Creating Inclusive Global Value Chains under the BRI from the Perspective of Public Goods Supply and Demand

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Abstract: *Supply and demand of public goods provide a brand-new theoretical framework for research on the creation of inclusive global value chains (GVCs) under the Belt and Road Initiative (BRI). The supply of international public goods is an important positive variable for creating global value chains under the BRI, in which China and other developing countries involved, as well as their small and medium-sized enterprises (SMEs), are microscopic entities. When the BRI's supply of instrumental, institutional, and conceptual international public goods is in equilibrium with the demand of GVC entities for public goods, the BRI creates necessary conditions for the extension of GVCs. GVCs created under the BRI are of great value in promoting inclusiveness, fair income distribution, balanced regional development, and the restructuring of international economic governance. Under the current GVC system, some developed countries have been wary about the BRI and even developed misgivings and biases. Nevertheless, developed countries may play an active role in bridging gaps in the BRI's development and complement their respective strengths with developing countries for win-win cooperation.*

Keywords: *BRI, inclusive global value chains, supply and demand of public goods, developing countries, SMEs*

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1. Background and Problem

In today's ever-changing global landscape, North America, Europe, and the Asia Pacific region constitute the three established global value chain (GVC) systems. By promoting specialization and the flow of commodities in these mega-regions, the global production network has elevated economic output and increased global economic prosperity. From the 1990s to the eve of the global financial crisis in 2008, GVCs had experienced unprecedented development. Before 2008, GVC trade as a share of global trade peaked at close to 52%, which started to shrink after the global financial crisis struck, down to 47% by 2015 (the World Bank, 2019). With de-globalization and structural factors precipitating a contraction in GVCs, countries need to explore a new value chain system on a global scale to jumpstart global economic growth.

At the 2015 APEC CEO Summit, Chinese President Xi Jinping stressed in his keynote speech the importance to build "balanced, open and inclusive global value chains".[1] In the same year, the G20

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[1] Xi Jinping. *Leading Role of the Asia-Pacific In Meeting Global Economic Challenges*, http://china.cnr.cn/gdgg/20151118/t20151118_520536307.shtml.

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Antalya Summit in Turkey put forth an initiative to create "inclusive global value chains".[2] At the subsequent G20 Trade Ministers' Conference held in Shanghai in July 2016, the Chinese government released the first statement of trade ministers in the history of G20. In this statement, China proposed an initiative to "promote inclusive and coordinated global value chains" for developing countries and their small and medium-sized enterprises (SMEs). As reaffirmed on various occasions, the creation of global value chains has become an important path for extending GVC systems and ensuring sustained global economic development.

The Organization for Economic Cooperation and Development (OECD) and the World Bank have defined the core concept of inclusive global value chains (GVCs), which allow low-income developing countries and their SMEs to participate by overcoming barriers to access.[3] Without a pro-SME business environment and systems, low-income developing countries are faced with high fixed costs and challenges to international competition. As microscopic entities, developing countries and their SMEs play a pivotal role in creating inclusive GVCs and should actively integrate into GVC systems via platforms offered by international public goods.

Unbalanced and insufficient regional development, among other problems in today's world, can be ascribed to an increasingly rigid structure of GVC systems, thus the need for GVCs to be extended more broadly and evenly across the world. In Asia, for instance, imbalances and gaps both exist in regional economic integration. On one hand, a unified institutional arrangement for regional economic integration is absent. On the other, developing countries in Asia struggle to integrate into the regional economy. As a new mechanism for regional economic cooperation, the BRI helps bridge those gaps (Li, 2018a). Over the years, West Asia has lagged behind East Asia in Asia's regional economic integration process. By creating inclusive GVCs, BRI countries including China will facilitate the westward extension and deepening of Asia's regional economic integration.

After a few years of development, the BRI has substantially increased trade and investment liberalization and facilitation in BRI countries. By 2018, China's goods trade with BRI countries exceeded 5 trillion US dollars on a cumulative basis, with outward direct investments (ODIs) worth over 60 billion US dollars, creating more than 200,000 jobs in recipient countries.[4] The BRI is intended not only to increase economic and trade ties between China and BRI countries, but at a fundamental level, to enhance China's industrial cooperation with BRI countries. The question is what should be done to achieve such in-depth cooperation. We believe that a possible solution is to create inclusive GVCs under the BRI. At a granular level, it takes the involvement of more developing countries and their SMEs to create a GVC system that enables them to contribute to economic growth by participating in the international division of labor and bridging regional imbalances.

