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From Justice to Prosperity: The Rule of Law's Impact on Economic Performance in the European Union

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Abstract

The rule of law plays an important role in fostering and advancing economic growth, not just within the EU, but on a global scale. The purpose of this article is to provide insight into the complex connections between law and economic development by combining empirical research and theoretical perspectives, and thus to further contribute to a deeper understanding of their complex dynamics. Certain correlations that are commonly acknowledged are confirmed, along with few notable exceptions. The findings underscore the imperative to cultivate a nuanced comprehension of how the rule of law influences economic performance, as such understanding is crucial for the decision-making processes of policymakers and companies, allowing them to adopt informed and well-founded decisions.

Keywords: rule of law, economic performance, GDP per capita, Innovation index, Foreign Direct investments

JEL: K40, 047

Introduction

In the current era of global economic interdependence and a rapidly evolving economy, the pursuit of sustainable economic growth has become a paramount objective for nations around the world. Governments, policymakers, and scholars are seeking to identify the key factors that underpin successful economic development. Although conventional determinants such as natural resources, infrastructure and human capital continue to play an important role (Valkov, 2014), growing consensus highlights the critical importance of the rule of law.

The rule of law represents a fundamental principle that upholds the supremacy of legal frameworks within a society, ensuring that all individuals and entities are subject to a consistent and impartial system of justice. It encompasses essential principles such as legal certainty, predictability, accountability, transparency and safeguarding individual rights. The influence of the rule of law on economic performance and progress has received increasing attention and recognition in the academic, political and economic spheres in recent years.

One of the key contributions of the rule of law to economic performance and

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growth relates to its promotion of good governance and the prevention of corruption. By establishing an environment of fairness and transparency, the rule of law creates the conditions necessary for economic advancement. It fosters economic inclusion by providing an appropriate and supporting environment, enabling individuals and businesses to participate and flourish in the marketplace. Additionally, the rule of law acts as a catalyst for social cohesion and stability, building trust between citizens and institutions. When people have confidence in the fairness and efficacy of the legal system, they are more inclined to engage in economic activities, invest in education and skills development, and actively participate in innovation and entrepreneurship. Innovations have great significance as they have a positive impact on competitiveness, which in turn emerges as a key factor determining the future economic development of individual companies and countries (Shotarov, 2022).

Although the relationship between the rule of law and economic performance is increasingly recognised, the dynamics and intricacies of this connection remain subjects of ongoing scholarly debate. Thus, the objective of this article is to provide a more in-depth understanding of the multifaceted interactions between law and economic development by synthesising quantitative research and theoretical perspectives.

1. Understanding the Rule of Law concept

The rule of law concept is a fundamental principle of legal and political theory and is recognised as an essential element of democratic societies. Despite its importance, defining the rule of law is a complex task since it has a multifaceted nature and different interpretations over the years. Although this concept could be traced back to Aristotle (Stanford encyclopaedia of philosophy, 2016), the present article provides a more recent brief overview of the main definitions and dimensions of the rule of law as proposed by prominent legal scholars, international organizations and institutions.

One of the earliest and most influential definitions of the concept was formulated by Dicey (1915), an eminent British jurist. He defines three fundamental principles that serve as pillars of the rule of law, the first being the supremacy of law. According to Dicey, under the rule of law, every individual, including government officials, is subject to and bound by the law. No one is exempt from legal obligations and everyone is equally responsible for their actions. The second pillar states that there should be equality before the law - the rule of law guarantees equal treatment and protection under the law for all individuals, regardless of their status, power, or influence. The third focuses on fundamental rights and civil liberties and emphasises that the rule of law encompasses the protection of individual rights and civil liberties. The law provides a framework for the exercise and enforcement of these rights, ensuring citizens' autonomy and dignity. Although his concept could be defined as 'ambiguous in certain respects' (Graig, 2007), Dicey's formulation of the rule of law is influential and has shaped the legal and political discourse of the concept.

In contemporary discourse, scholars and institutions have expanded the classical formulation, offering nuanced definitions that capture additional dimensions of the rule of law. With reference to the "inclusivity" of the definitions, in the literature a common distinction is also used that captures the complexity of the concept. Thin (narrow, formal) and thick (broad, substantive) concepts on the rule of law exist and while the first contain only the basic dimensions, the latter may contain other supplementary traits (Gutmann and Voigt, 2018).

From an institutional perspective, the rule of law is understood as the existence and effectiveness of institutions and procedures that protect legal certainty, impartiality, and access to justice. The legal scholar and eminent British judge Tom Bingham (2010) defines it as comprising eight core principles, including accessibility, clarity, fairness, and an independent judiciary. According to Bingham, these principles collectively constitute the rule of law, providing a framework for a democratic society. They guide the development and implementation of legal systems, ensuring that they promote fairness, equality, and the protection of individual rights.

Another perspective provided by Hertogh (2016) views the rule of law as a broader governance framework that encompasses not only legal institutions but also the quality of governance and adherence to democratic principles. This perspective highlights the importance of accountability, transparency, and citizen participation in governance processes. The author provides a comprehensive overview of the rule of law, its different dimensions, and the challenges of empirical study. He highlights the importance of the rule of law in ensuring justice and fairness in legal systems and the need for further empirical research to understand its impact on society.

