

APIR Discussion Paper Series No.43

2016/4

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--A New Development Cooperation Strategy for Japan--

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Abstract

The landscape of international development has changed dramatically, with a rise of emerging economies, more diverse actors of development cooperation, and intensifying aid competition. Moreover, Japan itself stands at a major turning point. There is a new wave of ‘internationalization’ of Japanese manufacturing FDI involving SMEs, which necessitates building much deeper and co-creative partnerships with Asia. The latest revision of the 2003 ODA Charter and the formulation of the new Development Cooperation Charter by the Japanese government can be understood as an attempt to respond to such changes. This paper stresses the four principles of Japan’s contribution to international development in a new era—i.e., a quality and knowledge leader, a people-centered approach, a solution-provider, and network-based cooperation. It then proposes three sets of enhanced partnerships with Asia: (i) manufacturing (*monozukuri*) partnership, (ii) city development (*toshizukuri*) partnership, and (iii) knowledge (*chitekiki*) partnership. Japan should create a global strategy that increases its soft power, making full use of the intellectual assets and expertise as well as the human networks accumulated in Japan and abroad, building on its sixty-year ODA cooperation. ‘Co-creative’ partnerships with Asia should be central to this global strategy.

Keywords: development cooperation, ODA, Asian dynamism, emerging economies, SME internationalization, co-creative partnerships, public-private partnership (PPP)

*This paper is based on the author’s Japanese article, “A New Strategy for the Age of Co-creation and Competition,” *Diplomacy (Gaiko)*, Vol.31, May 2015, pp.30-37. The author is grateful for Ms. Anjali Patel for her thoughtful comments and translation support.

1. New Era of Japanese Development Cooperation

On February 10, 2015 the Japanese Cabinet adopted the Charter for Development Cooperation as a new set of guiding principles for navigating the post-2015 development era. The new Charter marks the 60th anniversary of Japan's Official Development Assistance (ODA) and is the second revision of the ODA Charter that was introduced in 1992 and first revised in 2003.

Behind the latest revision of the Charter is the realization that both Japan and the world are entering into a new era. The 2003 ODA Charter was drawn up at a time when official flows from developed countries constituted the primary source of development finance. Nowadays, private financial flows to developing countries are two and a half times greater than ODA. The world's balance of power is shifting too, with China's presence as the lead emerging economy growing. And while global integration is accelerating, development challenges are becoming increasingly diverse and complex. Various threats to stability such as climate change, HIV/AIDS, and—as witnessed recently—the Ebola epidemic and terrorism cannot be contained by borders and spread in an instant. In today's world a host of issues exist that can no longer be solved by any one organization or by any one discipline. It thus becomes essential to address these global challenges in an inclusive and participatory manner, working together with emerging economies, the private sector, and civil society.

Japan itself stands at a major turning point. It is facing a relative decline in economic power and a shrinking population because of a low birth rate and ageing. Furthermore, the aftershocks of the 2008 financial crisis have given birth to a new era of 'internationalization' in which an increasing number of Japanese manufacturing small- and medium- enterprises (SMEs) are forced to consider investment abroad to ensure their survival. Traditional Japanese-style production networks (*keiretsu*) are disintegrating, and these manufacturing SMEs need to find new customers and markets overseas. As Japan prepares for its future, enhancing and deepening its ties with developing countries and emerging economies should form a key element of its revitalization.

The revision of the Charter includes a change in name from the 'ODA' to the 'Development Cooperation' Charter. The new name recognizes the significance of a new era that is characterized by the growing reach of the private sector and the rising presence of emerging economies. As such it includes not just developed countries but a range of other actors (such as businesses, NGOs, local governments, and emerging economies), who now also use their particular strengths to cooperate toward the common goal of sustainable global development and the development of individual countries. The new name also gives the sense of equal partnership based on cooperation for mutual benefit and a two-way dialogue, in a move away from the conventional aid-based, one-sided donor-recipient relationships of today. Of particular note in the revised Charter is the strong emphasis given to promoting public-private partnerships (with Japanese businesses as well as others) and enlarging the community of Japan's development cooperation partners to include upper middle-income countries and emerging economies.