What should be the foundation for creating inclusive GVCs in today's world landscape? Not only does the BRI meet the needs for extended GVCs, but it also creates opportunities for BRI countries and their SMEs to integrate into GVCs. By offering a pathway for creating inclusive GVCs, the BRI offers essential international public goods and plays its role through productive services and relevant institutional arrangements.

2. Literature Review

In the literature, academics have extensively discussed the BRI's relationship with international

[2] G20 Leaders' Communique Antalya Summit noted that "Inclusive Global Value Chains (GVCs) are important drivers of world trade. We support policies that allow firms of all sizes, particularly SMEs, in countries at all levels of economic development to participate in and take full advantage of GVCs and encourage greater participation and value addition by developing countries." http://www.xinhuanet.com/world/2015-11/17/c_1117160248.htm.

[3] "Inclusive Global Value Chains: Policy Options in Trade and Complementary Areas for GVC Integration by Small and Medium Enterprises and Low-Income Developing Countries," OECD and World Bank Report prepared for submission to G20 Trade Ministers Meeting, Istanbul, Turkey, October 6, 2015.

[4] Bo'ao Forum for Asia. *Asian Competitiveness Annual Report 2019*. Beijing, UIBE Publishing House, March 2019, page 10.

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public goods but seldom touched upon the BRI's relationship with GVCs. Theoretical explanations on inclusive GVCs are mainly found in the research reports of the OECD, the World Bank, and other international organizations.

2.1 BRI and International Public Goods

The concept of international public goods was put forth by Mancur Olsen in 1971. In 1999, Kaul *et al*.(1999) offered the following definition: "International public goods are goods whose benefits are extended to all countries, peoples, and generations". The reference of regional public goods has derived from the concept of international public goods, referring to international public goods supplied and consumed only in a specific region with benefits shared across the entire region but not globally (Fan, 2010). Morrisey *et al*.(2011) believed that the definition of public goods cannot be too generalized, and identified non-exclusiveness and non-competitiveness as the key features of public goods. Non-exclusiveness means no one will be excluded from sharing in the benefits of public goods once such goods are provided; non-competitiveness means consumption by one member will not cause a reduction in consumption by another member. In a general sense, cross-border activities over the BRI's platform have the attribute of regional public goods (Huang, 2015). However, it is impractical to endow the BRI with a multilateral attribute when it is still in the preliminary stage (Li, 2018b). Given BRI's aim to advance international cooperation and exchange,[5] public goods provided under the BRI are, in the long run, international public goods with a regional attribute.

The BRI's development encompasses instrumental, institutional, and conceptual dimensions (Xie, 2019). As an effective supplement to international public goods, regional international public goods derive from the concept of regional public goods in economics, i.e., countries within a region join hands to design a set of arrangements, mechanisms, or institutions that only serve and apply to the region with costs shared among countries within the region (Fan, 2008). Based on the "embedded public domain" concept put forth by Taylor (2007), Huang (2015) argued that when international public goods were in a severe shortage or could not meet individual needs, countries or groups of countries within a region or across regions would be driven by the common demand and shared interests to jointly design a set of institutional arrangements. Hence, the international public goods provided under the BRI will create a new platform for improving economic governance in BRI countries and fostering a regional order underpinned by GVC systems.

By improving global governance, the BRI will increase the supply of international public goods, promote sustainable global development, and help achieve inclusive development among developing countries along the route. Through trade, investment, financing, capacity building and infrastructure interconnectivity, the BRI will bring together countries along its route and provide them with opportunities for advancing sustainable development (Zhu *et al.*, 2019). Creating inclusive GVCs under the BRI will promote inclusive global development and offer valuable international public goods in such areas as income distribution, environmental protection, and labor rights within the region.

2.2 BRI and Inclusive GVCs

According to McKinsey's forecast, by 2050, the BRI will contribute 80% of world economic growth and lift 3 billion people to the middle class. In the coming decade, the BRI will add 2.5 trillion US dollars to global trade volume (Wang, 2017). At its inception, the BRI encompassed China, ASEAN, South Asia, Central Asia, West Asia, the Commonwealth of Independent States (CIS), and Central and Eastern Europe.[6] With its growing influence, the BRI is poised to extend to Africa and elsewhere. In its

[5] In May 2017 and April 2019, the first and second Belt and Road Forums for International Cooperation were held in Beijing, respectively.

