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EXPLORING GLOBAL MANUFACTURING DYNAMICS: MEXICO VS. CHINA

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new national president

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Consejo Nacional
de la Industria Maquiladora
y Manufacturera de Exportación

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MESSAGE FROM **THE PRESIDENT**

Within the manufacturing sector, a great constant is change. Relationships between suppliers, customers, partners, governments and educational institutions evolve at different speeds. Although these differences are part of the development of each organization, we must seek to capitalize on them so that time becomes a good ally, hand in hand with flawless execution.

Flawless execution, although it may sound difficult, does not require high spectrums of focus, but rather that each small task is executed well and with the will to create the right channels for follow-up. Execution also involves challenging the status quo to evolve to levels we are not yet aware of.

Our role within the national council of index is to participate with partners, anticipate problems and collaborate with Mexican authorities and those of any country that has investments in Mexico. We will seek to provide all of them with relevant information in a timely manner so that it can be implemented and executed quickly.

I am sure that this new publication will provide value to you, the members, so that you will have more tools to decide where to invest your energy and attention. As national president, I am at your service and close to you, seeking to add value, protecting your investment and creating better conditions for our sector.

I wish you all the success you are willing to obtain,

Luis Manuel Hernández

Consejo Nacional de la Industria Maquiladora y Manufacturera de Exportación, A.C. index

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CONTENIDO

LET US COMPARE OURSELVES WITH CHINA

THE FUTURE OF MEXICAN MANUFACTURING IS CLOSELY LINKED TO THE PERFORMANCE OF THE LARGEST ASIAN ECONOMY. HOW TO BEAT THEM?

INTERDISCIPLINARY PUBLIC RESEARCH TEAM [1]

For fifteen years now, specialists have been warning us that the development of Chinese manufacturing threatens our industry; since the beginning of the new millennium, their products have displaced ours in the North American market. The figures are shocking. Since 2003, China's share of total U.S. manufacturing imports has been higher than Mexico's for almost all subsectors, especially those requiring advanced technology. The beginning of 2021 offers an ideal time to compare ourselves and get down to work.

Let's start with questions: what has given the largest Asian economy these advantages; what can we learn from the last twenty years; which Mexican sectors have been most affected; where should we direct the public policy discussion today; what are we doing as leaders in the Mexican manufacturing industry? In the inaugural issue of TIER PLUS MX we dare to give some answers.

[1] *Meet out team in the last page.*

SUMMARY OF THE ARGUMENT
COMPARANDO A MÉXICO Y CHINA

TRENDS

CHINA IN THE LEAD

The growth of all sectors in China has been higher and more stable than the Mexican sectors since 2001, but especially the technology sectors.

THE TECHNOLOGICAL LAG

Compared to China, Mexico has weak public policies for scientific and technological development.

THE PANDEMIC

COVID-19 pushes Mexico to cement its competitive advantages from its supply chains given its geographic proximity.

CHALLENGES AND OPPORTUNITIES

HIGH IMPORT DEPENDENCE

México depends on foreign suppliers for intermediate, capital and technological goods required in key industrial processes.

OPPORTUNITY: to cement local production chains.

LABOR PRODUCTIVITY

México needs to increase the quality of formal education and implement adequate training programs.

OPPORTUNITY: take advantage of Mexico's demographic bonus while it lasts.

MAJOR THEMES

CHINA WILL CONTINUE TO GROW

We cannot omit that the trend will become more acute.

TECHNOLOGICAL DYNAMISM

It is essential to incorporate new technologies and develop our own in the face of an increasingly automated world.

EXCHANGE RATE DEPRECIATION

The depreciation of the peso does not benefit Mexico in the medium term to regain international competitiveness.

ENTRY POINTS FOR PUBLIC DISCUSSION

T-MEC

The decline in U.S. unit labor costs worsens domestic export performance.
The implementation of the labor section of the agreement will be critical, for better or worse.

SUPPLY CHAIN

The professionalization of smaller companies could reduce the sector's dependence on imports, making it more stable in relation to the exchange rate.