This paper will focus on Asia, where all the challenges and opportunities of the new era described above converge, and it will consider the direction that Japan's development cooperation should take, giving special attention to public-private partnerships.

2. Asian Dynamism and Intensifying Aid Competition

Asia is where Japan can demonstrate its ability to implement the new Development Charter to its fullest potential. The region is where Japan's postwar foreign assistance began and it remains the destination for most of Japan's ODA even today. For over sixty years Japan has provided ODA and engaged in economic cooperation in the region, and as a result, Asia boasts extensive human networks and organizations that share a common core of values with Japan. Moreover, Japanese companies have active business operations in the region, a fact that also makes it possible for Japan to mobilize a number of tools for economic cooperation, an important one of which is public-private partnerships.

Japan's future development cooperation in Asia should give greater attention to 'co-creation' and 'competition'. Asia is the world's growth center, with a large and diverse

group of drivers of economic growth led by China, India and ASEAN member countries. The Asian Development Bank (ADB) forecasts that between 2015 and 2016 the region will achieve a growth rate of 6.3 percent (ADB 2015). By the end of 2015, the ASEAN Economic Community (AEC) should be established, and a single market and production base populated by 600 million people will come into existence. To take advantage of this anticipated integration, Japanese companies are changing their business models into 'local production for local consumption' ones and actively promoting the 'localization' of their supply chains, including the R&D stage as well as design and distribution and sales. The nature of public-private partnerships must change in step with these developments. There is a need to go beyond the 'All Japan' model (constituted solely of Japanese partners) and evolve into a 'co-creative partnerships' one; a model that is based on deeper relationships with local human resources and organizations.

In recent years, emerging economies have extended a variety of cooperative initiatives, as exemplified by the China-led Asia Infrastructure Investment Bank (AIIB). In 2004, Korea launched the Knowledge Sharing Program (KSP) to make its development expertise available as widely as possible among developing countries. And Western donors, who once embraced poverty reduction as the overarching goal of development cooperation, have now shifted to give economic development and public-private partnerships greater emphasis too. These developments suggest a growing convergence of the major areas of assistance in which Japan and Western donors are active. As new initiatives take root and others move closer, competition among donors will intensify. Given the situation, Japan needs to clearly articulate its comparative advantage as a partner for development.

3. A New FDI Initiative by Japanese Manufacturing SMEs

Now let us look at recent developments in Japanese manufacturing FDI into Asia. Following the 2008 financial crisis, the number of manufacturing SMEs that sought to expand abroad independently of large parent companies increased dramatically. Their expansion represented a new wave of 'internationalization' that differed from past patterns, where SMEs bound in subcontracting relationships with larger corporations

would be asked by the parent company to relocate their production networks overseas.

As Table 1 shows, Japanese manufacturing FDI has traversed three broad phases: the first phase took place from the 1970s to the early 1980s, the second began in the mid-1980s, and the third phase started in the 1990s. From the 1970s to the early 1980s, the primary motivation behind outward FDI by Japanese business was trade friction between Japan and its Western trading partners. During this period, Japanese business shifted its manufacturing bases to various Western countries as part of an export substituting strategy to avoid the tariff and the non-tariff barriers set up by the US and Europe. The second phase of overseas expansion began in the latter half of 1980s and was the result of the appreciation of the yen following the Plaza Accord of 1985. Japan's domestic production costs and wages soared compared to those in the West and Asia, and Japanese outward FDI expanded further, shifting labor-intensive production processes to Southeast Asia. Thereafter, in the 1990s, the opportunities created by China's open-door policy and economic reforms prompted a global rush of FDI into the country, including from Japan.

