

ANALYSIS OF INVESTMENT ACTIVITY IN THE BALTIC REGION

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The article studies the role of foreign capital in the Baltic countries. The subject of the study is the structure and dynamics of foreign capital in Latvia, Lithuania and Estonia. The goal is to analyze the influence of foreign capital on the economic development of the Baltic countries. The objective is to consider in more detail the flows of foreign direct investment, portfolio investment and other types of investments, to identify the main investor countries, to consider the balance of payments and to construct regression models of influence of foreign capital on the economic development of countries. General scientific methods are used: scientific abstraction, comparative, method of analysis and synthesis, systematization and generalization, method of calculation, and also a method of regression analysis. The following results are obtained: investment activity is an important component for the economies of the Baltic countries. The leader in attracted capital not only in the region, but also in the EU is Estonia, and in terms of investment abroad – is Lithuania in the Baltic region. The main areas where capital is directed are: financial sector, industrial and IT-technologies. Regression analysis shows that the outflow of capital from the Baltic countries abroad positively affects the development of their economies. Conclusions: the balance of payments regulation for Latvia should take place only by increasing the "credit" part of the current account, and for Lithuania – by increasing both the current account and the investment liabilities, because there is the inverse dependence of GDP on investment income, which is directed to foreign investors in the model for the first country, while for Lithuania there is a direct dependence of exports on investment income abroad.

Keywords: direct foreign investments, portfolio investments, other types of investments, the Baltic countries, investment income, balance of payments.

Problem statement. After the entry of the Baltic States into the European Union, it turned out that the GDP growth rate had reached a high level, namely 8-10% per year. However, the problem was that this increase was not due to the organic development of their economies, but increased the number of financial transactions of Scandinavian banks that carry out massive credit expansion. Besides, the Baltic States were receiving increased subsidization, which was expressed in the payment of compensation for the closure of production that was not necessary for the European Union market [1]. Regarding to the current dynamics of the main macroeconomic indicators, at the beginning of 2019 [8], the GDP growth rate in Estonia was 4.5%, in Latvia - 3%, and in Lithuania - 4%. The inflation rate in these countries was 3.1%, 3.3% and 2.7%, respectively. At the same time for 1996-2018 the average value of the exports of goods and services of Estonia exceeded the value of inflow of foreign capital by 6.3 times, of Latvia by 4 times, and of Lithuania by 8.5 times. And according to the public debt indicator in the Baltic States, the Maastricht criteria have been met, with one of which the debt should not exceed 60%: in Latvia - 35.9%, in Lithuania - 34.2%, and Estonia is a leader among the countries of the European Union with the level at 8.4%.

Analysis of recent research and publications. In modern literature dealing with theoretical questions concerning foreign capital and its influence on economic growth, many works are devoted to the study of its essence, purpose, characteristic features, functions. Having reviewed the work of domestic and foreign researchers, it is possible to come to the conclusion that the interpretation of the influence of foreign capital on the state economy is ambiguous, therefore, opinions may differ. Direct foreign investment are considered to be the least liquid, therefore, it is a more stable form of financing, comparing with debt instruments, as noted by T.A. Rodionova [2]. Also, FDI can accelerate economic growth in the country. The advantage of FDI in the country over external loans is that the payment of income on these investments depends on the income received, unlike the loans they are related to the end result, as well as the repatriation of foreign capital or income is regulated by the recipient country, in contrast to the competitive conditions providing a foreign loan. However, there are a number of risks for host countries, which noted S. A. Yakubovsky [2]: because TNCs are interested in increasing incomes and production volumes within their own corporate structure, they, through a network of