INVESTMENT IN HUMAN CAPITAL FORMATION

Public-private partnerships are suggested to make programs specifically designed for each manufacturing subsector.

THE ESSENCE **OF THE ISSUE**

Let's unravel the mystery: why has China gained so much ground in the U.S. market? Summarizing the findings of much research[2], it has done so because of its large natural resources and population, which has attracted much foreign investment; because of its large investment in infrastructure and ports, which reduces logistics costs; because of its steadily increasing labor productivity, which lowers its labor costs by making its workers more efficient; because of its high political control, whereby local rulers are accountable to the Communist Party in their areas of influence; and because of its implementation of a successful industrial model known as "supply-chain cities", which combines all of the above at the regional level, making everything much more manageable and effective. As a result, China has achieved greater specialization in its manufacturing industry, investing in key sectors that allow it to produce more at a lower cost. If we add to this the fact that its government has not ceased to subsidize the exports of its national companies, we can understand the reasons for its high level of integration into global chains and the consequent displacement of many Mexican products in the United States. It is essential to recognize the gradualness with which China has carried out the process; nothing has been abrupt, and the dynamics of each subsector have been considered.

Mexico's bet during the same period has been very different and sought to resolve the continuous internal economic crises. Fearful, to date we have not left that model. During the last 30 years, our economic policy has followed the "Washington Consensus", a set of measures summarized in fiscal discipline to reduce government deficits; realignment of public spending towards health, education and infrastructure; tax reforms to broaden the taxpayer base, mainly by taxing consumption; liberalization of interest rates, foreign direct investment (FDI), exchange rates and trade, to attract capital, technology and expertise from other countries; and privatization, deregulation and protection of property rights, with the intention of boosting economic activity. All this has been accompanied by a variety of trade agreements, among which NAFTA, now T-MEC, stands out by far. With this model, Mexico has grown steadily, although at a lower rate than China. There has also been a stagnation in its share of the U.S. market, especially in the last 10 years.

The differences are notable. China has been able to connect FDI with its economic growth more effectively than Mexico, on the one hand, because of the economic control exercised by the ruling party, but also because of its access to abundant, relatively cheap and well-educated labor within a very flexible labor market. China's domestic market makes mass production possible, which reduces marginal costs and generates huge profits for investors. This has not been our story. Financial destabilization in Mexico caused the economy to stagnate in the 1980s, with a slow recovery in the 1990s. If we look at the figures, from 1993 to 2003 "private consumption grew an annual average of 2.7%, while exports grew 11.3% in the same period; likewise, gross investment in fixed capital was quite low (2.9% average annual growth)"[3]. In other words, our emphasis on exports has not been accompanied by the development of the domestic market and investments, even though they continue to grow, have not been predominantly in technology, which generates true economic growth. Finally, during the period of toughest competition for the North American market, we did not create as many new companies as we thought we would. Poor economic growth has been the national trend: are we already in a dead end? How can we break this trend in the next 5 years?

[2] *Mesquita, 2007; Gallagher et al., 2007; Gereffi, 2009; Lin, 2015*

[3] *Alenka y Toledo, 2007*

TRENDS:
THE 5 KEY ELEMENTS

INTERDISCIPLINARY PUBLIC RESEARCH TEAM

By keeping the following in mind, we can navigate the ups and downs of Sino-Mexican competition [4]:

- The penetration of Mexican manufacturing products into the United States is entirely associated with NAFTA.
- The growth of all manufacturing sectors in China has been higher and more stable than Mexican manufacturing sectors since 2001.
- Chinese products have been gradually displacing Mexican products in both labor-intensive industries and those of greater technological complexity.
- Compared to China, Mexico has weak public policies for scientific and technological development. The next big step for our industry must involve the training of engineers and the accumulation of capabilities that will help reduce dependence on technological imports.
- The momentary paralysis in Chinese supply chains caused by COVID-19 pushes Mexico to consolidate its competitive advantages given its geographic proximity. To do so, it is crucial to develop infrastructure, technology and human capital.

The trend is clear and our timing is critical.

