

May 6, 2010

*Stephen S. Roach*

*Chairman, Morgan Stanley Asia*

## America's *China Complex*

*The contrast between the world's two most important economies couldn't be sharper—the ascendancy of China versus the potential decline of America. The possibility of such an about-face does not sit well in Washington, where China bashing is on the rise once again. But this time—unlike earlier years—it may involve more than just words. In an era of acute labor market distress, America could well up the ante and resort to outright trade sanctions. Beijing would undoubtedly retaliate, setting in motion a dangerous chain of events that could quickly imperil the post-crisis world.*

America's fixation over China has not come out of thin air. Jonathan Spence, Yale's legendary Sinologist, has suggested that it has deep psychological roots. In *The Chan's Great Continent* (1999), Spence argues that since the time of Marco Polo in the 13th century, the West has had a consistent knack for seeing China through the same lens as it sees itself. This bias is painfully evident today. Consistent with Spence's thesis, the United States is blaming China for problems that are largely self-inflicted.

This saddens me. As an American living in Asia, I can appreciate both sides of this dispute. While serving as Morgan Stanley's chief economist, I had long warned of the mounting dangers of a bubble-prone US economy—a saving-short nation that had become increasingly dependent on Asian saving to perpetuate a reckless over-consumption. As a resident of Asia these past three years, I have found a region that still clings to an export-led growth model that, ironically, is very much dependent on the same over-extended American

consumer. The Crisis and the Great Recession of 2008-09 shattered dreams in both the West and the East. And now the United States and China both need to pick up the pieces—before it is too late.

### *America's Case*

America faces many tough problems in the early 21st century. But none seem as painfully intractable as those bearing down on US workers. A productivity paradox is at the heart of the problem. Despite a doubling of trend productivity growth over the past 15 years—with 2.7% average annual gains since 1995 representing a stunning turnaround from the anemic 1.4% pace over the 1973 to 1995 period—worker pay has continued to lag. Gains in inflation-adjusted compensation per hour (wages plus benefits) have averaged only 1.6% since 1995—fully one percentage point less than productivity growth over the same time frame.

This outcome violates one of the most basic tenets of economics—that workers are eventually rewarded in accordance with their marginal productivity contribution. The Great Recession of 2008-09 has added insult to injury—pushing the official unemployment rate up to 10% and more comprehensive measures of labor market slack into the high teens. Little wonder that American workers are feeling more disenfranchised today than at any point in the post-World War II era.

Curiously, China is being singled out as a major culprit behind this tough set of circumstances. At work, goes the argument, are the external pressures of a massive US trade deficit—the most visible manifestation of ever-increasing foreign penetration into America's vast domestic markets. Since China accounts for the biggest bi-lateral piece of the US foreign trade deficit—some 39% of the total trade gap in 2008-09—it is also judged as responsible for a disproportionate share of the forces bearing down on the

compensation and jobs of American workers. The verdict is typically sealed by the claim that these pressures are an outgrowth of a deliberately undervalued renminbi—supporting charges of a currency manipulation that break the rules of a just globalization. A growing bipartisan coalition in the US Congress demands consequences for these violations—either a reversal of Beijing’s currency policy, or punitive trade sanctions.

China would undoubtedly retaliate to any such actions, pushing the world to the brink of a very slippery slope. But, now, there is hope that an imminent confrontation can be avoided. The US Treasury has sidestepped an April 15 date of reckoning on the currency manipulation issue by delaying its biannual foreign exchange report. With any luck, this provides a breathing period that will allow both sides to stand down. Even so, the politics of US labor market distress are likely to endure for the foreseeable future. At the same time, any Chinese currency move is likely to be modest, at best. Consequently, notwithstanding the sensible cooling-off efforts by the US Treasury, there is still a distinct possibility that Washington could opt for anti-China trade sanctions.

---

### China is being singled out as a major source of angst for American workers.

---

Yet there is even more to the blame game. China has also been chastised for playing a leading role in causing the Great Crisis of 2008-09. As the world’s largest surplus saver, China’s purported mercantilist policies have required it to recycle a disproportionate share of its massive \$2.4 trillion reservoir of foreign exchange reserves back into dollar-based assets. None other than two successive Fed Chairmen, Alan Greenspan and Ben Bernanke, have blamed this so-called surplus saving glut for the bubbles in asset and credit markets that, when they finally burst, nearly pushed the world into the abyss in late 2008. According to that line of reasoning, China also deserves part of the blame for the Great Recession and its concomitant spike in unemployment. In short, the “China problem” has pushed some of the most serious hot buttons in the wounded American psyche. It has become a full-blown cause célèbre in Washington political circles.