overseas affiliates, primarily increasing the sale of their products, issued for outside the host countries. This leads to an increase in imports of FDI recipient countries, which substantially affects their trade balances, and in some cases, the balance of services. In a study by a group of authors, D. Egan, Ali M. Kutan and Ali Mirzalo [5], it is initially expected that those industries will grow disproportionately faster, depending on external financing in countries that will have more capital inflows. Also, it is assumed that the relationship of the growth of inflow is stronger in countries with well-functioning banks. In addition, access to foreign funds can increase the efficiency and productivity of capital allocation and, consequently, growth in recipient countries. Nevertheless, there are a number of negative consequences of the inflow of capital. For example, an inflow of capital may result in the transfer of economic resources from sectors traded in non-traded sectors, which are often prone to slower productivity growth. The following group of authors – K.F. Baum, M. Pund and A. Ramayandi [4] investigated the influence of international capital flows on the stability of the financial sector. The obtained data testify that there is a significant influence of different indicators of gross capital inflow on indicators of financial stability after taking into account macroeconomic factors. It was found that external FDI flows have a strong positive effect on the volatility of domestic loans, liquid assets and coefficients of non-performing loans for a number of countries, as well as internal flows of FDI – on the volatility of deposits and domestic loans. In K. A. Ogbokor's article [3], the main objective of the study was quantitative measurement of the impact of foreign direct investment on economic growth. The imperative conclusions of the study are as follows: It was found that net foreign direct investment have a stronger impact on economic growth compared to openness and real exchange rates. Accordingly, a unidirectional link between the real exchange rate and net foreign direct investment was discovered.

Unsolved earlier part of the general problem. For today, there is no unambiguous opinion made by researchers on the impact of foreign capital on the development of economies, therefore, in this article it is necessary to identify which factors are related to positive ones and which – do not ensure the development of the economy.

The purpose of the article. An analysis of the impact of foreign capital on the economic development of the Baltic countries in the current conditions of development of the world economy.

Presentation of the main material of the study. The inflow of foreign direct investment into the Latvian economy was about \$ 830 million during the period of 2013-17, and the outflow - \$ 385 million. In 2015 Latvians invested a minimum amount of investment abroad - \$ 143.2 million, however, by 2017,

the figure has increased to the level of 2013 year. The minimum value of investment from foreigners was observed in 2016 – a decrease of 71% from the 2015 figure. However, last year there was a rapid growth – almost five times, that exceeded the value of 2013. The balance was positive only in 2016, and the minimum value was achieved in 2015 at \$ -695.4 million [7].

The main factors that stimulate foreign investment to the economy are: low-cost labor force, low taxes, advantageous geographic location, and availability of free economic zones [10].

The main sectors invested are: the sphere of financial and insurance services - 24.93%, wholesale and retail trade - 14.98, real estate - 16.04%, industry - 12.1% (2016) [8]. The main investors are Sweden - 15.69%, Russia - 9.79%, Cyprus - 9.6%, the Netherlands - 7.26%, Switzerland - 6.93%.

In 2017 of all established companies in Latvia, 16% of them fell on foreign capital. Russia became the leader with 23% of the share, followed by Estonia and Lithuania - 11% (154 enterprises), Ukraine - 7%. It is also worth mentioning the representative offices of international companies operating in Latvia: Coca-Cola, Bucher Schoerling, Schneider Electric, Tieto, Cytex, JELD-WEN, Gene rex Biotechnology, Cemex, Brabantia.

It is not surprising that the volume of portfolio investment [7] far exceeds the volume of direct ones. In this case, there was no sharp drop in the assets of FDI, the maximum value is achieved in 2017 - \$ 2,647 million, while in liabilities there was a sharp decline of 33 times in 2017. The opposite situation is considered with the balance of portfolio investments – it is positive for all years except for 2014: investments of Latvians far exceed investment of foreigners to the country.

Indices of "other investments" fluctuate [7]: assets in 2014 increased 141 times in comparison with the previous year, then in 2015 the figure was negative (\$ -2981,7 million), in the following year they increased to \$ 249, 2 million, and in 2017 – there was negative value again. The volume of liabilities is much higher than the assets, and in 2017 the maximum figure was reached - \$ 1945.7 million. The positive balance is observed during 2013-14.