[4] *Alenka y Toledo, ibid.*

CHALLENGES AND **OPPORTUNITIES**

The results of almost three decades of competition between the two nations are summarized in Table 1. Again, China has displaced Mexico in many subsectors and the gap continues to widen. This generates a political temptation: to blame China for the stagnation and not take responsibility for the future of the industry.

Table 1. Manufacturing performance to the U.S. market, 1994-2020 [5].

MÉXICO	CHINA
• Most successful period so far: 1995-2001 (NAFTA). Since then the pace of growth has slowed. • In the period it quadrupled its exports for the automotive industry. • In the rest of the industries it has not performed as well as China, but it has gained some ground (e.g. machinery, material processing products and metal manufacturing). • The textile sector has suffered the most.	• It has increased its exports to the U.S. in all sectors, especially in those of high technology (electrical and electronic industries). • Its export boom began with its entry into the WTO (2001) and has diminished given the slowdown in the U.S. economy. • China represents an important challenge for Mexico in sectors that are moderately demanding in technology, such as the manufacture of process products.

Table 1 shows a direct comparison between Mexico and China. The story is clear: the dynamism of Mexican exports has lagged.

Given the context, are there any opportunities for Mexico? Many. Let's mention three specific ones: take advantage of what is still left of the demographic bonus, generating incentives to employ the young population; exploit the fact that Mexico currently has an average production cost 20% lower than China for a group of manufacturing subsectors; and the usual, but with greater emphasis: exploit our geographic position, investing to improve infrastructure and port capacities.

IT IS NOT A MATTER OF REINVENTING THE WHEEL, BUT OF REDIRECTING IT.

[5] *Ahumada y Calderón, 2019. http://dx.doi.org/10.22201/fca.24488410e.2020.2024*

MAJOR **THEMES**

IN SUCH A COMPLEX ISSUE, IT IS IMPORTANT TO DISCERN WHAT IS IMPORTANT. WE HAVE IDENTIFIED THREE KEY ISSUES FOR THE NEXT DECADE:

1. CHINA WILL CONTINUE TO GROW.

During the pandemic, the Asian giant experienced a slight economic slowdown and its recovery has been remarkable. This has been due to its financial strength, its large investments in infrastructure and the fact that it is a major exporter of medical and electronic supplies. In addition, it is plausible that U.S. President-elect Joe Biden will seek to improve the trade relationship with China, which would increase its exports to this country, although there is still little clarity as to how and when. Biden has been cautious on the subject, but specialists expect improvements. There are good expectations for China.

2. TECHNOLOGICAL DYNAMISM.

Although China has not reduced its imports of high technology, but rather increased them, it has also increased its exports in this subsector. The key is to incorporate technologies and develop our own, always respecting intellectual property, in order to reduce the cost of operations if the exchange rate appreciates.

3. INCREASED LABOR PRODUCTIVITY.

It is time to stop competing primarily through wages and opt for policies that make Mexican workers even more productive. This allows for greater adaptation of new technologies, greater capacity for resolution and higher production. China's rising labor costs have not diminished its economy or its attraction of investment. A large and specialized middle class is beginning to consolidate in that country, which is increasing its manufacturing production.

In short, we must recognize that China will continue to grow and that only technological development and good training adjusted to the realities of the market can give us competitive advantages in the medium term. If we do not take steps in this direction in the next decade, our favorite market, the North American market, will gradually become smaller.

ENTRY POINTS FOR **PUBLIC DISCUSSION**

If we were to sit down and talk with the government representative leading this agenda, how would we start the conversation? What issues should be in a good public discussion?

We propose the following three as a starting point.

1 Implementation of the T-MEC.

There is clear evidence that a drop in U.S. unit labor costs worsens the Mexican domestic export performance. Thus, when wages decrease there, we produce less here. There are subsectors that are very sensitive to labor costs. In this sense, the labor section of the T-MEC, which seeks to equalize wages in some subsectors, such as the automotive sector, is fundamental. It is clear that wages should not be artificially modified; if they are not accompanied by more labor capacities, a sudden wage increase in Mexico could be serious for the industry's export capacity.