Table 1: Trends in Japanese Outward FDI for Manufacturing

Period	Main Developments in FDI	Main Traits	Exchange Rates
1970s to mid- 1980s	<ul style="list-style-type: none"> • A rapid increase in FDI to North America and Europe • An increase in FDI to Asian NIEs 	<ul style="list-style-type: none"> • Trade friction with the West prompts the Japanese manufacturing industry to shift production overseas thus avoiding tariff and non-tariff barriers imposed on exports • The establishment of EPZ and SEZ by Asian NIEs 	<ul style="list-style-type: none"> • A floating exchange rate system is introduced in 1973 • The yen appreciates against the US dollar
Latter half of 1980s	<ul style="list-style-type: none"> • A gradual shift away from investment in Asian NIEs in favor of ASEAN countries 	<ul style="list-style-type: none"> • The transfer of labor-intensive production processes to Southeast Asia allowing the manufacturing industry to benefit from lower wages 	<ul style="list-style-type: none"> • The Plaza Accord of 1985 sees the yen appreciate against the dollar
1990s to the early 2000s	<ul style="list-style-type: none"> • A rapid increase of FDI to China • FDI to Asia recovers in 2000 having experienced a sharp drop between 1998 and 1999. 	<ul style="list-style-type: none"> • Expansion into the Chinese market as economic reforms and global integration progress • Asian enterprises demonstrate greater capacity and industrial clusters grow 	<ul style="list-style-type: none"> • The Asian financial crisis (1997) • China becomes a member of the WTO (2001)
Post 2010	<ul style="list-style-type: none"> • FDI to ASEAN increases • Interest grows in India and Myanmar • SMEs step up overseas production independently of Japanese big business 	<ul style="list-style-type: none"> • Asia becomes a center of global production and sales • China +1, Thailand +1 	<ul style="list-style-type: none"> • 2008 financial crisis • ASEAN economic integration (2015)

(Source) Elaborated by the author, based on Chart 2-2 of Kubota Norio (2012).

While the triggers and the destinations of the three stages of Japanese FDI differ, in each case large manufacturing corporations played a central role. The SMEs that expanded abroad were invited by large corporations to set up overseas production bases as part of the components supply chain, i.e. as 'supporting industries'. Once on the ground, these Japanese businesses created production networks that maintained domestic Japanese-style subcontracting relations and production partnerships. Major efforts were made to integrate local businesses into these Japanese production networks as 'supporting industries.' Only a few Japanese manufacturing SMEs ventured into global markets without the support of such long-term relationships with large corporations.

By contrast, following the 2008 financial crisis, traditional Japanese-style production relations, where the parent company and subsidiaries moved abroad in unison, crumbled and the number of manufacturing SMEs that expanded abroad on their own initiative increased. The motives behind their outward FDI also shifted from the pursuit of lower labor costs to the development of new markets for the parts and components industries. Within this new model, cultivating new customers among Japanese and non-Japanese alike took precedence over maintaining domestic-style subcontracting relations abroad (although some cases of this still remained). The fact that even small urban factories (*machi koba*) that possess little more than high-level skills and technology are now considering expansion abroad indicates the beginning of a new era of 'internationalization'. In terms of destination, there has been an increase in outward Japanese FDI into Southeast Asia to avoid the risks associated with doing business in China.

4. Aiming Beyond the Traditional Public-Private Partnership (PPP)

For over six decades, Japan has provided East Asia with cooperation that combines trade, investment and ODA, successfully incorporating its partner countries into dynamic production networks that have contributed to the economic progress of the region. This phenomenon is often referred to as the 'East Asian Miracle'; and Japan's Ministry of Trade, Economy and Industry has hailed this successful mix as the 'Japan ODA Model' (METI 2005). Japanese ODA has played a 'catalytic' role for private sector

development on a number of fronts. It has upgraded productive infrastructure through concessional loans. It has built institutions and systems to strengthen the functioning of the market economy. It has also developed human resources through technical cooperation. In turn, the improved business climate has attracted FDI from Japan and elsewhere, encouraging trade based on the import and export of finished goods as well as of raw materials, thus contributing to the development of partner countries.

