



With the end of fiscal 2005, RIETI has completed the five-year period envisaged for achieving its first set of midterm objectives. Throughout the past five years, we have strived to deliver outstanding results in our research activities including the production of more than 280 research papers and organization of more than 45 symposia. These achievements are gradually but steadily drawing public attention both in Japan and abroad, with our website logging more than 650,000 visits in the fiscal 2005.

This annual report, which covers the final year of our first midterm period, focuses on the introduction of 72 newly published research papers and 9 symposia held during the past fiscal year. The key characteristic of RIETI is that it is an institute that fosters active interactions between academia and policymaking authorities. Additionally, study groups and workshops at RIETI serve as opportunities for lively exchange among government officials from different ministries and agencies. Some of the outcomes of these interactions have been reflected in our policy symposia held in fiscal 2005, such as those on Japan's pension system and Japan's financial system. Based on these achievements, the Evaluation Committee for Incorporated Administrative Agencies once again awarded a high rating to our activities in the past fiscal year. We have also received an equally high rating in an overall evaluation of our activities throughout the midterm period. I believe it is our mission to continue to build and strengthen a framework for research activities by further taking advantage of our unique characteristic of being an incorporated administrative agency.

Beginning this fiscal year (fiscal 2006), we will continue to undertake activities in the four major policy research domains: 1) Maintaining Economic Dynamism under the Adverse Demographic Conditions of Low Fertility and Aging Population, 2) Promoting Innovation and Strengthening International Competitiveness, 3) Formulating Japan's Strategy in Response to Globalization and Deepening Economic Interdependence in Asia, and 4) Compilation of the History of Japanese Trade and Industry Policy Primarily of the 1980s and 1990s, as stipulated in our new midterm objectives. We are committed to working toward these new goals, building on our experience and achievements to date. I would like to call for further cooperation and constructive criticism from all of you.

July 2006

**Kozo OIKAWA**  
Chairman



The final year of RIETI's first five-year plan was just finished. Since I joined RIETI two years ago, my strong hope has been to establish this institute as Japan's intellectual headquarters, through conducting well-designed policy research on key economic issues across the ministerial boundaries and disseminating policy recommendations to the public. This is because the major problems confronting Japan cannot be solved without cross-cutting, across-the-board research undertakings. Take the problem of aging population as an example. Japan's fastest aging in the world will very rapidly raise our national cost of pension benefits, and medical and care expenditures for the elderly. We will only afford to take care of these expenditures within the overall pie (GNP) of the economy. But how can Japan expand the pie when the young generations who can only produce the pie tends to decline under the rapid aging? This is a policy challenge of vital importance. While containing the ballooning cost of aging within the overall pie as much as possible, we should promote the accumulation of the "health capital" of individuals so as for the elderly not only to reduce the social security cost but also to contribute to expanding the pie through greater participation in the labor force. Even more important is to grow the pie by raising total factor productivity, in addition to increases in the physical and intellectual capital-to-labor ratio. Total factor productivity can be enhanced by "creative destruction," as defined by Joseph Schumpeter, at firm-level made possible by technological, managerial, and institutional innovation. A key research issue is how such firm-level innovation can lead to innovation at various industry levels and eventually to the macroeconomic level, i.e. the overall pie. Furthermore, how can the interrelationship among international trade, foreign direct investment, and technology transfer be promoted in East Asian economic integration by multinational companies from Japan, the United States, South Korea, Taiwan and so forth? This issue is also associated with what should be the desirable exchange rate regime in East Asia. RIETI finds itself in a very privileged position to carry out such policy research and we will further exploit this privileged position.

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**Masaru YOSHITOMI**  
President and Chief Research Officer