2 Production chains.

We urgently need to discuss how to generate efficient production chains with small and medium-sized businesses that produce for the domestic market and large export consortiums. The manufacturing industry consumes around 6 billion dollars of domestic inputs per month and there is a great opportunity in the development of these suppliers. The professionalization of smaller companies could reduce the sector's dependence on imports, making it more stable in relation to the exchange rate and generating more jobs. To this end, it is critical to continue investing in roads, customs and ports.

3 Investment in human capital.

In addition to high wages, one of the benefits of working in manufacturing companies is the development of labor and technical skills. This knowledge allows both the adaptation of new technologies and their invention. However, in order to ensure that employees are able to meet the new demands of the working world, the education they receive in public schools is crucial. Looking ahead to the next decade, it is of utmost importance to continue improving the level of education and its focus. It is a matter of increasing technical and human capacities, and public-private partnerships can be very useful in achieving this.

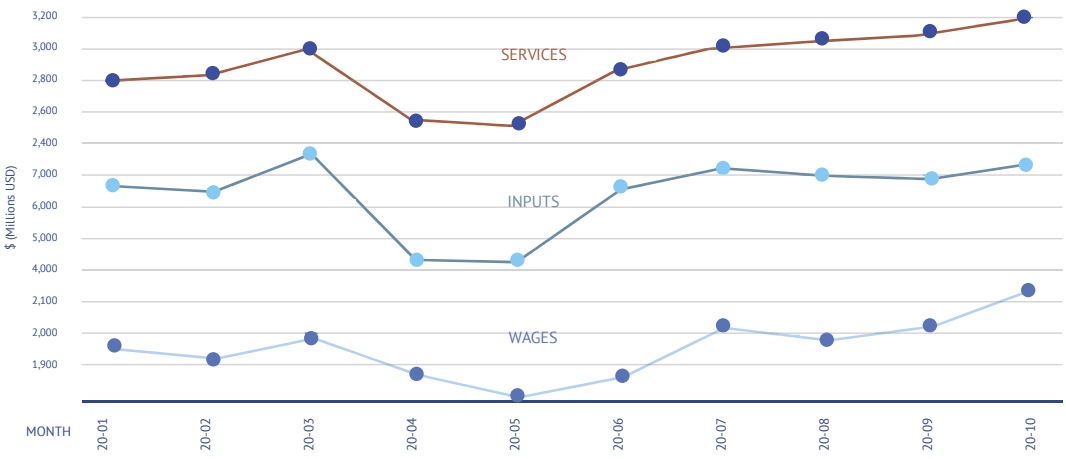
OTHER IMPORTANT ISSUES:

EMPLOYMENT FLEXIBILITY, FIXED CAPITAL INVESTMENT, BORDER SECURITY.

OUR WORK FOR MEXICO **THIS MONTH**

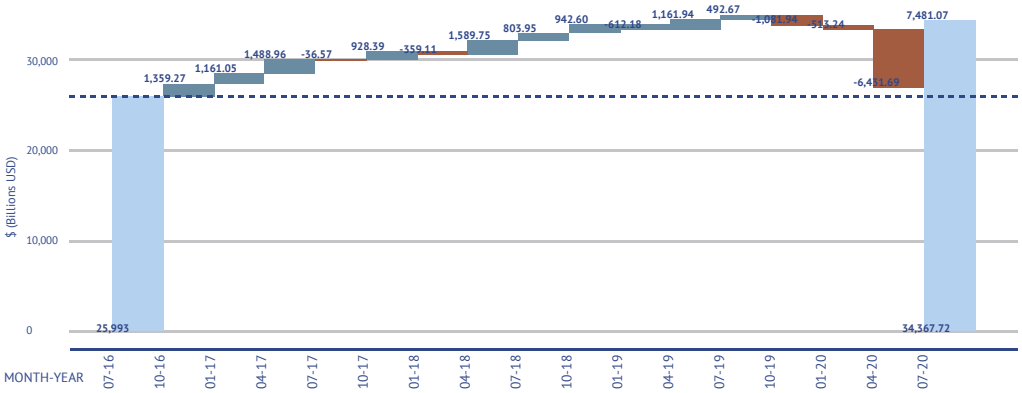
Our job is to advance the national industry with a human approach. The core value of manufacturing and exporting companies is in the lives they move, the jobs they create, the partnerships they make with entrepreneurs, domestic and foreign. Our underlying drive is to contribute to the trust that brings our society together and propels it into the future. In this section you will find our direct monthly impact, put in numbers: what we consume in goods and services and the remuneration we offer to the thousands of employees in our industry. Of course, our indirect spillover is even greater.