A formal legal and widely recognized definition is provided by an independent, multidisciplinary organization - the World Justice Project. According to their understanding, 'the rule of law is a durable system of laws, institutions, norms, and community commitment that delivers' and is constituted on four universal principles (World Justice Project, n.d.): accountability, clear, fair, and publicly accessible laws, open government and accessible and impartial dispute resolution. Their understanding of what constitutes the concept could be defined as thick, and the index the Organization has constructed is rather complex and exhaustive with reference to the subfactors included.

The United Nations (UN) defines the rule of law as 'a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards" (United Nations and the rule of law, n.d. a). The UN's commitment to its application and significance is reflected in various resolutions and declarations, such as the 'Declaration on the Rule of Law at the National and International Levels' (UN general Assembly, 2013). It is recognized that effective legal frameworks and institutions are crucial in promoting investment, economic growth, and poverty eradication in all its forms such as health poverty that becomes a pressing problem (Veleva, 2022). The promotion of the rule of law is also embedded in SDG 16 that "articulates the key role that governance and the rule of law play in promoting peaceful, just, and inclusive societies and in ensuring sustainable development" (United Nations and the rule of law, n.d. b).

The European Union (EU) makes no exception in acknowledging the significance of the concept – the rule of law is a fundamental principle embedded in its legal and political framework and closely related to values such as democracy, human rights, and the protection of fundamental freedoms. This commitment is evident in EU treaties, communications from the European Commission, and resolutions of the European Parliament. The EU supports the rule of law on a global level by developing cooperation programs and including dedicated provisions in trade and association agreements with non-EU countries. The respect for the rule of law is imperative for the effective implementation of EU legislation, the smooth functioning of the internal market, the maintenance of an environment conducive to investment, and the preservation of mutual trust among member states. Various instruments are developed to promote and uphold it with a goal a rule-of-law culture to be established across the member states. The EU also has the ability to intervene at an early stage to mitigate risks of escalation, employing a dedicated Rule of Law mechanism that includes annual reports as a central tool (Pech, 2022; European Commission, n.d.; Eur-Lex, n.d).

The rule of law has long been recognized as a fundamental principle in legal and political theory and represents an essential component of democratic societies. Scholars and institutions have expanded on the classical formulation, offering nuanced definitions that capture additional dimensions of the concept. Its link with the economic performance of countries around the world has attracted significant interest over time, and various empirical and theoretical investigations have been dedicated to the topic, searching for the formula of successful balance between governance and economic outcomes.

2. How is the rule of law interlinked with economic growth?

In recent decades, academic interest has increased in the relationship between economic growth and the rule of law. This section reviews key publications, including empirical studies and theoretical perspectives aimed to clarify the multifaced relationship between the rule of law and economic performance.

Mauro (1995) investigates the relationship between corruption and economic growth. The author employs empirical analysis using cross-country data to explore the impact of corruption on economic growth, as a significant negative correlation between both is detected: higher levels of corruption are associated with lower economic growth rates. One of the key findings of the research is that corruption affects the allocation of public resources - corrupt practices tend to divert funds away from productive investments and public goods towards private gains. This hinders economic growth by hindering the development of essential infrastructure, education, and health care. Furthermore, Mauro highlights the negative impact of corruption on private investment. The lack of investment stifles economic growth and limits the creation of job opportunities. The article also discusses the mechanisms through which corruption affects economic performance. Corruption creates inefficiencies, increases transaction costs, and undermines trust in public institutions. Although the rule of law is not specifically mentioned in the publication, it stands opposite to corruption, which erodes it, weakens governance, and impairs the functioning of markets. These factors contribute to an unfavourable business environment and hinder economic development. Policies aimed at reducing corruption should focus on improving governance, enhancing transparency, strengthening institutions, and actually enforcing the rule of law.

La Porta et al. (1997) make an interlink between legal framework and economic stability: a robust legal framework is crucial for providing stability and predictability in the business environment, which in turn promotes economic growth. The authors explore the relationship between a country's legal system and its ability to attract external finance. The study uses a comprehensive data set that covers 49 countries to analyse the impact of legal factors on external financing mechanisms such as stock market development, bank lending, and bond issuance. The authors argue that a well-functioning legal system, characterised by strong investor protection, contract enforcement, and legal stability, is vital for a conducive environment for external financing. They observe that countries with stronger legal systems, which provide better investor protection and contract enforcement, exhibit higher levels of external financing activities. Additionally, legal factors have a more substantial impact on external financing in countries with weaker financial systems. The article emphasises the importance of legal institutions in promoting financial development and attracting external capital. It suggests that policymakers should prioritize legal reforms to strengthen investor protection, enhance contract enforcement mechanisms, and establish legal stability to foster a favourable environment for external financing.

