



Palestine Economic Policy Research Institute

Enhancing The Local Capacity of the Palestinian Economy

# **The Role of Construction and Housing Sector in Palestinian Economic Development**

**Basim Makhool  
Nasr Atyani**

December 2002



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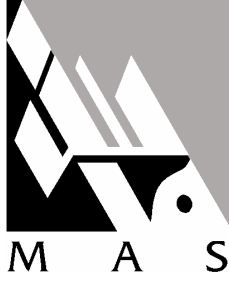
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2. The terms of reference of the study are approved by an internal MAS scientific committee (consisting of senior researchers) to ensure accurate goals, appropriate use of scientific methodology and procedures and the timetable for completion.
3. The internal scientific committee supervises the work of the researcher or team of researchers through periodic progress reports.
4. The initial draft of the study is reviewed by the scientific committee for objective content-related amendments to be added to the second draft.
5. The second draft is then submitted for evaluation in accordance with the terms of reference to two or three external academic experts specializing in the subject. Provided that there is a positive evaluation by at least two experts, the researcher is asked to review the study taking into consideration the objective recommendations of these experts.
6. The study is presented for discussion at a public workshop attended by academics, researchers, and representatives from public and private sector institutions related to the subject of the research.
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8. Research papers written in English are translated into Arabic and published in both languages. An executive summary in English is attached to research papers written in Arabic.

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## **Summary**

This study aims to outline the role of the construction and housing sector in the Palestinian economy and the impact of Israeli measures since September 2000. It identifies the supply, characteristics, potential demand, and cost of housing. It also reviews general policy towards the housing sector and the measures required to promote and enhance its performance, thereby benefiting the overall Palestinian economy.

### **Economic role of the construction and housing sector**

In addition to its social role in providing homes, public facilities, and the infrastructure for economic enterprises, the construction and housing sector is a driving force in the Palestinian economy. The value of its contribution rose from \$410 million in 1994 to \$483 million in 1999 in the West Bank and Gaza Strip (WBGs). Construction accounted for 12.7% of total West Bank employed persons between the first quarter of 1997 and the third quarter of 2000 and 10.5% in the Gaza Strip over the same period. Investment in this sector is considerable, particularly by the private sector. Between 1994-1999, \$6 billion was invested in the construction sector, comprising housing units, public and commercial buildings, and infrastructure facilities. Investment in buildings rose from \$906 million in 1994 to \$1.18 billion in 1999 in the WBGs. The sector is characterized by having several forward and backward linkages since a large number of products and services are used in buildings and complementary infrastructure. There were 5,180 enterprises involved in the construction industry in 2000, representing about 35% of all firms in the industrial sector, while 28% of workers in the industrial sector were employed in construction.

### **Impact of Israeli measures since September 2000**

Repressive Israeli measures aimed at quelling the Al-Aqsa Intifada forced a sharp decline in activities of 80% in the fourth quarter of 2000 and 60% in the first and second quarters of 2001. The area of new licensed buildings fell by 38% in the West Bank in 2001 and by 52% in the Gaza Strip in comparison with 2000. The area of new licensed buildings also dropped significantly by 44.8% in the first quarter of 2002 compared with the same quarter of 2000. The number of new licensed housing units fell by 42.1% during the first quarter of 2002 in comparison with the first quarter of 2000. Furthermore, employment in the construction sector dropped from

47,400 workers in the third quarter of 2000 to 25,120 in the second quarter of 2002 in the West Bank. In the Gaza Strip, the number of workers was down from 15,700 to 4,000 during the same period. In other words, there was a 47% drop in the West Bank and a 75% drop in the Gaza Strip. The relative importance of the construction sector in employment declined significantly from 13.5% in the third quarter of 2000 to 7.9% in the second quarter of 2002 in the West Bank and from 9.6% to 3% in the Gaza Strip over the same period.

In addition to the downturn in private sector investment in housing, public investment has also steadily declined. This has affected work on infrastructure which is principally, if not totally, funded by public investment. Work ceased on a number of projects related to infrastructure due to the inability of workers to reach their place of employment and the lack of materials to complete these projects. A number of approved projects related to infrastructure and public facilities have been frozen due to lack of funding and other obstacles.

