New Pyramid "Scheme"
Business Model Supports Globalization and Demand for U.S. Office Space
Market Perspectives
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Fifty percent of all the construction cranes in the world tower over the cities of China. The global economic revolution symbolized by these cranes and those in the cities of other developing countries where recently agricultural economies are hurtling into advanced post-industrial development is creating the demand for office space in American cities, including Atlanta, Los Angeles, New York, San Francisco and Austin.

The resurgence of demand for office space in the United States is concentrated in urban places where geographically clustered networks of economic activity have created locations that facilitate the innovations and productivity efficiencies of business at the top of 21st century business pyramids. These pyramids of complex business relationships are the result of what Herbert Meyer calls "fracturing" in a blog that my good friend and business advisor, Laird Durham, forwarded to me. Meyer's definition of fracturing refers to the trend for once horizontally integrated concerns to concentrate in-house employees on only the firm's vital core strengths, while out-sourcing other services and production inputs so as to optimize cost efficiency without sacrificing quality or the ability to continually innovate. Outsourcing is done under a variety of contracting relationships with individuals and firms whose staffs sometimes work in the office or other facilities of the prime contractor or other subcontractors.

As Monica Finnegan and Johanna Burram have also pointed out in an article on the impact of contract workers on the demand for office space in the February 12, 2007 *California Real Estate Journal*, this has led to a need to provide office space for a work-force that is much larger than the sum of the employee count American companies report to governmental agencies or disclose in their annual reports.

Whether engaged in financial, management, healthcare services or providing infor-mation, communication and design skills, many U.S. firms with the new business model are showing that they can improve their already strong worldwide market penetrations.

The proof of this success can be seen in America's ability to add enough jobs in service sectors to more than offset the loss of manufacturing jobs, as that sector continues to lose market shares to foreign competitors. The mammoth restructuring and construction of space in the strong service and technology urban agglom-erations of the U.S., as well as the imports of manufactured consumer goods, is being financed by the U.S. bonds, equities and real estate being purchased by the countries that are selling more to the U.S. than they are buying from America.

China, of course, is the largest source of the United States' trade deficit. But by returning many of the dollars U.S. consumers are paying for Chinese manufactured goods, they are also our biggest lenders. China's annual rate of economic growth exceeds 10 percent. But, even after 20 years of moving 250 million people from farms and rural villages to cities where cranes crowd the skylines, China still has 300 million more people it wants to move out of dependence on agriculture and into cities. To accomplish that, China must provide even more urban jobs. China's continuing indus-trialization and need to continue to provide employment for urban workers is a treadmill powered by the export of manufactured goods. China is motivated to continue to send back a goodly portion of the dollars American consumers spend on Chinese manufactured goods in order to keep that treadmill powered up for the next two decades.

Investments from Europeans, Japanese and other fully industrialized nations that are filling the financial gap created by America's trade deficit are motivated by more traditional reasons. These investors see the United States as the world's strongest economy and military, with a legal system that respects private property rights to a greater degree than most other countries. Put differently, just as the United States was a debtor nation in the decades following the Civil War, as it was building the industrial base that made it a manufacturing power, the United States is now viewed as the best bet for the preservation and appreciation of their capital.

They may well be right. A paper entitled, "The U.S. Current Account Deficit and the Expected Share of World Output," written by Charles Engel of the University of Wisconsin, models the discounted present value of the current account deficit under assumptions about the United States' *future* share of world GDP. What their work suggests is that given the ability of the United States to grow its share of world markets, the current account deficit may be sustainable for a considerable length of time.

To sustain the cranes over China, that nation is likely to lend back to the U.S. many of the dollars U.S. merchants and parts buyers are paying for manufactured goods. This inflow of dollars, plus the proceeds from foreign and domestic investors, may well support both U.S. consumers and restructuring businesses at relatively low interest costs without much further weakening of the dollar. It is too early to tell whether this optimistic scenario will become the reality of the future, as it will depend upon the success of firms that can stay at the top of the 21st century business pyramids. The economic geo-graphy that can attract and facilitate the success of such firms consists of locations with all or a combination of the following qualities:

- An existing network of academic and business professionals with the know-how and equipment that provides a foundation of knowledge and capital that successful businesses will emulate, refine and improve;
- An existing infrastructure of entre-preneurially sophisticated finance and marketing expertise;
- A local environment that is attractive to skilled, motivated young pro-fessionals;
- Local market conditions that provide affordable housing and the other accoutrements of a relatively high standard of living.

Urban regions, such as the high tech agglomeration of Silicon Valley in Northern California and the financial agglomeration of New York, have been able to succeed with a great deal of the first three qualities, in spite of scoring badly on the fourth quality. Locations such as Austin and Denver are able to provide the economic geography of success with somewhat less of the first two qualities, at least as much of the third qualifier in the eyes of many, but much more of the last qualifier than either New York or Silicon Valley. New York, Silicon Valley, and other communities with a "first-mover" advantage continue to grow because of the increasing returns that stem from the scale and diversity of the skills and know-how of the specialized activities for which they are best known. But over time, the scale and returns of fast-growing places that did not have a first-mover advantage also will increase. If these communities do not fall into the trap of allowing their cost of living to escalate, they will tend to grow at a faster rate than the powerful older but costlier urban places.

In today's market environment, global expansion by U.S. firms that produce leading-edge services and technology is generating a new spate of office demand. Those urban centers that facilitate the success of these entities will thrive and prosper.

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