In 2007, the Americas society and the Council of the Americas Working Group (2007) issued a report focused on the rule of law, economic growth, and prosperity. It states that the rule of law plays a crucial role in fostering business development and creating an environment that promotes economic growth. The Workgroup emphasises its importance in protecting individuals' political and human rights while instilling confidence in entrepreneurs and small business owners to participate in the formal economy and contribute to national development. There are four key aspects that play a vital role in attaining widespread economic development: ensuring fair and efficient legal systems, establishing effective regulations for business and investments, implementing alternative methods for resolving disputes, and safeguarding both physical and intellectual property rights. They form the foundation of the rule of law and significantly impact business operations and overall economic performance. A key factor examined is the need for a sound regulatory framework for business and investment. Simplifying regulatory codes, reducing business start-up costs, and ensuring a stable and transparent regulatory system can stimulate economic development, attract foreign direct investment, and generate sustainable growth. The rule of law not only safeguards fundamental rights, but also serves as a fundamental pillar for achieving fair and inclusive growth, fostering innovation, and attracting investment. To promote small business development and attract domestic and foreign investment, countries must address these fundamental challenges and prioritise the proper application and sustainable compliance of the rule of law. By doing so, they can consolidate a fair and accessible market economy, stimulate economic growth, and ensure prosperity for their citizens.

Haggard and Tiede's (2011) study provides further comprehensive assessment of the relationship between the rule of law and economic growth, contributes to the ongoing discourse on the topic, and underscores the need for further research and policy considerations in the area. The authors analyse existing literature and empirical studies to assess how the rule of law affects economic development. The study explores the various dimensions of the rule of law, including the protection of property rights, the enforcement of contracts, and the impartiality and effectiveness of legal institutions. Discussed are the mechanisms through which the rule of law promotes economic growth by providing a stable and predictable legal environment that promotes investment, innovation, and entrepreneurial spirit. The authors argue that it is positively associated with economic development, as countries with stronger legal frameworks tend to experience higher levels of investment, productivity, and overall economic performance. The importance of the quality of legal institutions and their enforcement capacity in ensuring the effectiveness of the rule of law is also highlighted. However, the study acknowledges that the relationship between the rule of law and economic growth is complex and is influenced by various factors such as cultural norms, political institutions, and historical legacy. The article concludes by suggesting that policymakers should prioritise the promotion of the rule of law as a crucial component of development strategies.

Another empirical research conducted by Özpolat et al. (2016), examines the relationship between institutional efficiency and economic growth in developed, developing, and underdeveloped countries. An argument is made that efficient institutional structures, including factors such as rule of law, corruption control, freedom of expression, political stability, bureaucracy quality, and protection of property rights, contribute to positive economic outcomes. These factors enhance the reliability of the economy, attract investments, and promote economic growth, particularly in developed countries. Furthermore, institutional factors play an important role in addressing income inequality. However, previous empirical studies have shown mixed results with respect to the impact of institutional efficiency on economic growth, particularly in developing countries. Some suggest that institutional efficiency has no effect or a negative effect on economic growth; therefore, it is argued to be not a cause but rather a consequence of economic growth. The relationship between governance dimensions and economic growth is analysed in high-, middle- and low-income countries. The findings indicate a positive correlation between indicators of rule of law, corruption control, voice and accountability, and GDP in high-income countries. However, the results for developing and underdeveloped countries are not statistically significant. The authors conclude that the positive relationship between the rule of law and economic growth is not applicable to middle and low-income countries. Based on evidence obtained from the analysis, the efficiency of institutional structures is viewed as a result rather than a determinant of economic growth.

In 2020, the European Economic and Social Committee issued an Opinion which emphasizes the significance of the rule of law in driving economic growth and provides recommendations for strengthening its implementation, measurement, and support within the EU context. The document focuses on the multifaceted impact of the rule of law on various aspects of society and economy. It emphasizes the critical areas where the rule of law influences economic growth and provides several recommendations. There is a pressing need to enhance the efficacy of current mechanisms, placing particular attention on the rule of law and placing

Source: World Bank Group, 2023
Figure 1. Why does justice matter for development?

greater emphasis on economic factors, as advocated in the discourse. Transparency and accountability are also highlighted as essential elements. The rule of law is acknowledged as integral to the EU's values and has far-reaching economic implications. Its erosion poses a threat to the functioning of the judiciary, fundamental rights, civil society, and the economy as a whole. Despite measurement challenges, efforts to develop comprehensive measurement systems are necessary for informed policy decisions.

In a more general sense, according to the World Bank, "when justice institutions operate effectively, accountability increases, trust in the government grows, and citizens and businesses can invest with confidence that their property rights will be protected" (World Bank Group, 2023). The presence of justice institutions plays a crucial role in accomplishing the World Bank's twin objectives of eradicating extreme poverty and promoting inclusive prosperity. Empirical research provides evidence of the significant impact of justice in fostering a favourable business environment, stimulating economic growth, ensuring equitable access to public services (especially for disadvantaged populations), combating corruption, and preventing misuse of power.

The World Bank states that justice serves as the foundation for the political process by safeguarding individuals' rights, facilitating collective action, and enabling trustworthy commitments. Justice institutions form the basis of the social agreement between citizens and the state. They address legal violations, provide remedies for rights infringements, and facilitate peaceful resolution of conflicts. In addition, they supervise state organisations and enforce regulatory functions. The effective operation of justice institutions improves accountability, fosters public trust in the government, and encourages people and businesses to invest confidently.

3. Research data and methodology

The literature review reveals the complexity of the rule of law and its fundamental relationship with governance, corruption, and economic performance: it acts as a critical instrument for promoting good governance and combating corruption, which are key determinants of economic growth (OECD, 2013b). However, quantifying the rule of law presents a challenge, even for reputable organizations such as the World Bank and OECD. The inherent complexities associated with measuring this concept cast doubt regarding the extent to which quantitative metrics could fully capture the multidimensional nature of the rule of law and its intricate relationship with economic indicators. Scholars and researchers acknowledge the need for a comprehensive and equitable approach to measurement. For example, Simion (2016) contends that a nuanced combination of both approaches is crucial for capturing the multifaceted aspects of the rule of law.