### **Justifications for state intervention in housing sector**

Failure in financial markets naturally justifies state intervention in the construction and housing sector. Financial institutions have been reluctant to provide loans, particularly to people on limited incomes. Furthermore, there has been a shortage of information for both the producer and the consumer concerning buildings, production needs, standards, and specifications. An additional factor justifying intervention by the state are the external impacts of housing. That is, the value of a housing unit depends not only on its specifications but also on other external factors such as location and infrastructure. Low flexibility in the housing supply creates an imbalance in the housing market. This leads to economic inefficiency and creates an opportunity for existing homeowners to achieve monopoly profit through increases in prices resulting than from an increase in demand.

### **Housing strategies and policies**

States adopt three main strategies to provide suitable, affordable, and good quality housing. One strategy is public responsibility where the state assumes direct responsibility for the provision of housing and the necessary infrastructure and then sells or rents them to families. In so doing, the state overrides the market mechanism and fixes housing and land prices. A second strategy is that of private responsibility where the

state leaves the private sector to provide housing. The third strategy is that of cooperative responsibility with a “marriage” of public and private sector involvement. The state’s role is limited to supporting the private sector which builds the housing.

### **Lessons drawn from other countries**

There is currently a global trend towards housing policies based on support for the private sector rather than government-built housing. Institutional failure, namely poor legislation governing the housing sector, is one of the factors influencing the slow growth in housing. Housing is targeted at the better-off due to the weak purchasing power of poorer low-income families. Countries with successful housing policies have matched housing programs to the goals of their economic strategies. They have also intervened in the land market, particularly in urban areas. In housing, the private sector faces a significant number of obstacles: few available sources of finance, a shortage of suitable land for construction, the high cost of land, and poor infrastructure.

### **Housing units available**

Excluding the so called ‘J1’ area in the Jerusalem governorate, there were 256,900 housing units in the West Bank and 132,800 in the Gaza Strip in existence in 1997. The pace of building started to increase after the start of the peace process in the region (1993) with an average of 12,700 newly licensed housing units built per annum between 1996-2000. The majority of these licensed buildings were in the West Bank, comprising 79% of all licensed building areas and equal to 7.6 million square meters between 1996-2000. The average number of rooms per unit was 3.3 in the West Bank compared to 3.6 in the Gaza Strip. The majority of these units were used for housing purposes only: 83.6% in the West Bank and 88.6% in the Gaza Strip.

### **Building costs**

In general, the cost of building in Palestinian areas is high at \$300 per square meter in 1991 compared to \$212 per square meter in ten countries with similar national incomes. The cost of building has risen significantly over the years. For example, in 1970 a square meter cost \$75. By 1990, the cost had jumped to \$250. At present, the average cost of one square meter is around \$400.

## **Indicators of housing sector performance**

Analysis of data on the WBSG housing sector produced the following results:

- ✧ The number of houses built in Palestinian controlled areas was low.
- ✧ Rental rates were also low although land and housing prices were very high.
- ✧ Levels of investment in the WBSG housing sector were high relative to GDP.
- ✧ Housing indicators, such as number of persons per room, were comparable with those of countries with similar incomes. Housing density was also falling dramatically over time.
- ✧ There was a significant improvement in the quality of housing in terms of the availability of infrastructure, durable goods, size, and individual share of space.
- ✧ Very poor financing of the housing sector exerted a negative influence.

Against this background, the prospects for the Palestinian housing sector to respond to demographic changes in terms of population growth and economic changes are good.

## **Anticipated demand for housing**

Demographic factors, namely the housing growth rate, new families, emigration and immigration, and housing density are all used to determine future demand for housing. The potential demand for housing units in 2003 was estimated at 47,870 but is expected to rise to 56,490 units by 2012. New families represented 49% of potential demand for housing units, underlining the importance of creating housing programs and policies that enable newlyweds to obtain their own home.