[6] In 2013, 65 countries had signed BRI cooperation documents with China, including 10 ASEAN countries, 18 countries from West Asia, 8 countries from South Asia, 5 countries from Central Asia, 7 countries from the Commonwealth of Independent States (CIS), 16 countries from Middle and Central Europe, as well as Mongolia in East Asia.

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preliminary stage, the BRI has fostered cooperation on non-commodity trade such as investment, M&As, and infrastructure construction by Chinese companies in BRI countries. As industrial cooperation deepens, BRI countries will also invest in productive assets and engage in business activities in China to form a new GVC structure of "crawler belt" cycles.

The BRI has catalytic and innovative effects on GVC theories. By breaking through the geographical constraints of traditional regional value chains, the BRI puts a premium on interconnectivity and industrial cooperation among countries along the route. By putting China's industrial strengths, technologies and price advantage at the service of the market, labor force and development transitions of Asian, European and African countries, the BRI creates GVCs with shared interests via strategic interconnections at all levels, allowing factor resources to flow and reallocate across Asian, European and African countries, and contributing to the formation of new GVCs (Wang, 2017). In Asia, in particular, the BRI has created conditions for GVC extension in this region. Apart from the challenge of shortening GVCs, Asia is also faced with the possible "Trumperian shocks"; international industrial cooperation under the BRI's framework is likely to extend GVCs in the region (Li, 2018b).

Countries have fostered a better policy environment for creating more inclusive GVCs. Most BRI countries remain in their preliminary stage of GVC participation. With their manufacturing strengths, BRI countries may cooperate with Chinese enterprises in terms of capital, technology, investment, project implementation, and industrial park development (Liu, 2018). Based on each country's competitive and comparative strengths, certain industries can be identified for mutually complementary division of labor and cooperation under the value chains with the BRI as the fulcrum (Zhou *et al.*, 2017). Creating GVCs under the BRI is the foundation that forms the microscopic economic mechanism for supporting the BRI, and the GVCs thus created are inclusive GVCs based on fair trade and benefiting all participating countries (Liu, 2019). Under the BRI, GVC participating countries have formed economic and technological ties and shared interests

Developing countries having integrated into inclusive GVCs will participate in GVC division of labor according to their economic development levels and comparative advantages. While low-income developing countries participate more in labor-intensive production, enterprises from higher-income countries will specialize in technology-intensive professional activities. By participating in the upstream and downstream links of GVCs, low-income developing countries will reap myriad economic benefits from higher productivity, more product sophistication, and increasing export diversity (Kowalski *et al.*, 2015). Policy change in low-income developing countries creates an important policy environment for their GVC participation. Hence, contributing to inclusive GVCs is an important way for countries to promote the BRI's sound development.

As microscopic entities, SMEs play a pivotal role in creating inclusive GVCs. There are numerous determinants of SMEs' participation in GVCs. Some scholars have identified product quality, financial stability, standards and certification, flexibility and adaptability, innovation, and business environment as potential factors influencing SMEs' integration into value chains (Zhang, 2014). Some variables directly or indirectly reflect the demand of SMEs for certain international public goods when integrating into global value chains.

3. Creation of BRI Global Value Chains under the Supply and Demand of International Public Goods

By supplying international public goods, the BRI offers instrumental, institutional, and conceptual public goods for international cooperation. This paper creates a theoretical research framework for the creation of inclusive GVCs under the BRI. Heterogeneous international public goods offered under the BRI for creating inclusive GVCs are essential for developing countries and their SMEs to create and integrate into the GVCs. According to market economic theories, under the supply and demand

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equilibrium of international public goods, the BRI will facilitate the creation of GVC systems for industrial cooperation between China and other BRI countries.

3.1 Supply of Public Goods under the BRI for Creating Inclusive Value Chains

GVC participation is determined by factor endowment, geographical location, market size, and institutional systems. In addition, such public goods as policies and institutions may attract foreign direct investment and compensate for a country's factor endowment deficiencies. With its institutional and conceptual public goods, the BRI will provide value chains along its route with essential service platforms and development concepts.

