

Policy Series Effects on Bangladesh Readymade Garments Exportation

Fahmida Mostafiz^{1,2*} and Jianqiang Sun^{3,4}

Abstract

This paper examines the effects of industrial policies series taken since 2005 on the ready-made garments in Bangladesh, including formation of export processing zones, taxation facility, flat-rate duty drawback facility, FDI with equity participation and so on. Difference in Differences technique is employed and a panel dataset of industrial policy and export data of 75 companies from 1991 to 2020 are used to evaluate the quantitative effects. Empirical findings show that the industrial policies have had a significant positive impact on the RMG export, and that RMG exports increase on an average 10.68% after industry policy 2005 introduced. This paper contributes by providing empirical evidence for the industrial policies effect on Bangladesh exportation.

JEL Classification numbers: L52, L53, F14.

Keywords: Industrial Policy, RMG industry, MFA phase out, DID.

¹Department of International Business, Faculty of Business Studies, University of Dhaka, Dhaka, Bangladesh.

*Corresponding Author

²School of Economics and Finance, South China University of Technology, Guangzhou, China.

³School of Economics and Finance, South China University of Technology, Guangzhou, China.

⁴Pazhou Lab, Guangzhou, China.

1 Introduction

The purpose of this paper is to investigate the impact of industrial policies on RMG exports in Bangladesh. Since the late 1970s, Bangladesh's apparel industry has risen substantially. This industry has remained internationally competitive after the Multi-Fiber Arrangement (MFA) was phased out at the end of 2004. Researchers have recognized three potential strengths of Bangladesh's RMG industry such as market power, governance, and industry dynamism (Alam & Natsuda, 2016; Alam, Selvanathan, & Selvanathan, 2017; Haider, 2007). However, the role of industrial policies needs to be addressed.

Numerous studies have been examined the effects of the RMG industry on Bangladesh's economy, employment generation, competitiveness, the end of MFA, future potential, and present constraints. The ready-made garments (RMG) industry, presently Bangladesh's sole source of export revenue, has been crucial to the restoration of the nation and economy (Anner, 2020). The industry employs over 4.2 million people and accounts for 83 percent of overall export profits in the country (BGMEA, 2021). Bangladesh's garment industry has expanded primarily due to the MFA's quota system. Following the expiration of the MFA system, the RMG industry may face intense competition from large competitors such as China and India (Majmudar, 1996). The dissolution of the MFA is expected to have far-reaching implications for the national economy and to significantly slow the pace of RMG industry expansion in Bangladesh due to a lack of product diversification, low productivity, a scarcity of qualified personnel, and little backward linkage support (Mlachila & Yang, 2004). Furthermore, the planned abolition of quotas alters the competitiveness of various exporting countries, with Bangladesh's comparatively weak competitiveness making the Bangladeshi economy especially vulnerable to the final stage of quota phase-out (Razzaque, 2005).

However, low-labor-cost countries have emerged as winners, since the MFA's dissolution. Bangladesh has experienced tremendous growth, particularly in low-cost labor-intensive RMG industry. According to Nordås and Kyvik (2004), there is no absolute decline in Bangladesh exports, but there is a decline in Bangladesh's market share in the United States. Adhikari and Weeratunge (2007) on the other hand, stated that while Bangladesh has experienced significant growth, particularly in low-cost labor-intensive RMG industry, the country's long-term viability is not guaranteed. A combination of global opportunities, restricted trade under MFA and GSP facilities, cheap labor costs, and government assistance contributed to the establishment and expansion of Bangladesh's export-oriented apparel industry (Ahmed, 2009; Khan et al., 2009).

This paper contributes to the literature by providing empirical evidence of the impact of industrial policies on Bangladesh RMG export following the abolition of MFA. We employ a panel dataset that includes RMG export data from 75 companies with industrial policies in place, as well as other country and industry-specific control variables from 1991 to 2020. Using the Difference in Differences (DID) regression model, we find that industrial policies implemented in 2005 had a positive and substantial impact on RMG export at a 1 percent significance level. After MFA phase out, RMG buyers increase, which has a positive and considerable effect on RMG exports. With a significant level of 1 percent, the interaction terms Policy and RMG buyers favorably and considerably effect RMG exports. This finding also suggests that the 2005 industrial policies for the RMG industry are a crucial determinant in Bangladesh's ability to overcome the negative impact of MFA abolition. We also take into account the average treatment effect on the treated of the interaction term on RMG export. According to the empirical results, RMG exports increased by 10.68 percent on average after the 2005 industrial policy was implemented.