Graph 2. Total national services and inputs consumed, and wages paid to employed personnel in the Mexican manufacturing industry (2019-2020; USD)[6].



2020 was a year of consistency, decline, recovery and growth. The effect of the pandemic was felt from March to May. Since then, growth has not ceased. The industry's contribution to the country is notorious and constant, mainly through the consumption of inputs. On average, our industry spills 2.863 billion in services, 5.825 billion in inputs and 1.976 billion in salaries.

Graph 3. Quarterly changes in national value added in manufacturing industry (2016-2020)[7].



We measure domestic value added as the sum of local inputs, services and remunerations disbursed during a month by the whole sector. From 2016 to 2020, such value has increased, but a fall is observed since the fourth quarter of 2019. In green, quarters with growth; in red, quarters with falls; in blue, initial total and final total. During this period, an average of 31.363 billion was shed each quarter.

- **quarters with growth**
- **quarters with falls**
- **initial total and final total**

[6] Figures in millions of dollars, exchange rate (1=19.757). Remunerations exclude subcontracted personnel and indirect jobs. Source: INEGI (2021): monthly statistics of the IMMEX Program. [7] Ibidem.

"EVERY QUARTER,
THE MEXICAN MANUFACTURING INDUSTRY
SPENDS, ON AVERAGE,

31.363 BILLION DOLLARS.

PUT IN **PERSPECTIVE, THIS IS EQUIVALENT** = **TO THE TOTAL SPENDING**

ALLOCATED TO **HEALTH** IN MEXICO IN **2020**"[8]

[8] *Exchange rate (1=19.757). Amount allocated to health in 2020: $634,388 million pesos. Source: Transparencia Presupuestaria.*

FROM THE NATIONAL COMMITTEES

WHAT TO EXPECT **FROM BIDEN'S ADMINISTRATION ON TRADE ISSUES?**

By Israel Morales, *Director of International Agreements and Treaties of index nacional*

THE MESSAGE IS VERY CLEAR: COMPLIANCE, COMPLIANCE AND COMPLIANCE.

The appointment of Katherine Tai as United States Trade Representative (USTR) -an experienced lawyer with a long career in trade issues in both the USTR office and Congress- means to the world a trade leadership characterized by experience, clarity and firmness in negotiating. While it is unlikely that the new representative will follow the protectionist line of the previous administration, it is clear that the Biden administration will be proactive toward free trade, but with restraint.

In a speech prior to President Biden's swearing-in, Attorney Tai advanced that the new administration will initially focus on two issues:

- confronting China's trade policies, especially those that flagrantly abuse intellectual property, and
- ensuring full compliance with free trade agreements, with emphasis on the T-MEC, signed with Mexico and Canada.

Regarding the T-MEC, let us recall that in the final stretch of the negotiation the Democratic party managed to modify President Trump's agreement through a protocol that modified the dispute mechanisms in labor matters (see Chapters 11 and 31 and Annex 31-A). These additions give the U.S. teeth to "bite," i.e., to trade sanction Mexico in case of non-compliance with any of the commitments (see chapter 23). "The president's vision," Tai said, "aims for a worker-centered trade policy, because people in the U.S. are not only consumers, but also workers who earn their wages. This suggests that the Biden administration will seek at all costs to ensure that Mexican companies, including those in the manufacturing and maquiladora industries, meet all of the labor commitments made in the T-MEC.

So, the questions for our industry's Labor Relations, Human Resources and Foreign Trade managers are: do you have a clear idea of these commitments and labor obligations; do you have a clear timetable for implementing the labor reform, which includes eliminating protective collective bargaining agreements, legitimizing new contracts and not interfering with union freedom; do you have a scheduled plan; and have you designated adequate resources to the different areas of your companies to implement the new obligations?