The BRI provides instrumental public goods for creating value chains: Inefficient infrastructure is a key driver of high trade costs. With better conditions of interconnectivity, countries will find it easier to participate in value chains unimpeded by geographical distance. Under the BRI, such sectors as infrastructure and equipment manufacturing provide much-needed public goods for countries to participate in value chains. In particular, such infrastructures as roads, railways, pipelines, electric power, and communication networks underpin the creation of BRI global value chains.

The BRI generates institutional public goods for creating value chains: Institutional international public goods refer to a set of international rules for assuring, maintaining, and extending the international division of labor and trade. Given the disparate internal and external institutional environments of BRI countries, most existing international rules are "non-neutral" (Zhang, 2016), thus the need for an international cooperation mechanism applicable to BRI countries. To this end, a practical solution is to create a set of international trade and investment rules under the BRI's GVC system.

The BRI offers conceptual public goods for creating value chains: Through high-level political dialogues, the exchanges of governance experience, and cultural interactions, the BRI offers institutional arrangements as a public good for creating GVCs. Under the BRI, China has called for creating an Asian community of shared future, putting forth the principle of extensive consultations, joint development, and shared benefits as a new perspective for Asia's economic integration.

3.2 Demand for International Public Goods from Participants of GVCs under the BRI

At the national level, most developing countries have been unable to effectively integrate into GVC systems due to a lack of a supply mode of international public goods for creating GVCs and an absence of leading countries in a "flying geese paradigm" for regional integration. Among factors for creating inclusive GVCs, the former plays a fundamental role for countries to integrate into GVCs. As more and more countries and international organizations participate in the BRI, their demand for infrastructure and institutional platforms for creating GVCs will increase. In particular, some low-income developing countries plagued by political turmoil or economic stagnation cry out for infrastructure development.

At the firm level, SMEs cannot develop in isolation from a globally or regionally integrated production system in today's world of economic globalization. Over the years, more and more SMEs undertook cross-border production assignments. While SMEs used to rely on domestic factors for self-development, the open economy now allows them to access external resources to unleash broader development potentials. Policy intervention is needed to create an effective operation mechanism for SMEs to integrate into GVCs in most cases, with the help of policy preferences. Access to GVCs under the BRI will allow SMEs facing various constraints in BRI countries to become leading companies and become value chain creators.

3.3 The Contribution of the BRI to GVC Creation under the Supply and Demand Equilibrium of International Public Goods

The supply and demand equilibrium of international public goods is essential for BRI participants to create GVCs (see Figure 1). Under such equilibrium, a new round of economic globalization will dawn

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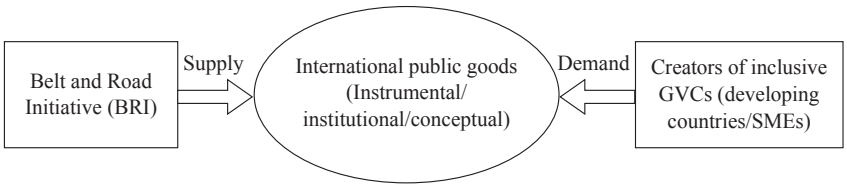

Figure 1: BRI's Contribution to Creating GVCs under the Supply and Demand of International Public Goods

Source: Drafted by authors.

for BRI countries, and the GVCs thus created will increase coordination and inclusiveness between countries.

The supply and demand equilibrium of international public goods under the BRI is an indication that inclusive GVCs serve the needs of economic globalization. The conceptual, instrumental, and institutional public goods offered by the BRI meet the fundamental needs of BRI countries and enterprises to integrate into GVCs. Firstly, BRI countries should be informed about what the BRI stands for. In its economic diplomacy, China upholds an ethical approach to principles and interests, giving priority to the greater good and win-win cooperation for common development. Conceptual consensus is the prerequisite for countries to actively contribute to creating GVCs. Secondly, material conditions such as infrastructures and industrial parks offered under the BRI for creating value chains are also the results of work by participating enterprises from all countries that helped create a new platform of cooperation based on interconnectivity. Lastly, the creation of institutional platforms for win-win cooperation, which are not least multilateral agreements and mechanisms for trade and economic cooperation, is more conducive to the formation of value chain systems. Institutional public goods provide BRI countries with a top-down design for taking part in economic globalization, unleashing the initiative and dynamism of developing countries and SMEs to integrate into GVCs.