In 2005, industrial policies enacted the necessary regulations to let the industry flourish while reducing the MFA phase-down. This industry plan involves a number of critical measures, including the establishment of export processing zones, taxation, flat-rate duty drawback, foreign direct investment (FDI) with equity participation, and financial incentives. These rules stimulate both domestic and foreign investment in the RMG industry. We hypothesized that the industrial policies of 2005 had a major impact on RMG exports. Our empirical findings also corroborate this proposition.

This paper is prepared in the following order. Section 2 includes the related literatures and proposes hypothesis. Section 3 defines the data and the econometric model. Empirical results describe in section 4. The section 5 describes the concluding remarks.

2 Background and Hypothesis

Industrial policies are critical for the development and growth of the RMG industry. Notably, the industry's growth has been fueled by novel policies that permit external funding through back-to-back letters of credit and the development of special bonded warehouses (Eusuf, Shams, & Sharmin, 2007). Moreover, following the repeal of MFA in 2004, the government of Bangladesh enacted an industrial policy in 2005 that introduced completely new and vibrant policies for the RMG industry, allowing and encouraging RMG firms to continue exporting. The government supports industries through a variety of policy measures, including the duty drawback program, monetary incentives, the implementation of investment-friendly regulations that attract foreign investment (IP, 2005). One of the most important policy initiatives is the establishment of export processing zones. Introducing trade exhibitions both within and outside the country and exempting corporate taxes for both domestic and international firms are noteworthy.

During this time, the import policy regime also adjusted for 100% export-oriented garment businesses in order to offer them with the scope of bonded warehousing facility rather than tariff draw back system. Due to the policy regime's anti-export bias, imports of raw materials were initially prohibited, but policy changes allowed 100 percent export-oriented RMG businesses to import fabrics and accessories with ease in a duty-free environment. This policy modification gave the sector a competitive advantage by quickly removing the bottleneck of trade barriers in terms of bureaucratic hazards, rent seeking power, and effective lead time reduction of production.

A number of changes are made to industrial policies in 2005 to lessen the impact of the MFA phase out on RMG exports such as lowering interest rates on both long- and short-term loans, rationalizing duties and taxes on imports of capital machinery, raw materials, dyes, and chemicals. This industrial policy is a forward-thinking policy that provides financial incentives to stimulate the use of indigenous fabrics in export-oriented garment enterprises. Capital machinery and cotton can also be imported duty-free to promote textile export firms. Furthermore, the government has implemented a number of regulatory reforms in order to foster a more open and competitive environment for foreign investment in the industry's backward linkages (IP, 2005).

In addition, the duty drawback procedure has been greatly streamlined, and a flat rate has been established for all exportable goods. Commercial banks provide a flat-rate duty drawback facility to RMG exporters. The method for extending up to 90 percent credit against non-negotiable and fixed L/C sale contracts remains in effect. In order to open offices overseas, advertise products, and participate in international trade fairs, RMG companies are granted the permission to handle foreign exchange in excess of the Bangladesh Bank's foreign exchange regulation. Industrial policies highly encourage foreign investment in RMG industry. Foreign investment legislations have been modified to assure equal treatment of domestic and foreign capital, protection of foreign investments against expropriation by the state, and assurance of repatriation of capital and profit from share sale. On the other hand, foreign investors or institutions might purchase shares on the stock exchange and borrow money from local banks to cover their operational expenses (IP, 2005).

The industrial policy of 2005 is vital for the expansion of the RMG industry. The policies offered in this year not only encourage the expansion of RMGs, but also alleviate the negative consequences of the MFA phase out. By sporadically providing different policy supports, industrial policies significantly contribute to the exportation of the readymade garments. Therefore, propose the following hypothesis,

Hypothesis 0: Industrial policies of 2005 do not promote the export of Bangladesh readymade garments.

Hypothesis 1: Industrial policies of 2005 promote the export of Bangladesh readymade garments.

3 Data and Methods

3.1 Data

In this section, we discuss the data and methodologies used to assess the influence of 2005 industrial policies on the export performance of RMG. The RMG export data is collected from 75 renowned garments manufacturers from 1991 to 2020. We consider RMG_Exp_{it} is dependent variable indicates that the export of RMG companies i ($i = 75$) in a year t . Industrial policies, other country and industry related variables data are collected from Bangladesh Garment Manufacturers and Exporters Association (BGMEA, 2021), Bangladesh Bureau of Statistics (BEPB, 2021), Worldwide Governance indicator of World Bank (WB, 2020), and Government of Bangladesh's Ministry of Industries.