### Flawed Assumptions

While these arguments are both emotionally appealing and politically expedient, they suffer from two fatal flaws: First, the United States does not have a bi-lateral trade problem with China. It has a saving problem that has spawned a multi-lateral trade deficit. Indeed, the US had trade shortfalls

with over 90 countries in 2008-09. This is a direct by-product of one of the classic stress points of macroeconomics: Saving-short nations are in a serious bind if they wish to keep growing. In order to do so, they must import surplus saving from abroad—and run current account and multi-lateral trade deficits to attract the foreign capital.

---

### The US does not have a bi-lateral trade problem with China. It has a saving problem that has spawned a multi-lateral trade deficit.

---

America’s sad saving record speaks for itself in that regard. The net national saving rate—the sum total of depreciation-adjusted saving by households, businesses, and the government sector—has averaged just 2.4% of national income since 2001. Moreover, reflecting a gaping federal budget deficit, domestic saving plunged into negative territory in mid-2008 and fell to an astonishing -2.5% of national income in 2009. That’s a record low for the United States—and most likely a record low for any leading world power in modern history.

With such an unprecedented shortfall in its overall saving position, massive US current account and trade deficits are unavoidable. Yes, China represents the biggest bi-lateral piece of this multi-lateral imbalance. But there is good reason to believe that this reflects the conscious outsourcing decisions of US multinationals, as well as strong preference by US consumers for low-cost goods made in China. Yet China bashers choose, instead, to blame it on Beijing.

The counter-factual argument does not support this claim. If the value of the Chinese currency were higher, a persistently saving-short US economy would still be facing a massive multi-lateral trade deficit. It is possible that the Chinese piece would be smaller, but, unless America miraculously starts saving again—highly unlikely in an era of trillion-dollar budget deficits—that would then require the non-Chinese piece to be larger. It would be like rearranging the deck chairs on the Titanic. Again, this is not a China problem. It reflects, instead, the unavoidable repercussions of America’s chronic saving problem.

A similar convoluted logic lies behind the second line of argumentation that inflames America’s China bashers—the global-saving-glut explanation of the Great Crisis and subsequent recession. Can Chinese savers and their ever-increasing purchases of dollar-denominated assets truly be blamed for a decade of America’s homegrown excesses that finally culminated in a wrenching crisis?

Hardly. Purchases of dollar-based assets by the world's surplus savers probably did contribute to keeping US interest rates somewhat lower than might have otherwise been the case. And low interest rates certainly were a significant prop to the multiplicity of asset and credit bubbles that nearly brought the world down. But China's role in all this seems seriously overblown. Foreign demand for US securities remains dwarfed by purchases of domestic investors; over the 1997 to 2008 period, domestic buying accounted for fully 70% of the incremental flows into US financial securities. While Chinese purchases of dollar-denominated assets have been growing rapidly, they still amount to less than 15% of total foreign holdings of US securities.

---

### America's global saving glut excuse —especially China's role—is exaggerated.

---

In the end, no one has a greater say over US interest rates than the Federal Reserve. Despite its protestations, the Fed had every opportunity to lean against a steady stream of asset and credit bubbles—irrespective of whether the demand for such assets came from foreign or domestic sources. Yet it repeatedly chose not to do so—arguing that monetary policy was too blunt an instrument to deal with asset bubbles and that the central bank could always move in to clean up the mess later. Moreover, in condoning the transition to an asset-based saving mindset, the Fed was perfectly content to let bubble-dependent US households squander their income-based saving—a key factor behind the shortfall of overall domestic saving that led to America's massive current account deficit. A painful squaring of the circle is unavoidable here: For every deficit there must be a surplus on the other side of the international accounting ledger. Should China and the rest of Asia's surplus savers be chastised for the excesses of America's reckless asset-based savers?

