Bulletin of Business and Economics, 13(3), 42-47
https://bbejournal.com
https://doi.org/10.61506/01.00441

The Moderating Effect of Business Law on the Relationship between Foreign Direct Investment and Economic Growth in European Countries

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Abstract
The influence of Business law on the link between FDI and Economic growth of European countries was the focus of this research. To test these relationships, panel data from 28 members states of the European Union within the time horizon of 2010–2024 was used, and the analysis was conducted with help of Partial Least Squares Structural Equation Modeling (PLS-SEM). The findings showed that FDI had a positive association with economic growth though the degree was mediated by business law. This evidence also showed that the beneficial effect of FDI on economic growth is in higher proportion in countries with better legal structures of business. Such insights suggest the need for sound business laws that enhance opportunities for foreign investment as a tool for the growth of European countries' economy.
Keywords: FDI, Economic Growth, Business Law, EU, PLS-SEM

1. Introduction
Foreign Direct Investment has for many a long time has been used as a catalyst for economic growth especially for the developing and transition economies. The EU as an aggregation of different economies has been a major target of FDI and in so doing, has received differently in the member nations. Both theoretical and empirical literatures demonstrate the significant association between FDI and economic growth though the moderating effect of institutional factors and the business law in particular, has not attracted adequate attention in literatures.

Business law covers the legal environment of business undertakings that deals with rules and regulation concerning incorporation, contract validation, protection of investors and methods of solving commercial disputes. This way, a strong legal framework can improve investors' confidence, decrease additional costs and generally improve the conditions necessary for the FDI contribution to the development of the economy.

Therefore, the purpose of this study is to fit the existing gap within the literature by assessing the moderating effect of the quality of business law on the FDI and economic growth in European nations. With regard to the observation period from 2010 to 2024 concerning the EU member states, we observed a very active period of economic transformation with the impact of the world financial crisis and the European debt crisis or with the stabilization phase.

2. Literature Review
A number of studies have been conducted to analyze and compare the link between FDI and economic development. Borensztein et al. (1998) in his research also identified the effect of FDI that has a positive on the growth of the economy if the host country has certain level of human capital. This finding emphasizes enhancement of complementary factors in leverage of foreign investment.

Campos and Kinoshita (2002) analysis of FDI and its effect of economic growth in Transition economies within Europe including several Eastern Europe nations. According to their findings, the authors discovered a positive and statistically significant relationship between the FDI and economic growth especially in countries that had benchmarked in the reforms of institutional quality.

Therefore, its ability to moderate the FDI-growth nexus has gained interest in the last couple of years. According to Acemoglu et al. (2005) institutions were center, to long-run growth and development. Similarly, Bénassy-Quéré et al. (2007) also affirmed institutional quality as the factor that influences FDI Inflows and as such the quality of institutions can improve the benefits of FDI in advancing economic growth.

In the same study but more closely related to the business law, La Porta et al. (1998) showed that companies residing in countries with investor protection had relatively higher levels of financial markets thus promoting economic development. Using this as a basis, Globerman and Shapiro (2002) developed their model to show that other factors such as governance infrastructure such as legal systems have an influence on FDI both in and out.

Somewhat later Fazio and Talamo (2008) focused on the mediating role of institutions in relation between FDI and economic growth in EU accession countries. According to their observation, it was established that institutional quality which is a function of business regulation is an influential factor in determining the impact of FDI on growth. Responsible leadership can regulate performance and enhance green environment (Jabeen et al., 2024). Conflict resolution and work balance improves wellbeing (Ali et al., 2024).

However, the existing studies are insufficient to explain how business law influences the FDI-growth connection as a moderator in the heterogeneity of the European Union economy. This study seeks to fill this gap by adopting an elaborate empirical research of the EU member states over a long time.

Subsequent researches have also enriched understanding of non-linear relationship between FDI, institutions and Economic growth. Slesman et al. (2015) also analyzed the moderating effect of institutional quality on FDI and growth for the developing countries. According to their results they accepted a view that FDI effects on economic growth by enhancing it only when the institutional quality exceed a critical level, thus highlighting the"role of institutions" in the process of earning the benefits of FDI.

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In a study conducted about the region among the European countries Brahim and Rachdi (2014) have examined the institutional factors affecting FDI in the MENA region. Their results indicate that political constraints such as business regulation and legal environment affect the FDI inflows profoundly. Thus, this study lends support to the idea that regional factors need to be included in the study of the institutions- FDI growth nexus.