The present quantitative analysis is further supported with qualitative insights related to selected criteria for the quality of management and management capacity in the public sphere. Effective implementation and enforcement of laws and regulations are further indicators of quality management and management capacity in relation to the rule of law. Although they are not the primary focus of this study, it is important to acknowledge that they also play a significant role in the discussion and analysis. These aspects provide additional insights that could help explain correlations or the lack thereof. By considering them, a better understanding of the underlying mechanisms and dynamics in the relationship could be gained and their inclusion in the discussion would expand the overall analysis.

By utilizing quantitative methods, the research aims to explore the link between the rule of law, whose scores are derived from the World Bank Governance Indicators Data bank (n.d.), and three indicators of economic performance using quantitative methods. They are selected based on the literature review and described in Table 1. Although the chosen indicators are not exhaustive, they may serve as good starting points for further in-depth research. The analysis is limited to countries that are members of the European Union (EU) and covers two non-consecutive years: 2017 and 2020. The periods are intentionally selected to represent variations in economic performance: in 2017 for the first time since the 2008 financial crisis, the EU observed a

Table 1. Summary of research indicators

Indicators	Source database	Definition
GDP US dollars/ capita	OECD	This indicator is based on nominal GDP and is measured in US dollars per capita (current PPPs).
Innovation index (0-100)	theGlobalEconomy.com	The index includes two sub-indices: the Innovation Input Sub-Index and the Innovation Output Sub-Index. The first sub-index is based on five pillars: Institutions, Human capital and research, Infrastructure, Market sophistication, and Business sophistication. The second sub-index is based on two pillars: Knowledge and Technology Outputs and Creative Outputs. Each pillar is divided into sub pillars, and each sub-pillar is composed of individual indicators.
Direct investment in the reporting economy (flows) - Annual data,% of GDP (FDI % GDP)	Eurostat	FDI is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor.

Source: adapted from OECD, 2023a; TheGlobalEconomy.com, 2023, Eurostat, 2023 notable period of economic expansion, with an overall GDP growth rate of around 2.8 %. The second year (2020) was defined by the outbreak of the Covid-19 pandemic, which had severe implications on the economic performance of EU member states with a GDP growth rate of -5,7 % (World Bank Open Data, n.d.).

The quantitative research methodology is inspired by Wilkinson and Pickett (2010). Graphs are used to examine the association between the rule of law and the selected indicators related to economic performance. The rule of law index is represented along the horizontal line (x-axis) at the bottom. Societies with lower results are positioned towards the left side, while those with higher levels are positioned towards the right side of the graph. The vertical line (y-axis) on the left side of the graph represents the selected data related to economic performance. The graphs feature a scatter plot of data points representing the EU member states. This allows to observe how each country compares to others. Additionally, a trend line is included on the graph. It is selected based on its ability to accurately represent the relationship between the rule of law and the specific examined outcome. Additionally, a regression line is included on the graph as determined by the used software to represent the trend that best fits the data points. The inclusion of a best-fit line means that the observed relationship between the two indicators is highly unlikely to have occurred by chance and the rule of law could be deemed as a factor, accountable for certain part of the chosen variable.

4. Quantitative research results

4.1. Rule of Law and GDP per capita

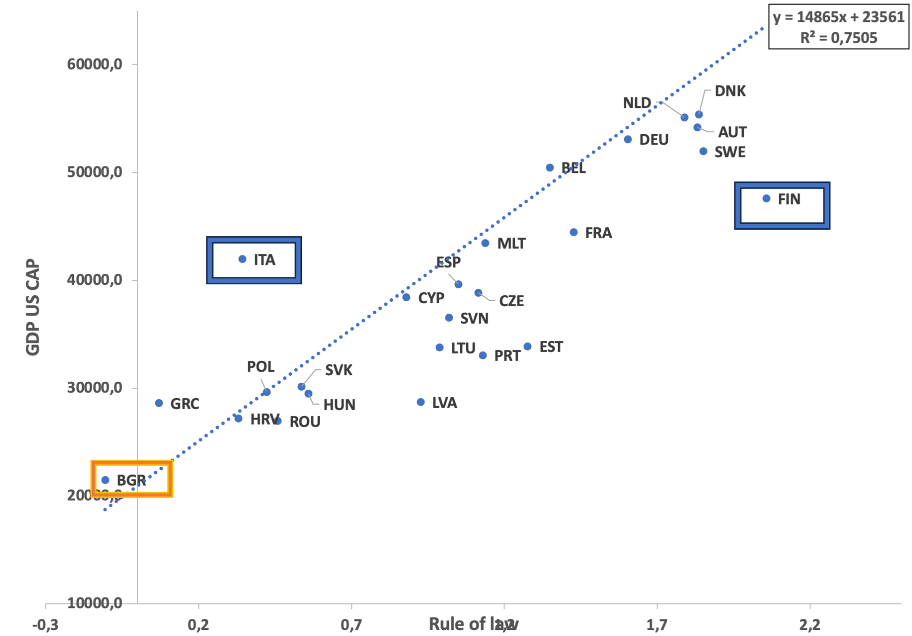
GDP per capita is widely acknowledged as a core indicator of economic performance, frequently used as a comprehensive measure of average living standards or economic well-being (OECD, 2013a). Based on prior scholarly investigations, a robust rule of law is anticipated to demonstrate a positive association with higher levels of GDP per capita.

