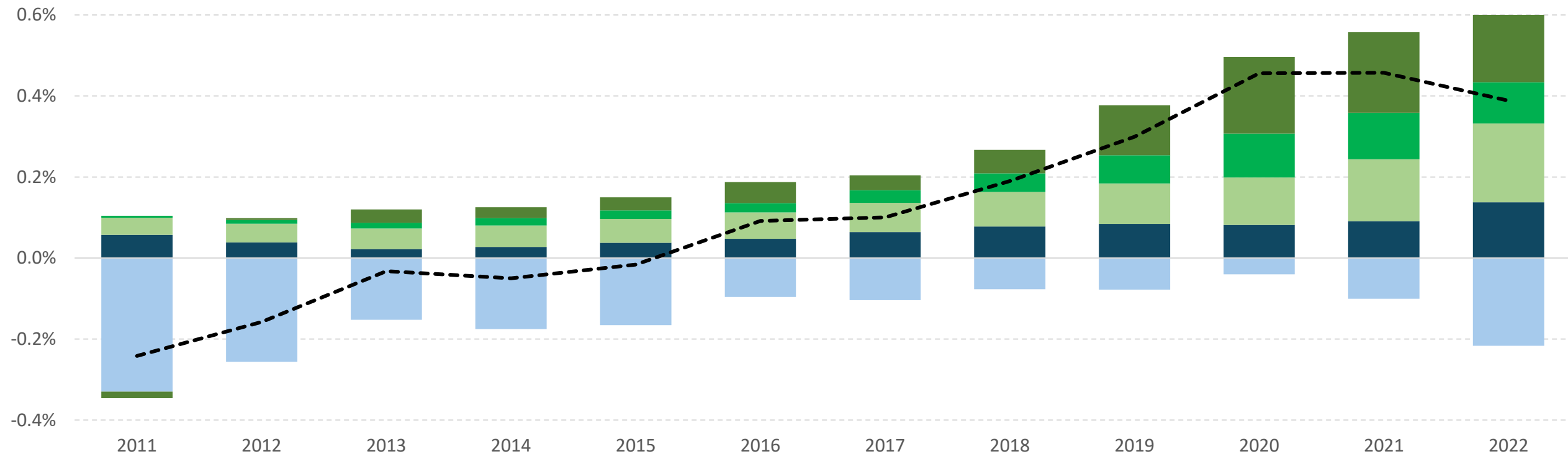
Employment share of the top 95+ firm fixed-effect decile, 2005–2022



2. Labor reallocation : AKM & FHK (2001) – Worker level

$$\underbrace{\Delta \bar{\psi}}_{\text{Change in average Firm FE}} = \underbrace{\sum_{i \in C} \Delta \psi_{i,t} \cdot \theta_{i,t-1}}_{\text{Reallocation (Movers)}} + \underbrace{\sum_{i \in CUE} (\psi_{i,t} - \bar{\psi}_{t-1}) \cdot \Delta \theta_{i,t}}_{\text{Composition (Continuers+Entrants)}} - \underbrace{\sum_{i \in X} (\psi_{i,t-1} - \bar{\psi}_{t-1}) \cdot \theta_{i,t-1}}_{\text{Composition (Exiters)}}$$

■ Entrants&Exiters NHT ■ Reallocation within NHT ■ Between sectors
■ Reallocation within HT ■ Entrants&Exiters HT --- ΔFirm FE



Summary & Implications

- Israel's macro patterns between 2013–2019 are exceptional in the global context
 - Increase in labor share
 - Increase in nominal wages and productivity
 - Stable low inflation
- They coincide with a revival of business dynamism
- This dynamic shift was enabled by increase in competition (due to reforms?) and reallocation of workers toward more productive firms (High-Tech boom?). Suggests productivity-driven growth, not overheating