4. Role of Value Chains under the BRI in Promoting Inclusive Globalization

The creation of inclusive GVCs under the BRI reflects the great value of international public goods offered by the BRI and the global governance concepts of extensive consultation, joint development, and shared benefits. Creating GVCs under the BRI is an important way for BRI countries to participate in global economic governance. Such participation will promote not only regional economic integration in Asia, but balanced regional development as well.

4.1 Reflecting a New Concept of Institutional Opening-up

The "hegemonic stability theory" offers a valuable perspective for explaining the relationship between public goods and international/regional order. This theory emphasizes the supply of public goods as a condition for a single nation-state to become a dominant hegemon (Gao, 2012). At the economic level, GVCs under the BRI represent a new international economic order and more importantly, an international cooperation mechanism maintained through international public goods. Kindleberger (1986) and Keohane (2001) both considered the existence of a hegemon as necessary to a stable international order, free and open trade and markets, an effective monetary system, among other international public goods. By providing international public goods for creating GVCs, China and other BRI countries have no intention to seek dominant power, nor do they deem those public goods as instruments for a hegemon to maintain a hegemonic order. Instead, the BRI advocates the new concept of opening up for common development.

Joint efforts of China and other countries to create GVCs under the BRI are intended to unveil a

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new round of economic globalization at a broader scale through international cooperation. The BRI itself represents a major initiative of opening up taken by China in the new era. International public goods and various platforms of cooperation created under the BRI serve as important conduits for institutional opening up. Under the framework of GVC institutions and international rules created under the BRI, countries will promote the flow of factors of production via the nexus of capital and services and fashion institutional strengths to reap the economic dividends of opening up.

4.2 Promoting Inclusive Development

Inclusive development aims to share the interests and benefits from globalization and regional economic integration to all countries, allowing economic prosperity to improve livelihoods for all, especially vulnerable groups and people from less developed countries. In creating GVCs under the BRI, the goal is to promote common development in all countries through trade, investment, and cross-border production.

GVCs created under the BRI promote inclusive development and serve as a policy framework for international cooperation as a public good to bring about the positive effects of GVCs. Policy integration helps multinational companies deepen their GVC links and cooperation, increase transparency, and reduce the cost of transactions. By fostering inclusive value chains, countries will have more policy space for industrial development and social, environmental, and educational progress. By creating GVCs for inclusive development under the BRI, countries may overcome the backlash against globalization and increase the significance of GVCs.

4.3 The Benefit on Fair Income Distribution

From a regional (international) perspective, GVC members not only participate in various GVC links such as production, consumption and transportation, but become embedded into the same network socially and politically and share information. Fairness is of great significance to GVCs. From this perspective, GVCs created under the BRI as an international public good provide all participating members and international organizations with a set of universal criteria of “fairness”. GVCs created under the BRI will also facilitate the orderly flow of resources, efficient resource allocation and supply and demand alignment, and raise labor efficiency.

Over the years, most developing countries including China have followed a crude pattern of development. While achieving economic growth in the short run, developing countries have been locked up at the low-end links of GVCs and faced insurmountable hurdles in climbing up the value ladder. The BRI offers the space and possibilities for transforming this pattern of interest distribution and to some extent, may help countries involved upgrade their industries and address industrial hollowing up and income inequalities.

4.4 The Benefit on Reshaping International Economic Order

Over the past decade, GVCs have shaped international economic order in profound yet implicit ways. Inclusive GVCs created under the BRI provide a brand-new platform of globalization that rewrites the rules for global economic governance with respect to production, service and tariff arrangements to secure more development space for developing countries. With their public goods attribute, inclusive GVCs under the BRI are committed to instituting a set of governance rules acceptable for all BRI countries to harmonize their internal interests and raise efficiency.

Aside from assisting developing countries in re-embedding in the GVC division of labor system without being locked up at their previously inferior position, BRI’s inclusive value chains also present new opportunities for SMEs to confront the unchecked power of multinational corporations (MNCs) in the global production system. Moreover, inclusive GVCs under the BRI will also influence international economic governance rules and contribute to the maintenance of a multilateral trade system.

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5. Impact of the Current GVC System on the Creation of BRI Value Chains

In contrast to the BRI's warm reception among developing countries, the developed world is deeply divided in its response to the BRI. While some Western countries have welcomed and decided to join the BRI, others have expressed reservations and even hostilities. From a value chain perspective, such heterogeneous responses stem from the perceived challenge of BRI value chains to the developed world that dominates the existing value chains.