However, in this Japan ODA Model, the catalytic mechanism is driven by the overseas expansion of large Japanese corporations and affiliated SMEs within the Japanese-style production system. In contrast, the new wave of outward FDI regards developing countries and emerging economies not only as destinations for production bases but also as important consumer markets. Further, the players are not limited to large corporations and their affiliates but include a wider range of businesses such as independent SMEs. In general, these small manufacturing factories in Japan (*machi koba*) possess superior technology, but face enormous structural constraints in terms of management strategy, sales, marketing, and foreign language skills. Thus, in those cases where Japanese manufacturing SMEs are seeking to expand abroad independently of large corporations, it is essential to help them to overcome these resource constraints by drawing on locally trained professionals and workers as well as local organizations. Such support is needed to transform the small factories of Japan to global players in Asia. In sum, the public-private partnerships needed now require a much broader and deeper interaction with partner countries. They should involve local human resources and systems, and go beyond the traditional PPPs based on a combination of investment, trade, and aid that Japan has practiced until now.

5. The Four Principles of Japan's Contribution to International Development

Here, I would like to stress the four principles on which Japan should base its contribution to international development for the new era.

First, Japan should position itself as a quality and knowledge leader in international development. Japan is already a mature economy with an ageing and shrinking population. With overstretched public finances, Japan ought not to compete only on

quantitative terms, such as the scale and speed of expansion or pricing in a fiercely competitive market, as it did do during former periods of high economic growth and trade surplus recycling. Rather, Japan should strive to make a unique contribution to international development by mobilizing the wealth of development expertise and knowledge it possesses.

Second, Japan should emphasize a people-centered approach, field-orientation, the pursuit of technological excellence, the guarantee of quality and productivity, and long-term commitment as its strengths. These distinctive qualities and values are ingrained in the Japanese professional and business psyche and can be commonly observed in both public and private sectors in Japan.

Third, as an experienced 'solution-provider', Japan should make full use of the expertise and know-how accumulated by industry, academia and government, as well as non-profit organizations (NPOs) to address the challenges faced by partner countries and in global development. Japan encountered a variety of environmental and social issues, such as pollution, energy shortages and waste disposal, during the process of rapid economic growth, and by dealing with them successfully, it developed preeminent technologies in these areas that are now emulated all over the world. Furthermore, as Japan is prone to natural disasters such as earthquakes, tsunami, typhoons and floods, the country possesses a wealth of experience and know how with regard to the hard and soft aspects of disaster prevention and reconstruction assistance. Currently, Japan is confronting a new set of social challenges, in terms of a low birth rate, an ageing population, and health care and pension issues. Undoubtedly present efforts to find solutions will become valuable intellectual assets to inform the other countries in the future. As such Japan should regard these assets as global public goods and promote them actively to improve global welfare. At the same time, it should develop its technologies and systems in these areas so that they become the global standard.

Fourth, to implement the above principles, Japan should enhance its intellectual partnerships with developing regions of the world through a 'network-based' cooperation that actively mobilizes the domestic and Asian organizational and human

networks that the country has built up through decades of ODA and economic cooperation. This model offers a novel form of public-private partnerships that benefits not only from Japanese business, local government, university, and NPO involvement, but also taps into the people and organizations in Asia that share similar core qualities and values with Japan.

Japan should design a new development cooperation strategy in Asia based on these four principles.

6. A Proposal for Three Sets of Partnerships with Asia

In particular, I propose three partnerships as key ingredients of the new strategy: (i) manufacturing (*monozukuri*) partnerships, (ii) city development (*toshizukuri*) partnerships, and (iii) knowledge (*chiteki*) partnerships.

6.1 Manufacturing Partnership: Enhancing Local Industrial Capability through Human Resource Development

In light of the events and circumstances described above, from 2011 national and local governments in Japan began actively supporting the overseas business expansion of Japanese SMEs. Yet within this support, there remains great scope to strengthen local-level assistance for SMEs to help them manage and sustain business operations successfully once they moved into Asia. Necessary support measures include: business matching with local companies; one-stop services for administrative procedures; the development of industrial human resources and 'supporting industries'; bolstering systems for attracting FDI and enterprise support; and strengthening legal systems and quality and environmental standards. These measures are not only useful for Japanese SMEs venturing abroad, but also contribute significantly to raising the industrial capability of partner countries. In fact, as the 2015 economic integration of ASEAN nears, member countries have placed the highest priority on upgrading industrial structures and competitiveness. Both middle-income and low-income countries in the region need to build up their human capital, infrastructure, and technology in line with the needs of their stage of development, and as such they

anticipate a great deal from Japanese business in terms of technology transfer and partnerships. In short, we can say that the recent wave of overseas business expansion by Japanese manufacturing SMEs closely matches the industrial development needs of both Japan and ASEAN countries.