With the benefit of hindsight, we now know that both Greenspan and Bernanke were wrong in assigning a passive role to monetary policy in dealing with asset bubbles and the imbalances they spawned in the real economy. Drawing support from an ideologically driven penchant for self-regulation, the Fed, in fact, wrote the book on bubble-prone central banking. Steeped in denial over their own culpability, the two Fed chairmen were far too willing to single out the East in marshalling the global-saving glut excuse for the bubbles that ended up defining the Era of Froth. Does China deserve blame for such egregious policy blunders?

## China's Case

China is a modern-day miracle. It has delivered 30 years of spectacular GDP growth and poverty reduction—unprecedented in the annals of economic development. The export machine has long been at the core of China's development miracle. The export share of Chinese GDP went up seven-fold over the past 30 years—from 5% in 1979 to 36% in 2007. The Chinese export machine was built on the foundation of a powerful investment impetus that spurred sharp increases in manufacturing capacity, supply-chain infrastructure, and modern port and air shipping terminals. Collectively, exports and fixed investment accounted for a highly disproportionate share of China's GDP growth over the past three decades. In 1979, these two sectors comprised 34% of Chinese GDP; by 2007, their combined share had more than doubled to 75%.

As fate would have it, there is often a serendipitous element to economic development. The export tilt to China's macro structure came at a most fortuitous moment. China's accession to WTO in 2001 granted it insider status to a new wave of globalization. That wave turned out to be far more powerful than anyone expected. World trade exploded from 24% of global GDP in 2001 to a record 32% in 2008. At the same time, China turned up the dials on its export machine—increasing the export share of its GDP from 20% to 36% over the 2000 to 2007 period. The Chinese export boom that ensued was strong enough to push average GDP growth up to 12% over the 2005-07 interval

---

### Foreign-funded export-led growth has been a major driver of China's 30-year growth miracle.

---

Seared by memories of the Asian financial crisis of the late 1990s, China did not want to rely on fickle inflows of foreign capital to finance the expansion of its export platform. High domestic saving, as well as a stable currency, became key ingredients of this powerful strain of export-led growth. The anchor of a stable currency and a massive reservoir of foreign exchange reserves took on added importance for a nation with an embryonic financial system—providing China with strong defenses to deal with the vicissitudes of sharp fluctuations on foreign exchange rates, such as those which wreaked havoc on most Asian economies and their financial systems in the late 1990s.

Foreign direct investment was also a critical element of China's export-led growth model. Beginning with Shenzhen,

Shantou, Zhuhai, Xiamen, and Hainan in the early 1980s, the Chinese government established a large network of special economic incentive zones in the coastal region that drew support from tax breaks to foreign investors, modern infrastructure, and unlimited access to low-cost labor and new technology. Foreign multinationals were quick to take advantage of these opportunities—not just to exploit the offshore efficiency opportunities of an extraordinarily attractive labor-cost arbitrage but also to gain a toehold into the world’s most populous market.

As a result, the rapid expansion of Chinese subsidiaries of foreign multinationals played a key role in driving China’s export miracle. Over the decade ending in 2009, exports of “foreign-funded enterprises (FFE’s)” accounted for fully 60% of the cumulative growth of total Chinese exports. Far from representing an indigenous threat by newly emerging Chinese companies, a disproportionate share of the Chinese export boom was, in fact, sponsored by foreign companies. The lines of distinction for those responsible for the Chinese export miracle have become increasingly blurred between “us and them.”

The benefits of this foreign-funded export boom were shared by Chinese workers, as well as by Western consumers and businesses. Employment growth in FFEs averaged 15% per annum over the 2002-08 period—over four times the 3.4% trend growth of China’s total urban employment over the same period. And the sharply expanded availability of low-cost, increasingly high-quality goods made and assembled in China not only represented critical efficiency solutions for high-cost manufacturers in the developed world but were also an important source of expanded purchasing power for the West’s large population of hard-pressed consumers. It was an outcome that seemed to fit the win-win script of globalization to a tee.

## Flawed Assumptions

Notwithstanding the extraordinary success of the export-led development boom, the Chinese growth model has now come up against two critical sets of constraints—internal and external. For China, these constraints must be taken as serious challenges to the sustainability of its growth miracle in the years ahead.

The internal constraints stem largely from the negative side effects of China’s increasingly unbalanced macro structure. While exports and investment surged to 75% of Chinese GDP over the past 30 years, the internal private consumption share plunged to 35% over that same period. This depicts an economy that is driven much more by supply

—exports and investment-led expansion of domestic production capacity—than by the self-sustaining demand of Chinese consumers. Despite the enormous infrastructure and investment requirements of any large developing economy, not even China can sustain such an outside supply-demand imbalance in perpetuity.