Another big issue for Biden in the T-MEC is the environmental (Chapter 24) and energy issues. As one of his first actions in office, the new president re-accepted the Paris Agreement. For Mexico this has several implications, including setting a clear policy to reduce the use of energy with a high carbon footprint. Therefore, there will be enormous pressure on Mexico on two fronts. On the one hand, to change the vision of the Mexican State to bet on renewable energies and actively promote private and foreign investments in this area. On the other, and no less important, industry must pay close attention to compliance with best environmental practices in its production processes, such as the use of renewable resources, reuse of water, proper handling and recycling of waste, among others. In this sense, our companies must be very aware that the governmental magnifying glass will also be focused on our environmental performance. Every company in the index's membership should aspire, at the very least, to the Clean Company recognition granted by SEMARNAT.

On both labor and environmental issues, penalties for non-compliance with the treaty would be commercial and could affect anything from a specific plant or facility to an entire industrial sector, be it manufacturing, agriculture or services. None of our companies will want to see their name in the news for this reason. The message we want to convey is clear: Don't just worry about it, but rather make sure you designate the right resources to comply. That includes getting involved in citizen participation through chambers or associations such as the index Council to ensure that municipalities, states and the federation also do their part in agreements, for example, the U.S.-Mexico water agreement.

There are more issues and opportunities on the horizon with the Biden administration, especially for our industry. We will talk about them in the next number.

LABOR CHALLENGES
TO BE FACED IN 2021

By Álvaro A. García Parga, *Director of the National Labor Committee of index nacional*

We begin 2021 in an extremely complex business environment. Many organizations have never seen anything like this before, and it is something many business executives are facing for the first time.

2021 is both a year of opportunity and a year of great challenges. The managers and staff of export manufacturing companies will face challenges that will mark our work agenda. For the Human Resources departments, the most relevant will be the full implementation of the 2019 labor reform, specifically regarding the elimination of the Conciliation and Arbitration Boards and the start of the new Labor Courts in charge of the Judiciary. Only a couple of states in which there are companies affiliated to index nacional have made the transition; we are about to see the real change.

The implementation of T-MEC and the commitments assumed by our country in labor matters are two other great challenges. This year, new exercises of freedom of association and collective bargaining must be implemented in our companies in accordance with the new culture of labor relations. From index nacional we will lead, together with the Ministry of Labor and Social Welfare, national and regional working groups to support companies. Among the exercises we will support are those related to the legitimization of collective bargaining agreements in those companies that have them.

As we work on the implementation of the reform and the T-MEC, companies will be faced with changes to labor regulations. By January, the law has already incorporated a new labor modality and we are about to see changes to our legislation, particularly in the area of subcontracting.

Unfortunately, the SARS-CoV-2 virus disease will continue to challenge the world. Although the announcement of the long-awaited vaccines gives encouragement and hope, the Herculean task of vaccinating most of the population will take months. It appears that we will not enjoy the benefits of vaccination anytime soon.

Our sector has distinguished itself for being at the forefront in many areas and surely this year we will once again stand out as a great source of employment and as an essential part of Mexico's economic recovery. We will experience a year of contrasts, since some companies affiliated with index have been hard hit by the pandemic, while others have had to increase their workforces due to the increase in production demand.

The National Labor Committee will be ready to help companies in the various challenges they will face this year.

RECOMMENDATIONS ON
THE IMSS'S PROACTIVE RULING STRATEGY

By Elisa Ibáñez, *member of the index Social Security Subcommittee*

On Friday, January 8, the agreement of the H. Technical Council (in ordinary session of December 15, 2020) was published in the Official Journal of the Federation authorizing the **"implementation of the strategy of proactive ruling as an occupational risk of workers of affiliated companies who died or with sequels due to serious COVID-19 conditions, during the contingency period".**

This means that COVID permits issued during the current health emergency may be classified as occupational hazards by the IMSS if the contagions are considered to have occurred in the company.