Moreover, such relationship suggests that a conducive legal framework and effective governance are vital factors in fostering economic prosperity.

Figures 1 and 2 show a strong, positive correlation between the two variables for the selected periods. The regression coefficient indicates that the rule of law is a significant factor in the formation of GDP per capita and its significance is not influenced by the 2020 crisis. However, few exceptions are visible for both of the years, the first one being Italy. Despite its lower score on the rule of law, it has a significantly higher GDP per capita. On the other hand, it is interesting that Finland, despite having the highest score in terms of the rule of law, exhibits a comparatively lower GDP per capita compared to other robust economies within the EU.

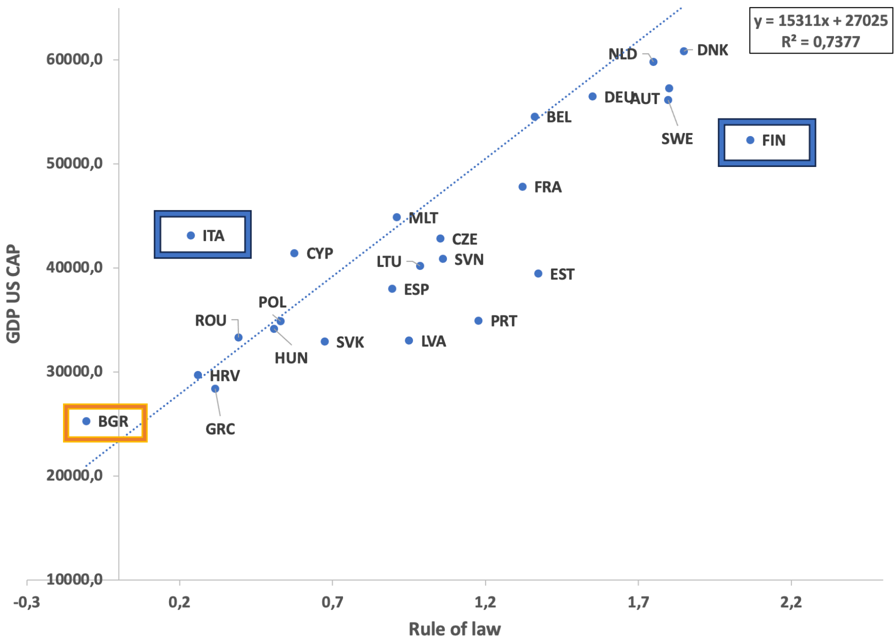
4.2. Rule of law and Innovation index

The relationship between the rule of law and innovation has been defined in various academic research and analyses. The principles of the rule of law, characterized by the existence of effective legal institutions, enforcement mechanisms, and property rights, play an important role in promoting innovation and technological progress. If entrepreneurs feel confident and assured that their innovative achievements would be adequately protected, they would be eager to invest in research and development (R&D).