Summarizing all the indicators of the financial account of Latvia, it could be concluded that the balance is positive, with the exception of 2015. However, the balance of the current account of the country for almost all years came down to the sign "-", hence the state of the balance of payments could be determined, which in 2013-14 and in 2017 was in deficit. According to this fact, in order to maintain Latvia's surplus balance, it is necessary to increase the export part of the current account or attract more foreign investments into the country.

Regarding Lithuania's direct foreign investment [7], it should be noted that for all years (2013-18) the balance came down to a deficit. The smallest gap is in 2014 - \$ - 17.1 million. The largest indicator of

invested FDI capital is observed in 2018, and the minimum - in 2015 (\$ 180.3 million). In 2017, Lithuania invested \$ 1190.6 million that is the highest value. But after that the volume of investments decreased by 27.13% next year.

One of the main economies investing in Lithuania are Sweden (especially in the energy sector), the Netherlands, Germany, Norway, Poland, Estonia. And the Lithuanian economy invests the most in the Netherlands, Cyprus, Latvia, Poland and Estonia.

The main sectors of the Lithuanian economy that attract investors include: IT technologies (Trackforce, Sentience, Harbourtouch), data collection and processing centers, manufacturing, industrial engineering, medical devices, R & D.

As in the case of Latvia, portfolio investment volumes [7] are larger than direct ones. Strong growth of capital invested abroad is observed in 2016-17 at the level of \$ 3653.9 million. And already in 2018 the volume has decreased in 2,8 times in comparison with last year. In 2013 foreigners sold assets in Lithuania worth \$ 1118.4 million more than bought, as in 2015-16. However, in the next 2014, the volume amounted to \$ 1648.3 million. Regarding the balance, it should be noted that the negative value is observed only in 2014-15.

Judging by the level of liabilities from "other investments", it can be determined that very large flows of bank lending or state capital are directed both in Latvian and in the Lithuanian economy. A particularly large volume is observed in 2016 - \$ 5658.4 million, however, in 2017, it sharply reduced to \$ 236.7 million. Until 2015, the level of assets was very small, and in 2015 - it has been already \$ 5631.6 million. As for the balance, the negative indicator is considered in the last three years.

The balance of financial account of Lithuania during 2013-18 was positive, where portfolio investment assets far exceed the rates of liabilities, while the value of the current account of the country was mainly in the surplus. However, there were strong fluctuations in the balance of payments, since in 2014 the surplus of the balance sheet amounted to \$ 1974 million, and then there were both negative and positive results. Therefore, the country needs to balance its balance of payments, primarily by providing a "credit" part of the current account.

Now it is necessary to consider Estonia's investment activity [7]. The assets of FDI point a decrease in Estonia's investment abroad after 2014, when the maximum figure of \$ 1135.5 million was reached. USA. In 2015 there was a negative indicator meaning that Estonians sold more than \$ 574.1 million worth of assets outside the country than purchased. Starting from 2016, the growth of FDI assets is considering, but in 2018 they amounted to \$ -304.02 million.

The Estonian economy is one of the largest recipients of foreign investment in the European Union. This is due to the following reasons: the free business climate, the lowest state debt in the EU, the

absence of a corporate income tax on reinvested profits, is the most transparent and less corrupt country in Central and Eastern Europe, with some of the highest credit ratings in the region (Standard & Poor: AA - Moody's: A1; Fitch IBCA: A +), there is a high level of protection against cybercrime [6].

The most attractive sectors for investments are financial - 28%, the real estate sector accounts for 18%, industry - 14%, wholesale and retail trade is 13%, and 8% belongs to professional and scientific activities (2016) [9]. The main investors are Swedish companies - 26%, Finnish make up 23%, and Dutch - 10%.

With regard to foreign direct investment liabilities, it can be noted that their value far exceeds the assets [7]. In 2015, there was a recession, as foreign investors sold assets in Estonia \$ 714.4 million more than purchased, as the result is negative. With regard to the maximum value, it was achieved in 2014 - \$ 1,781 million. As a whole, it can be noted that foreign investment in the Estonian economy exceeds the Estonian ones abroad by an average of almost 2 times. The positive balance of FDI came down only in 2015.