The policy variable is a binary variable with a value of 0 before the policy was introduced (1991-2004) and a value of 1 following the policy's implementation in 2005 (2005-2020). Industrial policies issued by the Government of Bangladesh's Ministry of Industries are used (IP, 2005). Buyers are crucial to the growth of any industry and rise or fall in the number of buyers is a barometer of the health of the industry as a whole. RMG buyers' data are collected from the BGMEA. It is a binary variable that has a value of 1 if the number of purchasers increases following the phase out of MFA and introduction of industrial policy 2005 and a value of 0 otherwise. $Policy_{2005}$ and RMG_Buyers_{it} are the explanatory variables. Figure 1 demonstrates the gradual increase in RMG exports following the phase out of MFA and the implementation of industrial policy in 2005.

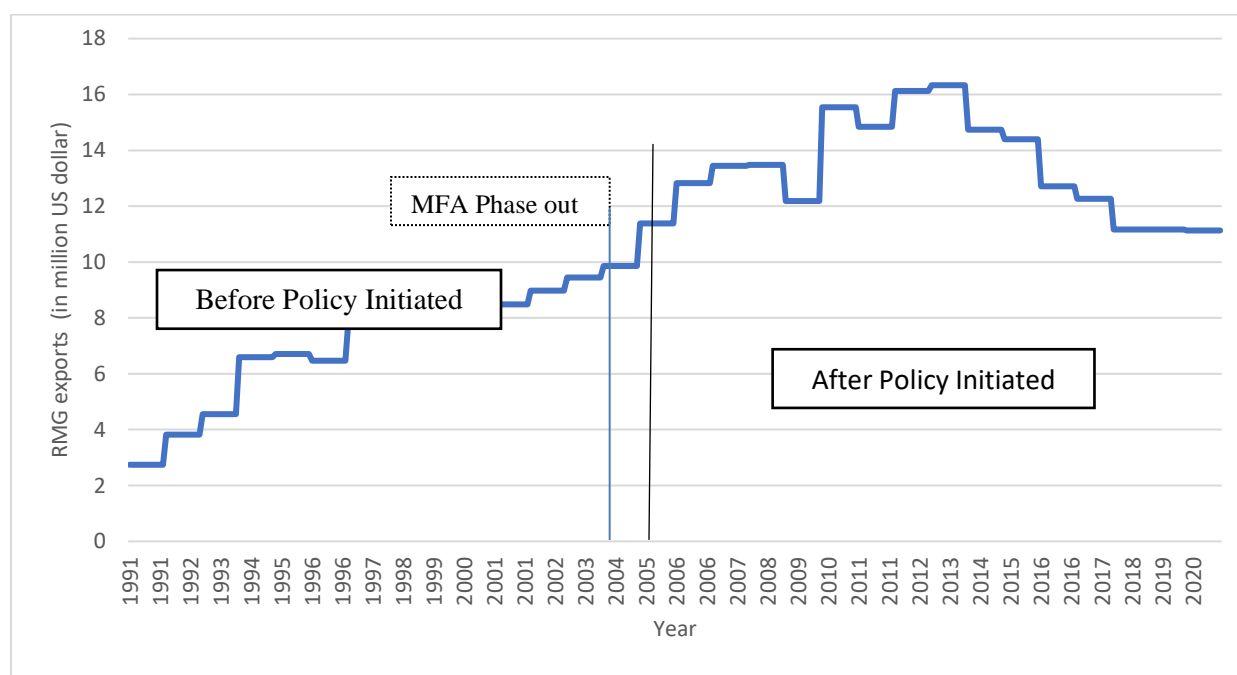


Figure 1: RMG exports from 1991 to 2020

Source: BGMEA Data and Authors own calculation

Other country and industry level control variables are taken into account, such as FDI in RMG utilized to quantify the FDI effect on RMG export, and data is acquired from the Bangladesh Bank (Bank, 2020). Political Instability is used to assess the influence of political instability and violence and data is gathered from the Worldwide Governance Indicators of World Bank Group (WB, 2020). Regulatory Quality is used to investigate the effects of regulatory quality using data from the World Bank Group's Worldwide Governance Indicators (WB, 2020). Table 1 describes descriptive statistics.