Here, it is important to note the key role of the Asian human resources and organizations that Japan has cultivated through its economic cooperation and ODA because they are uniquely positioned to act as a bridge between Japanese SMEs and ASEAN member countries, linking the industrial development needs of both sides.

Thailand and Vietnam illustrate the potential form manufacturing partnerships can take. Japan has been an active partner in Thailand's development since the 1950s, offering technical and economic cooperation and academic student exchange programs. Thailand values Japan's pragmatic, hands-on management style and its emphasis on manufacturing highly. The Thailand-Japan Technology Promotion Association (TPA) and the Thai-Nichi Institute of Technology (TNI) are good examples of organizations that possess human resources trained in Japanese industrial technology and production management systems, who in turn can train a new cadre of professionals. There is also a cadre of SME management consultants (*shindanshi*), trained through technical cooperation by the Japan International Cooperation Agency (JICA). These local human resources and organizations can assist the overseas expansion of Japanese SMEs in a way that will also respond to local needs for industrial upgrading, by providing consulting and business matching services, and supplying qualified industrial human resources. In Vietnam JICA is supporting industrial human resource development at various levels, including the training of technicians, engineers and managers through capacity development of Vietnamese universities and technical vocational education and training institutes (TVETs). It is important to strengthen industry-academia collaboration so that Japanese SMEs operating in Vietnam can benefit from such human resource development programs, through enhanced partnerships with these institutions.

6.2 City Development Partnership: Cooperation between Local Governments for Urban Management

Asian countries are experiencing rapid urbanization and their populations are concentrated in urban centers. Currently, about half of the world's urban population lives in Asia and that proportion is set to rise significantly. According to UN estimates, the urban population of Asia reached 2.1 billion in 2014 i.e., 48 percent of the region's population and by 2050 that figure will reach 3.3 billion or 64 percent of the region's population (UN 2015). The number of cities with a population of over 10 million rose from seven to eleven between 2000 and 2007, and by 2030 this number will more than double to twenty-three. Clearly, urbanization will exacerbate the social and environmental problems caused by the growth process, such as the lack of infrastructure, economic disparity, and pollution, thus sustainable urban management will become of vital importance to the region.

As a 'solution-provider' and mature economy, Japan is well positioned to share its know-how in a broad range of urban management issues with emerging economics and developing countries. In fact, the cities of Yokohama and Kitakyushu are leading the way as local governments that have been actively engaged in city development partnerships with counterparts in Asian countries. Their efforts are worth noting as these two local governments are engaged in supporting the overseas business expansion of local industries through a 'co-creative' process with partner countries. Here, the local governments act as a coordinating hub, garnering expertise and technology accumulated by the local community and business, and then offering it in the form of technical cooperation that provides business solutions for the social and environmental problems faced by partner countries. In doing so, the local governments are using the networks that have been built through ODA to their counterparts in Asia as well as inter-city partnerships. Japan should facilitate this type of network building at sub-national or inter-city levels through development cooperation so as to scale up such alliances.

6.3 Network-Based Knowledge Partnership

Recently the World Bank and the ADB have endeavored to become 'Knowledge Banks'. Also within Asia, China, Korea and Singapore have begun to actively

communicate their development experience. In this regard, although its public and private sectors possess practical knowledge and an admirable competence for on-the-ground implementation, Japan has yet to design a strategy for -- or effectively engage in -- the global discourse on international development. There is great potential for Japan to develop its knowledge sharing and global leadership capabilities.