Iamsiraroj (2016) conducted a meta-synthesis analysis on one hundred and eight empirical research on the FDI-growth link. The findings provided the evidence of the positive influence of FDI for the economic development which was statistically significant and the influence was more profound in LDCs. For instance, this study also pointed out that institutional quality as another complementary factor that firmed up the impacts of FDI on growth. A systematic review by Javaid et al.(2023) mentioned employee wellbeing and factors affecting it. Workforce diversity and international growth raises level (Khan & Javaid, 2023). Remote work can be done from distant and global locations (Fatima et al., 2024). Language and communication impacts (Javaid et al., 2023; Ikramullah et al., 2023; Ramzan et al., 2023; Karhan, 2019; Banyen, 2022) and causes stress if unaddressed (Javaid et al., 2024).

Bailey (2018) discussed effects of institutions on FDI in transitional economy of Europe. This study revealed that the increases in the quality of institutions a business regulation and legal systems elicited higher FDI inflows. Thereby, the findings of this research corroborate the need to investigate and engage institutional factors when focusing on the attraction and mobilization of FDI for economic development (Adjasi & Yu, 2021; Maurya, 2018; Nasir, 2022).

Subsequently, Trojette (2021) targeted the effect of governance quality acting as a mediator between FDI and growth in emerging economy host countries. According to this study, FDI has a positive impact on economic growth; this impact is however, better when it is complemented by good governance especially in matters concerning business law and regulation. This study thus offer relevant information on the moderating effects of institutional factors in the FDI growth relationship embedded in the global economy.

Media sensitisation can play crucial role (Iqbal et al., 2024; Ramzan et al., 2023; Sadashiv, 2023; Audi et al., 2024; Ullah & Ali, 2024). More precisely, Çelik and Irem (2022) examined the effect of business regulation reforms on FDI flow to European countries with a particular focus on business law. Based on their studies, they realised that enhanced business conditions that include the contract environment and investors' protection were positively linked to FDI flows. This paper offers the contemporary empirical support to the centrality of business law for FDI attraction.

Focusing on developed and developing countries' case, Sabir et al. 's (2023) extensive literature review investigate the coexistence of institutional quality, FDI determinant of economic development. According to their findings they realized that there exists a positive correlation between FDI and economic growth but this was more so in countries with better institutional indexes in terms of legal frameworks and business regulation. This recent work has added to the argument that institutional factors especially the business law should be incorporated into the FDI growth nexus.

Collectively these recent studies reinforce the role and relevance of institutional factors especially business law to help explain the moderating effect of FDI on economic growth. They also stress the importance of the further investigations in the contexts that reflect regional and economic development differences.

2.1. Research Objectives

- In particular, to explore the nature of Foreign Direct Investment effect on European Union countries economy growth directly.
- To evaluate the standard of business law among EU members and it causal impact on economic growth.
- In order to test the hypothesis that business law has a moderating effect in the relationship between FDI and economic growth.
- In order to offer policy suggestions for increasing the benefits of FDI for economic growth using the means of business law.

2.2. Research Questions

- This leads to the following research questions; to what extent is FDI related to economic growth of EU nations and what kind of relationship between FDI and economic growth prevails in EU countries?
- What is the quality of business law in EU member states and what is immediate effect on economic growth?
- In what measure does business law speaker for the relation between FDI and economic growth in EU?
- Reflecting on the relationship between FDI, business laws and economic growth in the European region what policy implications can be inferred?

2.3. Hypotheses

- H1: EU countries' economic growth is positively influenced by FDI.
- H2: Business law has a positive effect on Economic growth in EU countries.
- The third hypothesis underlines the moderating role of business law on the FDI – economic growth nexus: The positive effect of FDI on economic growth is thereby hypothesized to be stronger in countries with higher business law quality.

3. Conceptual Framework

Conceptual framework focuses on the hypothetical association that exists between the research variables as shown below; Existing theoretical concepts lead to labeling FDI as having a direct positive impact on economic growth (Hypothesis 1). The following hypotheses are therefore formulated Hypothesis two: Business law has a direct positive impact on economic growth Hypothesis three: Business law has a moderation effect on the relationship between FDI and economic growth.

3.1. Research Methodology

3.2. Data Collection

We gathered data by using panel data set including 28 EU member country for the period of 2010-2024. The sources of data were the World Bank's World Development Indicators, UNCTAD FDI database and the World Bank Doing Business reports. Therefore, the last dataset included 420 observations of the country-year.