But there are more immediate sustainability constraints. At the top of the list is a jobs problem. Over the 2000-08 period, China was Asia’s leader in terms of GDP growth (10% per annum) but its laggard in terms of employment growth (0.9% per annum). With manufacturing productivity strategies long premised on capital-labor substitution, the Chinese economy has an unmistakable bias toward labor-saving growth.

This gets to the crux of China’s toughest challenge. Social stability has long been China’s ultimate tripwire. Job creation is the glue that holds the system together—specifically, enough job creation to absorb the job-seeking portion of an enormous reservoir of surplus Chinese labor. The nation’s leadership will literally do everything in its power to avoid a shortfall in employment growth that could lead to an outbreak of mounting unemployment that might trigger a destabilizing social backlash.

This value proposition poses a unique set of problems for the labor-saving manufacturing model that has long dominated Chinese economic development. In particular, it means that China must churn out excessively rapid GDP growth in order to create the jobs necessary to maintain full employment and social stability. Unfortunately, that also spells serious trouble for a Chinese economy that is a very inefficient user of energy and other natural resources. Excessive GDP growth, in this instance, has led to the increasingly serious problems of environmental degradation and pollution.

Notwithstanding these tough side-effects, China is having a hard time coming to grips with the need to break away from the labor-saving, resource-intensive, export-led growth model. Such inertia is understandable. The time-honored formula of the past 30 years has delivered spectacular top-down results in terms of sharply rising per-capita GDP growth. The very palpable fear of losing that momentum makes the Chinese leadership reluctant to opt for a different approach.

The external shock of the Great Crisis of 2008-09 could well break that inertia. With the over-extended, bubble-dependent American consumer likely to be in a post-crisis retrenchment for years to come, and with long sluggish European consumers unlikely to fill the void, China’s once

unstoppable export machine now faces an entirely new set of constraints. Such a post-crisis slowdown in global demand poses enormous challenges to export-led Chinese economic growth.

---

### China's development model will be challenged by lingering post-crisis aftershocks to external demand.

---

In short, the Great Crisis is China's wake-up call. It puts a new and very important set of external pressures on the Chinese economy—pressures that are very much at odds with the underpinnings of the model that has worked so well over the past 30 years. It provides great incentive for China to shift to a new model—one driven much more by the internal demand of its 1.3 billion consumers than by the external demand of shell-shocked Western consumers.

There is, unfortunately, more to China's external demand shock than subdued consumption growth in the US and Europe. Also at work are the mounting risks of trade frictions and protectionism—especially those made in Washington. For China, the moral high ground is no consolation to the reality of the growing drumbeat of bi-partisan China bashing in the halls of the US Congress. Chinese leaders cannot afford to be complacent in ignoring these risks.

China's export-led successes—it recently surpassed Germany as the largest exporter in the world—means that it has long had to contend with pushback from the West. But the politics of this external pushback are entirely different in today's post-crisis era than they have been in the past. Over the 2005-07 period, the US Congress introduced 45 separate pieces of anti-China trade legislation. None of them passed. The reason: America's unemployment rate averaged just 4.7% over that three-year period. Today, with the US jobless rate easily twice that, the politics of China bashing need to be cast in a very different light.

This is hardly the supportive external climate that China needs to sustain its export-led growth model. Nor can China expect things to go back quickly to the way they once were. The developed world is not only facing a lasting post-crisis demand shock but it is also staring at the politically combustible condition of chronically higher unemployment. For China, as well as for other export-dependent economies, these twin pressures could well have the potential to re-write the rules of engagement with the rest of the world.

## A Treacherous Resolution

There is no quick fix for the post-crisis world. Unfortunately, that means that US-China trade tensions are likely to persist for years to come. Over time, structural rebalancing is necessary for both economies. For America, that means less consumption and more savings—with the bulk of that saving being recycled into investments in infrastructure, export capacity, alternative energy technologies, and human capital. For China, rebalancing needs to take the opposite form—namely, less exports, investment and saving, and more internal private consumption. In the end, rebalancing is not an option for an unbalanced post-crisis world. That's especially the case for the US and China—the two nations that ultimately hold the trump cards in any such realignment.