5.1 Concerns Raised by Western Countries

Firstly, the BRI's inclusive value chains inevitably have an impact on the international economic order. Western countries worry that the BRI's potentials to upend the international economic order established by them. Some forces in the US have held false cognitions and biases about the BRI, describing it as the "China's Marshall Plan", "China's rebalancing strategy", "self-redemption of the Chinese economy", and "China's new policy of conciliation" (Ma, 2015) and spread "debt trap", "environmental damage" and "investment-induced corruption" theories to impede the BRI.

Secondly, some Western countries fear their global influence being eclipsed by the BRI's inclusive value chains. China's neighborhood strategy, they fear, would raise China's political clout among BRI countries. Even China's normal trade and investment dealings with other developing countries tend to be misinterpreted as seeking alliances through foreign aid, thus stoking political and security concerns in some countries.

Thirdly, inclusive GVCs under the BRI are an important instrument for China to provide the world with new development and governance modes. Conceptually, inclusive GVCs under the BRI reflect China's concepts of development and governance in the era of globalization. Inclusive GVCs under the BRI will promote high-quality development under diverse economic, political, and social conditions of various countries, which may somewhat challenge the established development modes dominated by the Western world.

5.2 New Opportunities to Developed Countries

For many developed countries, their priority is to increase their trade in value added through GVCs. This demand can be satisfied by inclusive GVCs under the BRI, which will drive more balanced and sustainable regional development and industrial upgrade in the countries involved. Amid the strategic opportunities from the restructuring of international order, inclusive GVCs under the BRI will follow a rules-based approach consistent with the global governance values and code of conduct for developed countries.

5.3 Impact of Existing Value Chain Systems on Developing Countries' Integration into BRI's Value Chains

The BRI's inclusive value chains are not at odds with the existing three global GVCs. They provide developing countries with more opportunities and compensate for their gaps in GVCs. To integrate into GVCs, however, developing countries need to explore suitable paths of development through their participation in GVCs created under the BRI. On one hand, developing countries should coordinate their participation in the BRI's inclusive value chains and other GVCs and manage relationships with different partners. On the other hand, low-income developing countries should actively serve as destinations for industrial relocation from other BRI countries and integrate into the broader world market by leveraging opportunities from BRI's inclusive value chains.

6. Conclusions

The supply of international public goods has become an influential variable in creating GVCs under

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the BRI, calling for more institutional designs and policy assurances from BRI countries, including China. Conceptually, the ultimate goal of creating GVCs under the BRI is to build a community of shared future for mankind. In offering instrumental public goods, China should work closely with other BRI countries in creating inclusive value chains and providing infrastructures and material assurances necessary for industrial cooperation. In offering institutional public goods, BRI countries should reach multilateral agreements on trade and economic cooperation and provide more service platforms for institutional openness. As microscopic entities for creating GVCs under the BRI, China, other BRI countries and their SMEs should provide public goods at all levels as needed by relevant countries and firms. The above-mentioned public goods should be supplied under an improved model to expedite the creation of GVCs under the BRI. In the preliminary stage of the BRI's development, China established a framework of non-commodity cooperation with BRI countries in such forms as investment, M&As, and infrastructure construction. As industrial cooperation deepens, BRI countries will also seek to invest and engage in business activities in China, forming a new GVC structure of "crawler belt" cycles.

In the context of the sluggish world economy plagued by a backlash against globalization, China and other BRI countries should join hands to unveil a new round of globalization and pursue economic governance through openness and cooperation by creating inclusive GVCs under the BRI. Under the international rules and governance platforms dominated by advanced countries, developing countries should leverage the strategic opportunities for value chain extension, actively participate in the creation of new governance systems and international rules, provide intellectual factors and public goods, and enhance their right of discourse in international rules and governance. Meanwhile, BRI countries should also strive to communicate the important role of GVCs in promoting inclusive globalization, fair income distribution, balanced regional development, and the restructuring of international economic governance. Another priority is to dispel misgivings and biases held by some Western countries about the BRI's development, which may otherwise stand in the way in developing countries' development. Some developing countries already in the existing GVCs face the challenge of selecting a pathway for integrating into a value chain. Indeed, BRI countries also expect developed countries to participate in the BRI, bridge the gaps of inclusive GVCs through international cooperation, complement each other's strengths, reap economic benefits, and join hands in building a community of shared future for mankind.

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