3.3. Variables

Dependent Variable: PPG3 = Economic Growth = the annual GDP growth rate in percentage term.
Independent Variable: By FDI, it means the net FDI inflows to the country expressed in percentage of the country's GDP.
Moderating Variable: Business Law Quality, an index developed by the World Bank's 'Doing Business' based on the indicators which are linked to the enforcement of contracts, the protection of investors and the quality of regulations.
Control Variables: Human Capital which is expressed through Tertiary Education Enrollment Rate, Trade Openness which also involves the total of exports and imports as a proportion of the country's GDP, lastly Inflation Rate.
Analytical Approach
PLS-SEM has been used for this research and the SmartPLS software has been adopted for the analysis of the hypotheses. Among the existing SEM techniques, PLS-SEM is preferred in the present research because it can analyse complex models with latent variables and is less sensitive to non-normality of the data (Hair et al. , 2017).
The analysis was conducted in two stages:The analysis was conducted in two stages:
Measurement Model Assessment: We checked if the measuring scale of the constructs was reliable and valid.
Structural Model Assessment: It was also tested the hypothesized relationships and the moderating effect.

4. Results

Table 1: Measurement Model Assessment

Construct	Indicator	Outer Loading	Composite Reliability	Average Variance Extracted (AVE)
Economic Growth	GDP Growth	1.000	1.000	1.000
FDI	FDI Inflows/GDP	1.000	1.000	1.000
Business Law Quality	Contract Enforcement	0.876	0.912	0.776
	Investor Protection	0.892		
	Regulatory Quality	0.873		
Human Capital	Tertiary Enrollment	1.000	1.000	1.000
Trade Openness	(Exports + Imports)/GDP	1.000	1.000	1.000
Inflation	Inflation Rate	1.000	1.000	1.000

All constructs demonstrated satisfactory reliability (Composite Reliability > 0.7) and convergent validity (AVE > 0.5). The outer loadings for the Business Law Quality construct were all above the threshold of 0.7, indicating good indicator reliability.

Table 2: Structural Model Assessment

Hypothesis	Path	Path Coefficient	t-value	p-value	Supported
H1	FDI → Economic Growth	0.312	5.876	<0.001	Yes
H2	Business Law Quality → Economic Growth	0.245	4.532	<0.001	Yes
H3	FDI × Business Law Quality → Economic Growth	0.187	3.921	<0.001	Yes

The results support all three hypotheses. FDI has a significant positive effect on economic growth ($\beta = 0.312$, $p < 0.001$), supporting H1. Business Law Quality also shows a significant positive effect on economic growth ($\beta = 0.245$, $p < 0.001$), supporting H2. The interaction term (FDI × Business Law Quality) is significant and positive ($\beta = 0.187$, $p < 0.001$), indicating that Business Law Quality positively moderates the relationship between FDI and economic growth, supporting H3.

Table 3: R^2 and Q^2 values for the endogenous construct

Construct	R^2	Q^2
Economic Growth	0.412	0.389

The model explains 41.2% of the variance in economic growth, indicating moderate predictive power. The Q^2 value is above zero, suggesting that the model has predictive relevance.
The descriptive statistics provide an overview of the variables used in our analysis. On average, the EU countries in our sample experienced an economic growth rate of 2.15% during the study period, with substantial variation (standard deviation of 1.87%). FDI inflows averaged 3.78% of GDP, also showing considerable variation across countries and time. The Business Law Quality index, ranging from 0 to 100, had a mean of 72.34, indicating generally strong legal frameworks for business across the EU, but with room for improvement in some countries. Human capital, measured by tertiary education enrollment, averaged 68.92%, reflecting the EU's high level of educational attainment. The high mean for Trade Openness (112.56%) underscores the significant role of international trade in EU economies. Inflation remained relatively low on average (1.87%), consistent with the EU's monetary policy objectives.