Yet the endgame of global rebalancing is not a panacea for the more immediate threats confronting the United States and China. An asymmetrical rebalancing is an especially worrisome and potentially destabilizing possibility in the years immediately ahead. America seems likely to be the laggard in such a scenario. With its budget deficit out of control, a spontaneous regeneration of domestic saving is highly unlikely. That underscores the prospects of a chronically large US current account deficit—putting increased pressure on the rest of the world to fund it.

---

### An asymmetrical global rebalancing is likely—with a pro-consumer China leading a deficit-constrained America.

---

Meanwhile, there is good reason to believe that a pragmatic China could shift surprisingly quickly to a pro-consumption growth model—using the occasion of the upcoming 12th Five-Year Plan (2011-16) to introduce new incentives aimed at boosting rural income, promoting job-intensive services industries, and reducing excess household saving. If China takes such actions, a pro-consumption tilt to its economy would quickly emerge—having the important effects of reducing its surplus saving, current-account surplus, and accumulation of foreign exchange reserves. That, of course, would mean that China would have less of a need—as well as less surplus capital—to recycle back into dollar-denominated assets. Needless to say, that raises the distinct possibility of serious external financing constraints for the United States.

The West has yet to appreciate the full ramifications of China's rebalancing agenda. Ironically, a consumer-led China could play a much more constructive role in global

rebalancing than a saving-short United States. As usual, the Washington consensus is so focused on the currency “remedy”—the never-ending call for a large RMB revaluation against the US dollar—that it fails to consider other potential rebalancing options. Unfortunately, this is the same misdirected mindset that gave Japan poor advice on yen appreciation in the late 1980s and came up with the dollar-depreciation “answer” to America’s current account deficit in recent years.

At best, currency adjustments offer a very circuitous route to tempering current account and trade imbalances. China is likely to opt for a very different approach—structural rebalancing initiatives—which have the potential for greater traction and a relatively prompt payback. Yet the RMB-fixated West fails to appreciate the relief to Chinese imbalances that could arise from the pro-consumption structural agenda of the 12th Five-Year Plan highlighted above. This boils down to politics—not analytics. America’s middle-class angst is blinding an increasingly politicized Washington to the possibility of a much more effective resolution of the so-called China problem.

### What Would Spence Say?

None of this should be all that surprising to Jonathan Spence. Once again, the West—especially the United States—is viewing China by looking in the mirror. America does, indeed, have very serious economic problems. But is it correct—and in the best interest of the United States or the rest of the world—to blame China for those shortcomings?

Trade is, by far, the most contentious of the economic issues between the two nations. There is broad bipartisan support in Washington for the view that an upward adjustment in the Chinese renminbi adjustment will ease the plight of America’s beleaguered middle class. Unfortunately, a currency realignment—or the countervailing trade sanctions that might occur in the absence of such a shift—might well backfire. After all, as noted above, three-fifths of China’s recent export surge has come from Chinese subsidiaries of foreign multi-nationals—in effect, offshore efficiency solutions for high-cost companies in the West and low-priced substitutes for hard-pressed western consumers. Consequently, any tariffs imposed on Chinese exports in an effort to offset the so-called currency subsidy—a possibility that is actively being explored by leading members of the US Congress—would ultimately shift the sourcing of US imports to higher cost foreign producers. That would be the functional equivalent of a tax hike on both US companies as well as on American consumers. Consistent with the Spence

dictum, by attempting to punish China, the United States would actually be punishing itself.

Unfortunately, there is an even darker side to such politically expedient remedies. If Washington were to up the ante on China bashing and impose broad-based trade sanctions on Chinese exports, there is good reason to believe that China would retaliate. Depending on the severity of America’s action, that retaliation could take several forms—ranging from a WTO complaint, to Chinese trade sanctions on imported US products, to a reduction in China’s demand for US Treasuries.

The latter two options would hardly be inconsequential for the United States. Tariffs on US exports to China would hit what is now America’s third largest export market—a serious problem for the Obama Administration’s newly stated goal of a doubling US exports over the next five years. Similarly, reduced Chinese buying of US Treasuries would be highly problematic for the funding of Washington’s trillion dollar budget deficits. If China plays that trump card and reduces its participation in upcoming Treasury auctions, the dollar would undoubtedly plunge and long-term interest rates would soar—developments, in and of themselves, that could well trigger the dreaded double-dip recession in a still fragile US economy.