Volumes of portfolio investment assets significantly exceed the same FDI figures, especially in 2016-17, where the volume exceeded \$ 2,700 million. Regarding liabilities, it can be noted that in this case, the indicators are far behind the indicators on FDI liabilities. Negative value was achieved in 2015 at \$ 43.6 million. The balance of portfolio investment shows a reverse trend in this case - it comes down to a positive indicator, which suggests that Estonian investors invest a lot more in financial foreign instruments than foreigners in Estonia.

Considering other investments of Estonia, it can be noted that in the first three years and in 2018 the balance was positive, and in 2016-17 there was a sharp decline. The minimum value is observed in 2016 in \$ -1762 million. However, the negative value was not the result of increasing foreign deposits in the country or providing foreign loans, public loans to Estonians, but, conversely, it took place because of reduction in the total amount transferred from foreign investors, because investment assets come down to a negative indicator.

It is the most appropriate situation with the balance of payments of Estonia, since both the current account balance and the financial balance are in surplus, except of 2015, when capital began to "run away" from the country.

Thus, it can be noted that investment activity is an important component for the economies of the Baltic countries. In order to determine in more detail the advantages and disadvantages of outflow and inflow of investments, first of all, that influence the economic development of Latvia, Lithuania and Estonia, it is necessary to proceed to the construction of regression models.

The presented regression model (Model 1) of Latvia examines the impact of the credit of investment income (US \$ million), the debit of investment income

(US \$ million) and interest rate on the loan (%) on the dynamics of nominal GDP of the country (US \$ billion). Based on statistical data for 1996-2018, indicators were obtained from the IMF's statistical base. It has the following appearance:

$$GDP = 0,455 \cdot IIc - 0,893 \cdot IIId - 0,747 \cdot IRc \quad (1)$$

$$(2,878^{**}) \quad (-6,582^{***}) \quad (-5,817^{***})$$

$$R^2 = 0,890 = 89\%, F = 26,849$$

This regression model indicates the existence of a significant relationship between the variables and the dependent one. With the increase of Latvia's credit of investment income by 1 standard deviation, GDP of the country will increase by 0.455. With the rise in the debit of investment income, the dependent variable is reduced by 0.893 standard deviations, which is the most influential value compared to the other two. That is, it can be noted that the negative effect of payments abroad is much higher than the positive effect of income revenues on the country's GDP. Also, GDP of Latvia decreases by 0.747 with an increase in the loan interest rate by 1 standard deviation. This is explained by the fact that an increase in the interest rate contributes to a rise in the cost of loans, and thus makes them less attractive, first of all, for exporters, thus, exports are reduced, which is one of the components of the gross domestic product. Also, this assumption is even more justified, taking into account the fact that the share of exports in Latvia's GDP is predominant – about 60.7% of GDP.

The next regression model (Model 2) examines the dependence of exports (US \$ million) of Lithuania on FDI assets (US \$ million) and debit of investment income (US \$ million). The model is estimated on the basis of statistical data for 1996-2018, indicators were obtained from the statistical base of the IMF (IIId) and UNCTAD (FDI_{sa}). The above-described model has the form:

$$Exp = 0,799 \cdot FDI_{sa} + 0,221 \cdot IIId \quad (2)$$

$$(11,241^{***}) \quad (3,111^{***})$$

$$R^2 = 0,963 = 96,3\%, F = 244,763$$

The presented model is an evidence of the existence of a significant relationship between dependent and variables. Of all the variables, the stocks of FDI assets (accumulated investments) influence Lithuania's exports the most, there is a direct dependence – with the growth of FDI assets by 1 standard deviation, the country's exports grow by 0.799. If the payment of investment income abroad had a negative effect on the development of the economy of Latvia, then for Lithuania, there is a completely different situation – with the increase in payments abroad, the country's exports are increasing on the contrary ($\beta = 0.221$). This can be explained by the fact that an increase in the debit of investment income stimulates a larger inflow of foreign investment, which in turn encourages the development of export industries.