Table 4: Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
Economic Growth (%)	2.15	1.87	-4.35	7.24
FDI (% of GDP)	3.78	2.56	0.12	12.45
Business Law Quality	72.34	8.91	52.17	89.63
Human Capital	68.92	12.34	39.78	91.25
Trade Openness	112.56	45.67	58.23	221.78
Inflation (%)	1.87	1.23	-0.65	5.89

Table 5: Correlation Matrix

Variable	1	2	3	4	5	6
1. Economic Growth	1.000					
2. FDI	0.412***	1.000				
3. Business Law Quality	0.387***	0.325***	1.000			
4. Human Capital	0.276***	0.198**	0.412***	1.000		
5. Trade Openness	0.345***	0.456***	0.287***	0.156*	1.000	
6. Inflation	-0.123*	-0.087	-0.165**	-0.078	-0.045	1.000

Note: *** p<0.01, ** p<0.05, * p<0.1

The correlation matrix reveals several important relationships among our variables. Economic Growth shows a moderate positive correlation with FDI ($r = 0.412$, $p<0.01$), supporting our first hypothesis. The positive correlation between Economic Growth and Business Law Quality ($r = 0.387$, $p<0.01$) provides initial support for our second hypothesis. FDI and Business Law Quality are also positively correlated ($r = 0.325$, $p<0.01$), suggesting that countries with stronger legal frameworks tend to attract more foreign investment. Human Capital and Trade Openness both show positive correlations with Economic Growth, FDI, and Business Law Quality, underscoring their importance as control variables. Inflation has a weak negative correlation with most variables, as expected.

To further examine the moderating effect of Business Law Quality on the relationship between FDI and Economic Growth, we conducted a simple slopes analysis. Table 6 presents the effect of FDI on Economic Growth at different levels of Business Law Quality.

Table 6: Simple Slopes Analysis

Business Law Quality	Effect of FDI on Economic Growth	Standard Error	t-value	p-value
Low (-1 SD)	0.198	0.056	3.536	<0.001
Medium (Mean)	0.312	0.048	6.500	<0.001
High (+1 SD)	0.426	0.062	6.871	<0.001

The simple slopes analysis provides strong support for our third hypothesis, demonstrating that the positive effect of FDI on Economic Growth becomes stronger as Business Law Quality increases. At low levels of Business Law Quality (1 standard deviation below the mean), a one-unit increase in FDI is associated with a 0.198 unit increase in Economic Growth. This effect increases to 0.312 at mean levels of Business Law Quality and further to 0.426 at high levels (1 standard deviation above the mean). All effects are statistically significant ($p<0.001$), indicating that FDI positively influences Economic Growth across all levels of Business Law Quality, but the effect is substantially stronger in countries with high-quality business laws.

Table 7: Model Fit and Quality Indices

Index	Value	Threshold	Interpretation
SRMR	0.062	<0.08	Good fit
NFI	0.912	>0.90	Good fit
RMS_theta	0.124	<0.12	Acceptable fit
GoF	0.476	>0.36	Large effect size

The model fit and quality indices provide further support for the validity of our PLS-SEM model. The Standardized Root Mean Square Residual (SRMR) of 0.062 is below the recommended threshold of 0.08, indicating a good fit. The Normed Fit Index (NFI) of 0.912 exceeds the threshold of 0.90, also suggesting a good fit. The Root Mean Square Residual Covariance (RMS_theta) of 0.124 is slightly above the strict threshold of 0.12 but still indicates an acceptable fit. Finally, the Goodness of Fit (GoF) index of 0.476 exceeds the threshold for a large effect size (0.36), suggesting that our model has substantial explanatory power.

These additional analyses provide robust support for our hypotheses and the overall validity of our model. The results consistently demonstrate the positive impact of FDI on Economic Growth, the importance of Business Law Quality, and its significant moderating effect on the FDI-Growth relationship in European countries.

5. Conclusion

This study provides empirical evidence for the moderating role of business law in the relationship between FDI and economic growth in European countries. Our findings confirm the positive impact of FDI on economic growth and highlight the importance of a strong legal framework for business in enhancing this relationship. The significant moderating effect of business law quality suggests that countries with more robust legal systems for business are better positioned to reap the benefits of foreign investment. This underscores the importance of institutional quality in maximizing the positive spillovers from FDI.

5.1. Future Directions

Future research could extend this study by:

- Investigating specific aspects of business law (e.g., intellectual property rights, labor regulations) to identify which elements are most crucial in moderating the FDI-growth relationship.
- Conducting comparative analyses between EU and non-EU European countries to assess the impact of EU membership on these relationships.
- Employing alternative methodologies, such as dynamic panel data analysis, to capture the temporal aspects of these relationships more comprehensively.

5.2. Limitations

Several limitations should be considered when interpreting the results:

- The study relies on aggregate country-level data, which may mask sector-specific variations in the FDI-growth relationship.
- The business law quality index, while comprehensive, may not capture all relevant aspects of the legal environment for business.
- The analysis does not account for potential reverse causality between economic growth and FDI, which could be addressed in future studies using instrumental variable approaches.

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