The Washington consensus smugly believes that China wouldn’t dare take actions that might jeopardize the value of its vast holdings of dollar-denominated assets. However, in keeping with Spence, this is yet another example of a classic western misinterpretation of Chinese values. Rightly or wrongly, China feels that it has been mistreated by the West for nearly 200 years. Yet China today is a proud nation, with a strong sense of nationalism. Irrespective of the consequences retaliation might have for its currency portfolio, I suspect today’s China would find it unfathomable to ignore an aggressive trade action by the United States.

---

### If the US takes actions on Chinese trade, retaliation is likely.

---

As a saving-short and increasingly debt-dependent nation, the United States is not exactly operating from a position of strength these days. It has formidable problems that need to be addressed at home. Yet like China, America also has enormous global responsibilities that need to be taken very seriously. Unfortunately, in a tough economic climate, localization tends to take precedence over globalization.

Such are the risks today as the US and China veer ominously toward mounting trade frictions and protectionism.

Over the years, I have had the opportunity and the privilege to express many of these concerns as testimony in front of the US Congress. I have had similar chances to present my views to senior Chinese officials. I now look back on that dialog with a sense of foreboding. While Beijing has been willing to engage me on the substance of this debate, Washington has not. Steeped in denial, the US Congress has become increasingly quick to point the finger at China.

This juxtaposition is worrisome. In the US, there is a growing chorus of indignation over the supposed extremes of Chinese mercantilism. Yes, China's saving bias and currency management tactics have led to an outsize build-up of foreign exchange reserves—the “ah ha” for China bashers who want the US Treasury to render a manipulation verdict and Congress to impose trade sanctions. But the ice is very thin here. The bulk of China's foreign exchange reserves are recycled into dollar-based assets—rather helpful in funding America's massive shortfall of saving. Whom might deficit-prone Washington turn to if it shuts off the Chinese funding spigot?

---

Unwilling to face up to its imbalances, the United States is blaming China for many of its own problems.

---

Unfortunately, America's increasingly strident reaction to the “China threat” avoids the other side of the story altogether—thereby perpetuating the reluctance of the United States to face up to its own role in fostering destabilizing global imbalances. On that count, there can be little dispute: As long as the US views saving-short growth as an entitlement, it must import surplus saving from abroad. As such, it counts on the world's savers, such as China, to run large current account and trade surpluses to provide both cheap capital and low-cost imports. In that critical sense, Chinese currency policy can also be seen as an inevitable by-product of America's insatiable appetite for unbalanced growth.

The record of history does not speak kindly of such a contentious disconnect between two great powers. That is especially the case in the aftermath of a severe financial crisis and recession. While history doesn't repeat itself, as Mark Twain famously said, it often rhymes. Remember the 1930s?

---

Mr. Roach is the Chairman of Morgan Stanley Asia and author of *The Next Asia* (Wiley 2009).

This communication is not a product of Morgan Stanley's Research Departments and is not a research report but it may refer to a Morgan Stanley research report or the views of a Morgan Stanley research analyst. We are not commenting on the fundamentals of any companies mentioned. Unless indicated, all views expressed herein are the views of the author's and may differ from or conflict with those of the Morgan Stanley's Research Departments or others in the Firm. For additional information, research reports and important disclosures, see <https://secure.ms.com>.

The information provided herein has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell the securities or instruments mentioned or to participate in any particular trading strategy. This information is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty can be given with respect to the accuracy or completeness of the information, or with respect to the terms of any future offer or transactions conforming to the terms hereof.

This report does not provide individually tailored investment advice. It has been prepared without regard to the circumstances and objectives of those who receive it. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages them to seek a financial adviser's advice. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. Morgan Stanley Research is not an offer to buy or sell any security or to participate in any trading strategy. The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized.

Permission from Morgan Stanley is required before republication of this essay.  
Contact: Noel Cheung at Morgan Stanley Corporate Communications at (852) 2848-6788 or [noel.c.cheung@morganstanley.com](mailto:noel.c.cheung@morganstanley.com)

© 2010 Morgan Stanley. All rights reserved.

# Morgan Stanley

[www.morganstanley.com](http://www.morganstanley.com)