Of course, if proper sanitary measures were followed in the workplaces, the company should not be liable for the contagions. For this reason, it is necessary to have all the elements that demonstrate compliance with these measures and to properly document all cases.

Now that we are preparing for the 2020 annual accident report to be submitted in February 2021, it is a good time to consider a series of actions to face this new year. To this end, we have prepared five recommendations in this regard:

1. **Document in detail the implementation in workplaces of all sanitary measures imposed by the federal government.**

2. **Identify cases of workers with COVID from March 2020 to date and register them as a general disease in the payroll system and in the SUA.**

3. **Download the cases of occupational risks that appear in the IMSS portal and reconcile them with those registered by the company.**

4. **Be aware of any qualification on occupational risks notified to the company**

5. **Have specialized advice so that when there is an affectation you can legally defend yourselves**

We recommend contacting this subcommittee on the progress related to these strategies and we remain at your disposal for any questions you may have. We have scheduled a transmission for the first week of February in which we will talk in more detail and we will be able to resolve any doubts you may have in this regard.

LEGISLATIVE **LIAISON**

Information provided by ***Grupo Estrategia Política***

On February 1, 2021, the second period of the third year of the LXIV Legislature begins. The Chamber of Deputies will be renewed in its entirety in the July elections, while the Senate of the Republic will continue with its current composition until 2024, regardless of the changes that may occur within the Senate due to those senators seeking candidacy in 2021.

As in every beginning of a new term, the parliamentary groups of both Chambers are shaping their parliamentary agendas and relevant regulations of the majority group in the Chamber of Deputies are beginning to appear, mainly in labor, science and technology, and environment. Undoubtedly, the priority issues of the executive branch will take on great relevance in the agenda of the Congress.

Regardless of knowing in depth the details of the legislative agendas of the Congress, it is important to keep in mind two fundamental issues that will be discussed in the coming days:

Elimination of autonomous agencies.

The elimination of autonomous agencies has been a proposal of the President of the Republic, which would justify the presentation of an initiative under the argument of avoiding corruption and maintaining an austerity policy that avoids the duplication of functions between agencies and Secretariats. The project would seek to first review the autonomous bodies created by Executive decree, which do not require a constitutional reform or secondary law for their disappearance. Its approval could be a major blow to democratic institutions such as the INE, INAI and the CNDH.

The Private Initiative has positioned itself against this initiative and considers that the technical sense for which they were created would be lost. The foundation and historical development of the specialized autonomous agencies is mainly the democratic consolidation they imply. Together, they constitute a system of citizen control over the activities of the State, and they contribute to a professional, objective and efficient performance of the public sector.

Outsourcing reform

The initiative presented by the President of the Republic regarding outsourcing at the end of 2020 created great discussion in the public and private spheres, monopolizing a large part of the national agenda. Following various positions and in view of the disagreement of the business sector, a tripartite agreement was signed between the private sector, labor unions and the Federal Government to create working groups and reach consensus.

As a result, it is expected that at the beginning of the ordinary period of sessions a new initiative on subcontracting will be presented with preferential character, which means that it will be approved in a term not exceeding 60 calendar days by both Chambers. Among the proposals are prohibition of insourcing, prohibition of subcontracting of personnel except for the provision of specialized services, all those different from the corporate name of the company and its main economic activity, as well as the implementation of a registry of subcontracting companies and the establishment of margins for the payment of profits to employees. In this regard, it is extremely important to point out that, once said reform enters into force, its legal effects will begin to apply, possibly without a term for its implementation.

Finally, it is important to point out that the Ministry of Economy published the Economic Reactivation Plan, which contains the following main lines: Domestic market, employment and business; Investment promotion and facilitation; International trade; and Regionalization of sectors. The main objective of this plan is to address the economic paralysis caused by COVID-19.

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INTERDISCIPLINARY PUBLIC RESEARCH TEAM

This publication is produced by a committed, multidisciplinary team. Our goal is to take the economic, political and social knowledge of the manufacturing industry to the next level. By disseminating our findings, we seek to raise the level of public debate. Share and comment freely, let's start the dialogue.

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