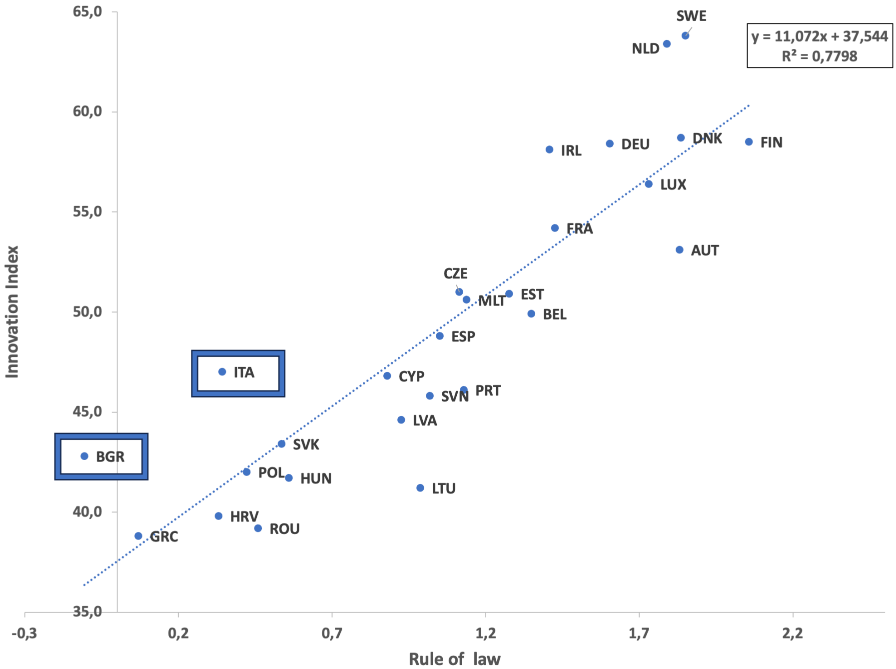
Source: Author's calculations

Figure 2. Rule of Law vs. GDP US CAP, 2017



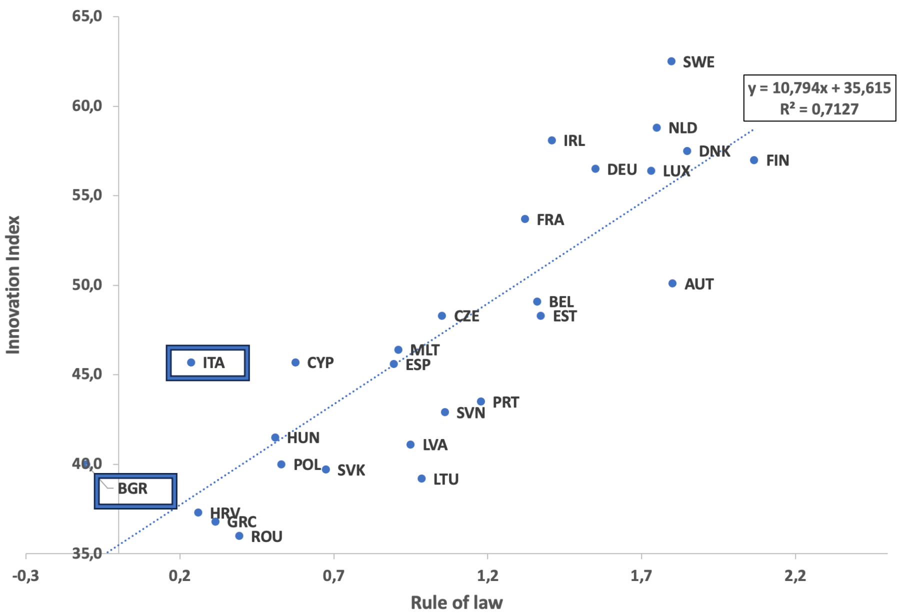
Source: Author's calculations

Figure 3. Rule of law versus GDP US CAP, 2020



Source: Author's calculations

Figure 4. Rule of law vs Innovation Index, 2017



Source: Author's calculations

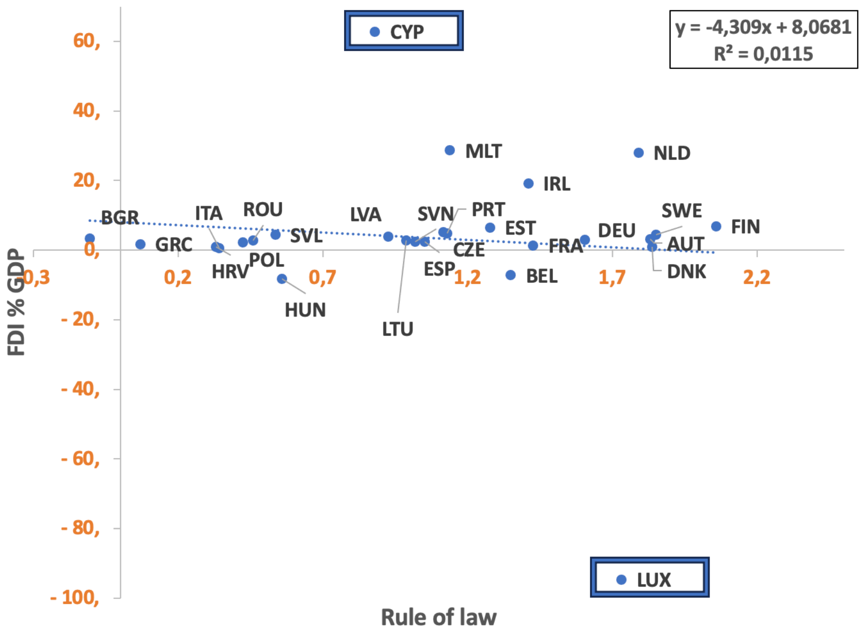
Figure 5. Rule of Law vs. Innovation Index, 2020

While it is generally expected that higher levels of the rule of law are associated with higher levels of the innovations, the results show that Bulgaria and Italy make an exception. In both examined periods, Bulgaria exhibits a significantly higher Innovation Index score compared to countries with higher GDP, such as Poland and Hungary, despite having the lowest score of the rule of law indicator. Italy, while slightly outperforming Bulgaria in terms of rule of law, also demonstrates a remarkable Innovation Index score in comparison to Greece, Romania and Croatia, which share a similar score on rule of law.