Table 1: Summary of descriptive statistics

| Variables | Obs. | Mean | Standard Deviation | Minimum | Maximum |
|---|------|--------|--------------------|---------|---------|
| RMG_Exp_{it} | 2175 | 2.8395 | 0.4491 | 1.9140 | 3.5628 |
| $Policy_{2005}$ | 2175 | 1.6667 | 0.3732 | 0 | 1 |
| RMG_Buyers_{it} | 2175 | 3.5561 | 0.1674 | 0 | 1 |
| $Policy_{2005} \times RMG_Buyers_{it}$ | 2175 | 0.2111 | 0.4087 | 0 | 1 |
| $Regulatory\ Quality\ (RQ_{it})$ | 2175 | 1.2621 | 0.0534 | 1.0906 | 1.3569 |
| Political instability (PI_{it}) | 2175 | 0.3694 | 0.4833 | 0 | 1 |
| FDI_RMG_{it} | 2175 | 0.0862 | 1.3065 | 1.5818 | 1.4375 |

3.2 Difference-in-differences (DID) method

The use of a time dummy variable has been the standard strategy in most fields of economics to estimating the consequences of a policy change such as switching to a floating exchange rate (Miles, 2008), changing industrial policies for particular sectors (Chang & Li, 2021; Neureiter, 2019), or changing educational policies (Pedraja-Chaparro, Santín, & Simancas, 2016). Wooldridge (2013) provides an excellent explication based on Kiel and Katherine (1995) research on the effect of locating a waste incinerator on property values near the site using DID method. According to Slaughter (2001), if a certain set of countries has received some type of treatment or intervention at time t , the following empirical model can be considered,

$$y_{it} = \alpha + \beta d_t + \varepsilon_{it} \quad (1)$$

Where y_{it} is the dependent variable for a country i at time t , and d_t represents a dummy for the intervention and equals zero for $t = 0$ and one if $t = 1$ is employed.

To analyze the impact of 2005 industrial policies on the export performance of RMG industry, we used the DID method. Therefore, the model specification is as follows:

$$RMG_Exp_{it} = \alpha + \delta_0 Policy_{2005} + \beta_1 RMG_Buyers_{it} + \delta_1 Policy_{2005} \times RMG_Buyers_{it} + \sum_{i=1}^n \beta_i (X_{it}) + u_{it} \quad (2)$$

Where, X_i denotes the other control variables affecting the export of RMG such as regulatory quality, Political instability, FDI in RMG; u_{it} denotes the unobservable factors; $\delta_0, \delta_1, \beta_1,$ and β_i are the coefficients. Most importantly δ_1 represents the treatment effect which reveals the difference between treatment group and control group.

To use DID to determine the influence of industrial policy on RMG export performance, it is necessary, to have group of companies that functioned before the industrial policy of 2005 was implemented and also after the policy was implemented. To detect the effect of the policy, DID approach is applied by defining two dummy variables policy and RMG buyers. Except two binary variables other variables including dependent take the logged form. For this study, Average Treatment Effects on the Treated (ATET) is further considered as an estimate to assess the export performance of RMG companies operating before and after 2005 policy initiation and MFA phase out.

4 Analysis and Discussion

The empirical findings are discussed in this section. The empirical results of the DID model are presented in Table 2 and confirm the proposed hypothesis. The empirical results of models (1) and (2) show that industrial policies of 2005 have a positive impact on the RMG export with a 1 percent significant level. Similarly, RMG buyers have positive impact on RMG export with a significant level of 1 percent. The interaction term $Policy_{2005} \times RMG_Buyers_{it}$ indicates that industrial policy 2005 and RMG buyers together have positive impact on RMG export performance with a 1 percent significant level. These results confirm the hypothesis 1.

Table 2 shows the results of the controls, which are mainly compatible with the current literature. The empirical results indicate that Regulatory Quality (RQ) has positive impact on RMG export with a 1 percent significant level. This finding is consistent with previous research indicating that Bangladesh's regulatory quality considerably facilitates RMG exports (Ali, Grava, & Reaz, 2019; Roy, 2006). Political instability (PI_{it}) has a negative impact on RMG export but significant at a 1 percent level. This finding suggests that political instability is one of the factors impeding the overall performance of the clothing sector (Papon, Nabi, & Parvin, 2017). FDI of RMG sector has positive impact on RMG export with a 1 percent significant level. These findings are consistent with previous research suggesting FDI increases exports (Hossain & Hosoe, 2017; Islam, 2021).