Japan's strength as a mature donor lies in its wealth of experience and its capacity to conduct international comparative analysis of best practice drawn not only from its own development experience, but also from that of advanced East Asian countries. Japan also has the experience and ability to manage the process of knowledge co-creation through joint work with its developing country partners. Clearly, applying Japan's own development experience directly to today's developing countries would be difficult. The same is true of Korea's experience, which is typified by the New Community Movement (Saemaul Undong), export promotion and the formulation of five-year development plans, or China's experience, which includes Special Economic Zones (SEZ). What Japan can do that is distinctive, however, is to build networks using the people and organizations that it has cultivated over many years through its ODA and economic cooperation to Asia, and implement development cooperation led by them. These networks of people and organizations can play a bridging role, matching both Japanese and Asian needs. As such Japan is uniquely positioned to conduct policy dialogue and provide intellectual support that incorporates an international comparative analysis of the development experience of other countries.

For example, at the request by the former Prime Minister of Singapore, Lee Kwan Yew, JICA implemented an eight-year long project to raise Singapore's industrial productivity (Productivity Development Project) in the 1980s. The project trained a large number of public and private experts, who are actively engaged as Singaporean experts in international cooperation in Asia and Africa now. Furthermore, under the ongoing industrial policy dialogue with the Ethiopian government conducted by JICA and the National Graduate Institute for Policy Studies (GRIPS), Japan invited seasoned practitioners from Malaysia and Thailand to Ethiopia to share their experience with FDI and export promotion. JICA also organized a study tour that send Ethiopian policy makers and practitioners, all of whom were officials of the Ministry of Industry, the

Ethiopian Investment Agency or other related agencies, to Malaysia. There, the participants were given the opportunity to learn the specifics of the country's industrial development; knowledge that contributed to speeding up the revision of Ethiopia's own investment laws.

Japan should capitalize on these individual achievements so that it can transform its conventional cooperation, which focuses on creating 'something out of nothing', into the next generation of development cooperation that would create 'something more out of what has been built so far' by drawing on the assets accumulated through its past ODA to Asia (quotes from Mitsuya Araki, Chief Editor of *The International Development Journal, Co. Ltd.*). Here Japan would be working with emerging donors as key players. In partnering with the advanced ASEAN economies, Japan can also position itself to offer intellectual support and engage actively in policy dialogue with latecomer Asian countries such as Myanmar, Laos, and Cambodia, as well as countries in the other developing regions including Africa.

7. Making Co-Creative Partnerships with Asia a Key Element of Japan's Foreign Policy Vision

In the late 1970s, then Prime Minister Takeo Fukuda, announced the three principles that were to govern Japan-ASEAN partnerships. Called the 'Fukuda Doctrine', these tenets emphasized: (i) a strong resolve not to become a military power, (ii) the desire to nurture mutual confidence and trust (the 'heard-to-heart' relationship), and (iii) equal partnership. The Doctrine was based on a genuine recognition of the anti-Japanese sentiment building up in Southeast Asia at the time because of the flood of Japanese exports to the region. The Fukuda Doctrine clearly laid stress on cooperation that sought mutual benefit, moving away from the one-sided relationship dominated by Japan. Later in 1981, Prime Minister Zenko Suzuki announced 'The ASEAN Human Resources Development Project', where core projects were formulated and implemented in each ASEAN country by combining technical cooperation and grant aid. This framework provided an important basis for Japan's current cooperation, which gives prominence to a human-centered approach.

In a new era of development cooperation, Japan should establish 'co-creative' partnerships with Asian countries as a key element of its foreign policy vision. Japan should look beyond the traditional 'All Japan' partnerships and work more deeply with local human resources and organizations that share values with Japan. Furthermore, this vision should be realized through three sets of partnerships with Asia: 'manufacturing (*monozukuri*) partnerships', 'city development (*toshizukuri*) partnerships', and 'knowledge (*chiteki*) partnerships'. It is important for Japan to create a global strategy that increases its soft power, making full use of the intellectual assets and expertise as well as the human networks accumulated in Japan and abroad. 'Co-creative' partnerships with Asia should be central to this global strategy.

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