4.2. Rule of Law and Foreign Direct Investments

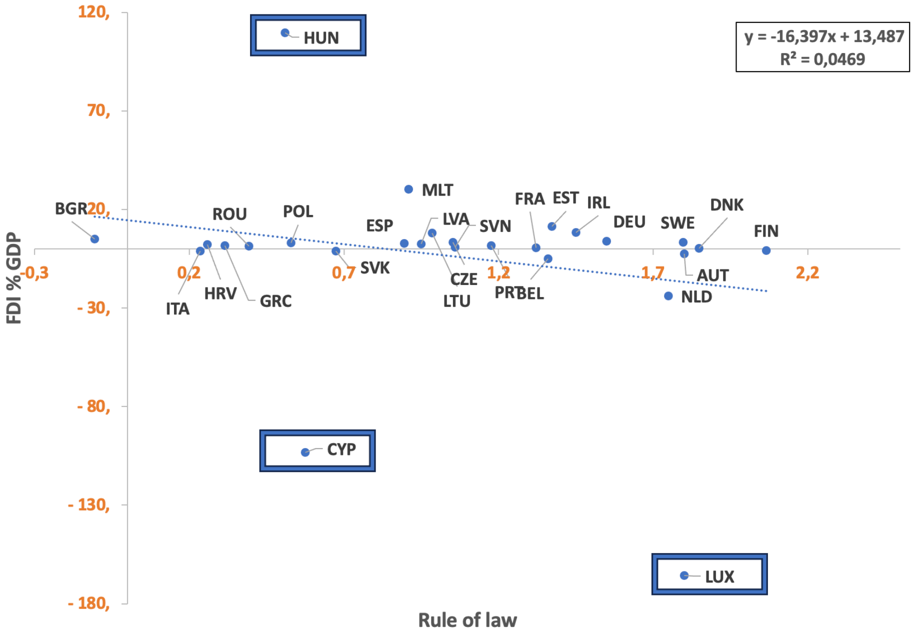
As stated in the Hogan Lovells report (2015) 'the Rule of Law is among the top three considerations when multinationals make FDI decisions, together with "ease of doing business" and "a stable political environment"'. The three major concerns related to the rule of law are corruption, political or social instability, and lack of transparency in rule-making. Conversely, the survey reveals that the most important elements of the rule of law for these investors are integrity, stability, and transparency.

In contrast to expectations, between the rule of law and foreign direct investment in the EU during selected periods no significant relationship is found. Also, countries with lower rule of law scores, such as Cyprus in 2017 and particularly Hungary in 2020, demonstrated higher levels of FDI as a percentage of their GDP. These findings highlight the complexity of the relationship between the rule of law and foreign investment and suggest that additional factors may influence investment decisions in



Source: Author's calculations

Figure 6. Rule of law vs FDI% GDP, 2017



Source: Author's calculations

Figure 7. Rule of law vs FDI% GDP, 2020

these specific contexts such as the overall quality of management and management capacity in the public sphere.

Discussion

The quantitative results of the research provide further insight into the intricate relationship between the rule of law and three key economic indicators with a focus on the EU member states. The strong positive correlation between the rule of law and GDP per capita was confirmed and coincides with results related to the more generalised link between economic growth and rule of law obtained by Mauro (1995), Haggard and Tiede (2011) and Bhagat (2020). The rule of law represents a key factor that sustains and promotes economic growth not only in the EU, but globally. Efforts with respect to its implementation and heightened application should be welcomed and supported by governments. For example, Bulgaria has faced many criticisms and challenges in upholding the principle, as concerns have been raised by domestic and international observers regarding issues such as corruption, political influence on the judiciary, and the effectiveness of law enforcement agencies. These challenges undoubtedly impact public trust in the legal system and hinder the full realization of the rule of law. The country has a long history of lowest and negative results with regard to its implementation. For the period 2008-2021 its average score is calculated at -0,08 points compared to the EU average score of 1,1 points (World Bank Data Bank, n.d.). Despite the fact that in recent years targeted economic, political, and legal measures have been taken to increase the accountability of public authorities (Boyanov, 2020, p. 21), this persistent trend continues to hinder Bulgaria's economic development and further integration. However, notable exceptions such as Italy challenge such interdependence - it demonstrates a higher GDP per capita despite a lower rule of law score. Similarly, Finland, despite its high rule of law score, exhibits a comparatively lower GDP per capita compared to other robust economies within the EU.

These exceptions raise further questions and confirm that factors beyond the rule of law influence economic outcomes, and they also differ on county level. When public organizations operate transparently and efficiently, it enhances investor confidence and attracts domestic and foreign investments (OECD, 2003). This can contribute to economic growth and, in turn, increase GDP per capita. Transparent decision-making processes, fair procurement practices, and efficient resource allocation could further add to a favorable business environment. For example, the adoption of digital platforms and tools in promoting transparency, accessibility, and fairness within the legal system could significantly enhance the rule of law by facilitating easier access to legal information, improving efficiency, and fostering evidence-based decision-making (OECD, 2023b, p.27). Similarly, adherence to the rule of law ensures a stable and predictable legal environment for businesses by promoting contract enforcement, protects property rights, and reduces the risk of arbitrary actions. This fosters a climate of trust, encourages investment, and supports economic development. Effectively combating corruption is vital for economic growth. When public organizations have strong anti-corruption measures in place, it reduces corruption-related barriers to business operations, improves governance, and promotes fair competition. The professionalism and integrity of public officials can impact the business environment and economic growth. When public officials act ethically and exhibit high levels of professionalism, it reduces the risk of corruption, enhances public trust, and facilitates economic activities (UNODC, n.d.) thus positively influencing GDP per capita.