Table 2: Regression Results of DID Model

| Model | (1) | (2) |
|---|-----------------------|------------------------|
| Dependent | RMG_export | RMG_export |
| $Policy_{2005}$ | 0.6909*** (0.0248) | 0.2801*** (0.0317) |
| RMG_Buyers_{it} | 0.1583*** (0.0219) | 0.1846*** (0.0169) |
| $Policy_{2005} \times RMG_Buyers_{it}$ | 0.1805*** (0.0302) | 0.1366*** (0.0233) |
| RQ_{it} | | 0.9712*** (0.2078) |
| PI_{it} | | -1.2841*** (0.1718) |
| FDI_RMG_{it} | | 1.2146*** (0.0418) |
| Constant | 2.3433*** (0.0191) | -1.1751*** (0.2667) |
| Observations | 2175 | 2175 |
| R Squared | 0.7995 | 0.8963 |

Notes: Standard errors are presented in parentheses. ***/**/* specify significance at the 1%, 5% and 10% levels, respectively

4.1 Average Treatment effects on the Treated (ATET)

To examine the economic significance of policy impact on RMG export, this paper further calculates and reports the average treatment effects on the treated of interaction term in Table 3. Since Policy and RMG_Buyers is a dummy variable, report the average treatment effects on the Treated derived from the DID model (1) and (2). The average treatment effect on the treated of interaction term on RMG_export is 0.1068 and statistically significant at the 1 percent level. The empirical results indicate that RMG exports increase on an average 10.68 percent after industry policy 2005 introduced and MFA phase out. This result further confirms the hypothesis 1.

Table 3: Average Treatment Effects on the Treated (ATET)

| Model | (1) | (2) |
|---|-----------------------|-----------------------|
| Dependent | RMG_export | RMG_export |
| $Policy_{2005} \times RMG_Buyers_{it}$ | 0.1776*** (0.0235) | 0.1068*** (0.0274) |
| Observations | 2175 | 2175 |

Notes: Robust standard errors presented in parentheses.

***/**/* reflect respectively 1%, 5% and 10% significance level.

4.2 Impact of Industrial Policies 2010 and 2016

Following 2005, two more industrial policies were initiated and implemented. To test the validity of our major findings, we looked at the impact of industrial policies on RMG export in 2010 and 2016. These two industrial strategies introduced new incentives for the RMG industry and modified previous policies. Table 4 shows the DID regression findings for industrial policy in 2010 and 2016 rather than 2005. Industrial Policy 2010 provides similar incentives for the RMG sector as IP 2005, such as the establishment of Economic Zones, Industrial Parks, High-Tech Parks, and Private EPZs (IP, 2010). While making some incremental changes, industrial policy in 2016 has some completely new inclusions, such as the establishment of training centers for RMG workers, the recognition of successful entrepreneurs through the conferment of state awards, and the special respect and privilege accorded to them by the state authority (IP, 2016). Table 4 shows that industrial policies in 2010 and 2016 had a significant and favorable impact on RMG exports. The interaction terms indicate that the results are favorable and significant. These findings also suggest that industrial policies play an important role in RMG export, and our base result is robust.

Table 4: Regression Results of DID Model with Industrial Policies 2010 and 2016

| Model | (1) | (2) | (3) |
|---|-----------------------|------------------------|---------------------------|
| | IP 2010 | IP 2016 | Pooling IP 2010 & IP 2016 |
| Dependent | RMG_export | RMG_export | RMG_export |
| <i>Policy</i> ₂₀₁₀ | 0.7891*** (0.0543) | | |
| <i>Policy</i> ₂₀₁₆ | | 0.8175*** (0.0213) | |
| <i>Policy</i> _{2010 & 2016} | | | 0.1243*** (0.0731) |
| <i>RMG_Buyers</i> _{it} | 0.1583*** (0.0219) | 0.1546*** (0.0169) | 0.1446*** (0.0169) |
| <i>Policy</i> ₂₀₁₀ × <i>RMG_Buyers</i> _{it} | 0.0905*** (0.0302) | | |
| <i>Policy</i> ₂₀₁₆ × <i>RMG_Buyers</i> _{it} | | 0.1023*** (0.0233) | |
| <i>Policy</i> _{2010 & 2016} × <i>RMG_Buyers</i> _{it} | | | 0.1055*** (0.0278) |
| <i>RQ</i> _{it} | | 0.9712*** (0.2078) | 0.9523*** (0.2456) |
| <i>PI</i> _{it} | | -1.2841*** (0.1718) | -1.4562*** (0.1067) |
| <i>FDI_RMGI</i> _{it} | | 1.2146*** (0.0418) | 1.3623*** (0.0678) |
| Constant | 2.3433*** (0.0191) | -1.1751*** (0.2667) | -1.7849*** (0.4523) |
| Observations | 1500 | 1500 | 1500 |
| R Squared | 0.7995 | 0.8963 | 0.9705 |

Notes: Standard errors are presented in parentheses.