## **Matching supply and demand: housing shortage**

It was estimated that there will be a shortage of 41,270 units in 2003, increasing to 49,890 in 2012 if Israeli repressive measures continue. If Israeli measures cease, the shortage will be 34,670 units, rising to 43,210 by 2012. The average annual shortage will be 47,130 units if Israeli measures persist and 40,500 units if these measures cease. The production needs ratio in 2003 was estimated at 27% but could drop to 23% by 2012 if Israeli measures cease. The results of the study clearly showed the weakness of the housing sector in meeting the needs of the WBSG

population for homes. It is therefore important to enhance effective demand by increasing the possibilities of obtaining finance to purchase houses.

### **Problems in the Palestinian housing and construction sector**

Like all Palestinian economic sectors, the housing sector is facing tremendous difficulties and challenges which prevent it from developing. These challenges can be summed up as follows:

- ✧ High cost of building in Palestinian areas and shortage of suitable land for construction.
- ✧ Repressive Israeli measures and policies, including consistent refusals or delays in issuing building permits to Palestinians, particularly in Arab East Jerusalem and its environs, as well as in Area C which is under Israeli control according to the Oslo agreements. In addition, there is a longstanding Israeli policy of house demolitions.
- ✧ High number of disruptions during the building of new housing projects.
- ✧ Scarcity of resources and financing opportunities and difficulties in making use of the opportunities available.
- ✧ Absent or inadequate legislation regulating the housing sector.
- ✧ Presence of a large number of poor and low-income families.
- ✧ Existence of several references relating to relevant standards and specifications, failure to recognize their importance, coupled with an inability to apply them. There is also little information to assist the analysis, evaluation, and formulation of housing plans, policies and strategies.

### **Estimated volume of investment in housing sector**

The volume of direct investment required to meet the potential demand for housing is estimated at \$12.64 billion in 2003, rising to \$3.1 billion by 2012. In 2003, a shortfall of \$1.92 billion in financing potential demand is anticipated. That is, existing purchasing power equals 27% of the potential demand. Therefore, there will be a financial shortfall of 73% of the value of potential demand. These are large sums which cannot be provided by the resources available to the Palestinian National Authority at present or in the foreseeable future. Measures should be taken immediately to reduce building costs. This will increase the number of Palestinian families able to afford to buy a house while lower costs will give financial institutions an incentive to increase financing opportunities for low-income families.

## **Short-term housing strategies and policies**

After more than two years of war, reconstruction of the damage caused by the current occupation is urgently required. Given the scarcity of available financial resources, priority must be given initially to homes that have been completely demolished and then to heavily damaged houses. Also, infrastructure needs to be repaired as it is essential to people's daily lives. In addition to the reconstruction process, a detailed study is needed to explore the possibility of initiating housing projects and thus create jobs and housing units at reasonable prices. To encourage rapid expansion of the construction sector, some of the financial assistance offered to the PNA needs to be allocated to this sector in the form of soft loans. A fund could be established to provide guarantees for financial institutions providing loans to low-income families. Another fund could be established to provide guarantees against possible risks resulting from political instability in the Palestinian Territories.

## **Long-term housing policies and strategies**

The focus should be primarily on providing decent and suitable housing, taking into consideration quality and price. The housing strategy proposed for the Palestinian territories is based on the philosophy of "enabling the private sector". That is, the role of the government is to provide land and infrastructure in addition to an appropriate legal, financial, and administrative environment for building companies and the public.

## **Suggestions for lowering building costs**

To reduce building costs, a number of measures could be taken:

- ✧ Encourage buildings with walls made of cement or bricks instead of stones.
- ✧ Reduce the size of new houses.
- ✧ Encourage the building of multi-storey buildings instead of separate houses.
- ✧ Lower land prices: How?
- ✧ Promote the production of pre-fabricated homes.
- ✧ Encourage the use of caravans.
- ✧ Make building permits conditional on the conducting of soil testing so results can be taken into consideration when designing buildings.
- ✧ Encourage the creation of a local cement industry.
- ✧ Enhance the participation of the Engineers' Union and consultancy centers.