With reference to the link between rule of law and innovations, the results largely confirm the existence of a strong, positive correlation with most countries aligning with the expectations. However, there are two interesting exceptions that deserve attention. They highlight the presence of additional factors that contribute to innovation in these contexts and deserve further exploration. The innovation index is a complex, multidimensional construct built on 80 indicators, including measures on the institutional and business environment, education, infrastructure, and knowledge creation. Behind these results there might be national specifics that restrain the influence of the rule of law on the innovation environment and provide conditions that overcome the local need for legal and administrative reforms. One crucial criterion for assessing the quality of management and management capacity in the public sector regarding the link between the rule of law and innovations is the identification of sector-specific strengths and historical investments in research and development. This criterion recognizes that the relationship between the rule of law and innovation can be influenced by unique factors within each country. For instance, in the case of Bulgaria, the rapid growth of the ICT sector plays a significant role (International Trade Administration, 2022a) while Italy's historical pro-investment culture, robust manufacturing base, hi-tech performance and established tradition of innovations contribute to its appealing national landscape (Wolters Kluwer, 2020).

Effective management entails leveraging these sector-specific strengths and historical investments by providing targeted support, creating conducive regulatory frameworks, fostering collaborations, and strengthening linkages between research institutions, industry, and the public sector. By considering these context-specific factors, policymakers can develop tailored strategies to enhance innovation, considering both the rule of law and the specific dynamics of different sectors (European Commission, 2014).

While the first two results coincide with the common understanding and empirical results, the analysis of the relationship between the rule of law and FDI as percent of the GDP provided unexpected results. Strong rule of law typically creates a favourable investment climate by providing stability, predictability, and legal protection for businesses. When investors perceive that a country has a robust legal system and effective governance, they are more likely to invest. Contrary to expectations, no significant correlation between both indicators is observed at the EU level for the selected years. One of the explanations may lie in the fact that although the rule of law is an important factor in attracting FDI, it is not the sole determinant.

Despite the lack of correlation, notable exceptions exist such as Hungary in 2020. In the year the pandemic hit, the country had much higher FDI flows compared to other EU member states with far better rule of law scores. This comes as a result of the dedicated investment incentives that the Hungarian government implemented related to specific economic benefits for foreign investors, such as preferential tax conditions, special economic zones, etc. Hungary also has an advantageous central location in Europe and well-developed infrastructure. Between 1989 and 2019 the country received approximately USD 97.8 billion in FDI primarily in sectors such as banking, automotive manufacturing, software development and life sciences. The local government actively encouraged investments in sectors that promise high added value and employment, including R&D, defence, and service centers, while facilitating investment activities through measures such as reducing the corporate tax rate to 9% in 2017, the lowest in the EU (International Trade Administration, 2022b). In 2020, FDI by Asian sources accounted for more than 30% of newly attracted FDI which marked an annual CAGR of 500%, primarily due to the closure of an important deal for a second Samsung SDI plant for batteries (Gupta, 2023). However, the adopted policy of national favoritism and corruption-prone problems led to the country's second lowest level of FDI as percent of the GDP in 2022 falling to -7% (Eurostat, 2023).

As seen in the Hungarian case, there are other factors, such as economic stability, political environment, infrastructure, and market potential, which could influence the flow of FDI more strongly and play a significant role in investment decisions. According to Zhang and Liu (2021, p. 121) 'to attract more inward FDI into the host country, the overall level of Rule of Law should be enhanced. For which, corruption should be constrained, government regulations should be enforced effectively, and the governance should be more open.' The absence of a significant correlation between the rule of law and FDI emphasises the need for policy makers and business entities to consider a broader set of factors when promoting, devising and evaluating the attractiveness of a country or a region and adopt a 'thick' understanding of the concept of rule of law combined with national specifics, policy design and cultural context. Such an approach could provide a more comprehensive framework for assessing the investment potential and creating an environment conducive to sustainable economic growth. They could be, for example, related to legal certainty and investor confidence (The Constitution unit, 2022). When public management effectively upholds the rule of law, it reduces the perceived risks for foreign investors, making the country more attractive for FDI (Hassan, 2022). Transparent public management practices foster a transparent business environment, which is highly valued by foreign investors. When public organizations operate with transparency and accountability, it reduces the potential for corruption and arbitrary decision-making. This transparency enhances the credibility and attractiveness of the investment environment, leading to increased FDI inflows. A robust legal system and effective dispute resolution mechanisms are crucial for protecting the interests of foreign investors. When government regulation ensures investor protection, including fair treatment, access to legal remedies, and efficient dispute resolution, it instills confidence in foreign investors. This, in turn, can positively influence the level of FDI as a percentage of GDP. The efficiency of business regulations that prioritize streamlined administrative procedures, and reduced bureaucracy could attract foreign investors. When the regulatory environment is well-managed and business-friendly, it reduces barriers to entry and facilitates smoother operations for foreign companies, thereby encouraging higher FDI inflows. Moreover, when public management ensures that contracts are enforceable and intellectual property rights are protected, it provides a secure business environment for foreign companies, strengthens investor confidence and contributes to an increased FDI (OECD, 2002).

Conclusion

Quantitative analysis, despite its inherent limitations, serves as a valuable starting point for policymakers and researchers to explore the relationship between governance indicators, such as the rule of law, and national economic performance. It offers a foundation for comparative analysis and provides a means of estimating and monitoring the influence of government indicators based on available data from reliable sources. However, to gain a comprehensive understanding, it is essential to further incorporate additional criteria to assess the quality of management and management capacity in the public sector. By doing so, a more complete picture could be created, enabling a more nuanced evaluation of the interplay between governance indicators and national performance. This holistic approach ensures that policy makers and researchers can make informed decisions and take the necessary actions to improve governance practices and promote effective public management for sustained development.

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