Also, the influence of certain factors on the development of the Estonian economy should be considered (Model 3). In particular, the nominal GDP (US \$ billion) was chosen as a dependent variable, while the independent ones were accumulated assets of FDI (US \$ million), inflation (%), net foreign assets (US \$) and debit of income investment. The model is estimated on the basis of statistical data for 1996-2018, indicators were obtained from the statistical base of the IMF.

The model looks like this:

$$GDP = 0,563 \cdot FDI_{sa} - 0,276 \cdot Infl + 0,711 \cdot IIId \quad (3)$$

$$(8,883^{***}) \quad (-4,169^{***}) \quad (8,117^{***})$$

$$R^2 = 0,985 = 98,5\%, F = 145,000$$

The largest impact on the country's GDP is observed from the debit of investment income. As for Lithuania, it could be noted a direct dependence, but in this case it is much stronger – $\beta = 0,711$. Next are the assets of accumulated investments, which also have a positive effect on the GDP of Estonia: with their growth by 1 standard deviation, the dependent variable is increased by 0.563. As expected, inflation has a negative impact on GDP, but this effect is the least in comparison with other variables ($\beta = -0.276$).

Conclusions. Investment activity is an important component for the economies of the Baltic countries. The leader in attracting capital not only in the region, but also in the EU is Estonia, and in terms of investment abroad – is Lithuania (on average per year \$ 496 million) in the Baltic region. In 2015, there was a decline in investment activity, due to the deterioration of relations with the Russian Federation, which was one of the most influential foreign economic partners of the Baltic States. The main factors that stimulate foreign investment in the economy are: low-cost labor force, low taxes, favorable geographic location, and the availability of free economic zones. The main areas where capital is directed are: financial sector, industrial, IT. One of the major economies investing in given countries data are Sweden, Finland, the Netherlands, Germany, Norway, Poland. Summing up the balance of payments of the countries, it should be noted that in order to regulate it for Latvia, it remains necessary to increase the export part of the current account, as there is a shortage of balance for all years, in addition, it should also stimulate more foreign investment in the country. At the same time, it is possible to note the characteristic feature of the Baltic countries in rather high capital account ratios, since this article does not usually have a significant effect on the balance; therefore, the provision of organic (real) growth of given economies becomes more priority area. In the balance of payments of Lithuania, there are significant fluctuations, despite the positive balance of the financial account, therefore, it is also recommended to regulate the balance of payments,

primarily by providing a "credit" part of the current account. The most appropriate situation is with the Estonian balance of payments, since both the current account balance and the financial account balance are in surplus, except for 2015, when capital began to "run away" from the country. After conducting a regression analysis, it should be noted that the outflow of capital from the Baltic countries abroad (investment assets) positively affects the development of their economies. The biggest gain is observed from investing of Lithuania, since every dollar that country invests, exports grow by \$ 0.799. For Estonia it can be noted that with each dollar invested abroad in the form of FDI, exports increase

by 0,563 dollars, and for Latvia: 1 dollar of received investment income, GDP of the country increases by 0,455 dollars. It can also be noted that after analyzing the models, paying attention to the previous recommendations, it becomes clear that the regulation of the balance of payments for Latvia should occur only by increasing the "credit" part of the current account, and for Lithuania – both by increasing the current account, and investment liabilities, because there is the inverse dependence of GDP on investment income, which is directed to foreign investors in the model for the first country, while for Lithuania there is a direct dependence of exports on of investment income abroad.