***/**/* specify significance at the 1%, 5% and 10% levels, respectively

4.3 Robust Check with Alternative Model

We employed a logistic regression model to test the robustness of our base results. Logistic regression is commonly used to statistically assess the parameters associated to group differences in the before and post implementation of policies. The number of times export increases is utilized as the dependent variable in logistic regression to estimate the impact of industrial policy on RMG export. The logistic regression model's regression results are shown in Table 5. The results show that the 2005 Industrial Policy had a 1% substantial positive influence on RMG exports. The interaction term has a positive and significant impact on RMG export, which is consistent with our base results in Table 2.

Table 5: Regression Results of Logistic Regression Model

| Logistic Regression Model | |
|---|------------------------|
| Model | (2) |
| Dependent | RMG_export |
| <i>Policy</i> ₂₀₀₅ | 0.1245** (0.0457) |
| <i>RMG_Buyers</i> _{it} | 0.0692*** (0.0923) |
| <i>Policy</i> ₂₀₀₅ × <i>RMG_Buyers</i> _{it} | 0.1805*** (0.0302) |
| <i>RQ</i> _{it} | 0.7657*** (0.1238) |
| <i>PI</i> _{it} | -0.9884*** (0.1543) |
| <i>FDI_RMGI</i> _{it} | 0.6547*** (0.0543) |
| Constant | -0.4275*** (0.0230) |
| Observations | 2175 |
| R Squared | 0.7995 |

Notes: Standard errors are presented in parentheses.

***/**/* specify significance at the 1%, 5% and 10% levels, respectively

The empirical findings demonstrate that industrial policies play an important role in the exportation of the RMG goods and fill a research vacuum that has hitherto gone unnoticed. Our findings also corroborated the findings of Alam et al. (2017), focusing that industrial policies can play an important role in the development of Bangladesh's RMG industry. Over the last decade, Bangladesh's RMG industry has made significant strides in addressing growth concerns, particularly in diversifying clients and goods, boosting supplier and workforce performance, and strengthening compliance and sustainability. Though there is still some gap between policy initiation and implementation. Bangladesh can learn from Vietnam's planned implementation of its growth and diversification policy. The near-perfect synergy in the share of Man-Made Fibre (MMF) to cotton in line with global trends, while also maintaining an even balance of the basket's principal goods and export destinations, is exceptional (Majumdar et al., 2021). The commitment to provide improved living conditions and pay to workers while achieving a high level of environmental sustainability demonstrates how Vietnam has already vowed and entailed to a broader view of total appropriateness (Giang et al., 2021). Aside from duty-free access, enterprises in Vietnam benefit from a plethora of trade partners, tax breaks, and free land supplied by the government when these have played significant roles in the growth of a sector in a focused and planned manner (Nayak et al., 2019). Given the urgency of the circumstances, Bangladesh can also replicate similar incentives, if not more, in order to swiftly expand the Man-Made Fibre (MMF) industry. Cotton mill advantages could be altered so that less efficient mills are forced to transfer to other industries in keeping with the worldwide trend. Similarly, policymakers might concentrate on policies that assist the creation of more efficient and modern central bonded warehouses, as well as policies that promote industry innovation and encourage foreign investment.

5 Conclusion

Using a panel data set spanning 1991 to 2020, this paper investigates the pivotal impact of industrial policy on the export of Bangladesh readymade garments following the MFA phase out. To measure the policy impact, we used Difference in Differences (DID) method. The empirical findings show that the industrial policies have had a significant positive impact on the RMG export, and RMG exports increase on an average 10.68% after industry policy 2005 introduced. This finding also implies that Bangladesh's ability to overcome the negative impact of MFA abolition is heavily influenced by the 2005 industrial strategies for the RMG industry.

The paper provides empirical evidence that industrial policies have played key role in RMG export. Bangladesh's success in the RMG industry is supported by the government's prompt policy initiation and implementation. This paper does not go into detail regarding industrial policies and their impact on various industries; further research on the function of industrial policies in various sectors can be done.

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