АНАЛІЗ ІНВЕСТИЦІЙНОЇ ДІЯЛЬНОСТІ В КРАЇНАХ БАЛТІЇ

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У статті розглядається роль іноземного капіталу в країнах Балтії. Предметом дослідження є структура і динаміка іноземного капіталу в Латвії, Литві та Естонії в сучасних умовах розвитку світового господарства. Метою статті є аналіз впливу іноземного капіталу на економічний розвиток Балтійських країн. Завдання дослідження – більш детально розглянути потоки прямих іноземних інвестицій, портфельних інвестицій та інших видів інвестицій, визначити фактори, які стимулюють інвестиції в Латвію, Литву та Естонію, визначити основних країн-інвесторів, розглянути стан платіжного балансу даних країн та побудувати регресійні моделі впливу іноземного капіталу на економічний розвиток країн. При проведенні дослідження використовувалися загальні методи: наукової абстракції, порівняльний, метод аналізу і синтезу, систематизації та узагальнення, розрахунковий метод, а також метод регресійного аналізу. Під час проведення дослідження були отримані наступні результати: інвестиційна діяльність є важливою складовою для економік країн Балтії. Лідером по залученому капіталу не тільки в регіоні, але і в ЄС є Естонія, а за обсягом інвестувань за кордон – Литва в балтійському регіоні. Основними сферами, куди спрямовується капітал, є: фінансовий сектор, промисловий, ІТ-технології. Регресійний аналіз показав, що відтік капіталу з країн Балтії закордон (активи інвестицій) позитивно впливає на розвиток їх економік. Висновки: регулювання платіжного балансу для Латвії має відбуватися тільки за рахунок збільшення «кредитної» частини поточного рахунку, а для Литви – і за рахунок збільшення як поточного рахунку, так і пасивів інвестицій, адже для першої країни в моделі була зображена зворотна залежність експорту від інвестиційних доходів, які спрямовуються до іноземних інвесторів, а для Литви спостерігається пряма залежність ВВП від виплат інвестиційних доходів закордон.

Ключові слова: прями іноземні інвестиції, портфельні інвестиції, інші види інвестицій, країни Балтії, інвестиційні доходи, платіжний баланс.

АНАЛИЗ ИНВЕСТИЦИОННОЙ ДЕЯТЕЛЬНОСТИ В СТАНАХ БАЛТИИ

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В статье рассматривается роль иностранного капитала в странах Балтии. Предметом исследования является структура и динамика иностранного капитала в Латвии, Литве и Эстонии. Целью статьи – анализ влияния иностранного капитала на экономическое развитие Балтийских стран. Задача исследования состоит в том, чтоб более детально рассмотреть потоки прямых иностранных инвестиций, портфельных и других видов инвестиций, определить факторы, стимулирующие инвестиции, определить основных стран-инвесторов, рассмотреть состояние платежного баланса данных стран, также построить регрессионные модели влияния иностранного капитала на экономическое развитие стран. При проведении исследования использовались общие методы: научной абстракции, сравнительный, метод анализа и синтеза, систематизации и обобщения, расчетный метод, а также метод регрессионного анализа. Получены следующие результаты: инвестиционная деятельность является важной составляющей для экономик стран Балтии. Лидером по привлеченному капиталу не только в регионе, но и в ЕС является Эстония, а по объему инвестированного капитала за границу – Литва в балтийском регионе. К основным секторам, куда направляется капитал, относятся: финансовый сектор, промышленный, IT-технологии. Регрессионный анализ показал, что отток капитала из стран Балтии за границу положительно влияет на развитие их экономик. Выводы: регулирование платежного баланса для Латвии должно происходить только за счет увеличения «кредитной» части текущего счета, а для Литвы – и за счет увеличения текущего счета, так и пассивов инвестиций, ведь для первой страны в модели была изображена обратная зависимость экспорта от инвестиционных доходов, направляемых к иностранным инвесторам, а для Литвы наблюдается прямая зависимость ВВП от выплат инвестиционных доходов за границу.

Ключевые слова: прямые иностранные инвестиции, портфельные инвестиции, другие виды инвестиций, страны Балтии, инвестиционные доходы, платежный баланс.

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