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**ESTONIA'S STRATEGIC FUTURE**

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## **Abstract**

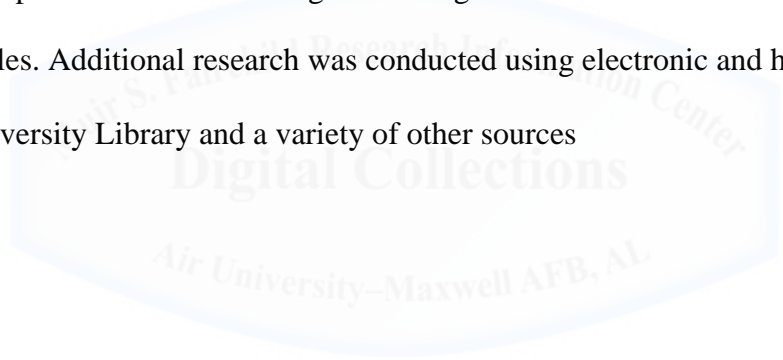
Estonia has demonstrated a keen interest in contributing to and leading in the European Union (EU), North Atlantic Treaty Organization (NATO), and United Nations (UN) security and economic advancements since gaining membership in 2004. Given the current events unfolding in Ukraine and Crimea, as well as the continued aggression of Russia in the Baltic region, Estonia's security is a priority for NATO. It is without question the United States (US) will continue to maintain strong ties to the EU and NATO while fostering other regional, bi-lateral, and global security and economic prosperity. The US relationship with the former republics on Russia's periphery given the continuing unrest in Ukraine will be key to enhancing future US and European security arrangements. However, competing priorities in providing economic and military assistance are driving the need for the US to re-evaluate the need to be the world's police. As part of re-prioritizing, Estonia's strong and consistent regional influence in the Baltic States, its' contributions and leadership within NATO, and its unique geographic location on the peripheries of both Eastern and Western Europe all serve as important reasons for Estonia to invest in their strategic future.

This research discussion will focus on the importance of Estonia's future in light of continued support from the US. This paper will further argue that Estonia, must work to strengthen cooperative defense arrangements and export diversification as their two key strategic priorities in light of Russia's continuing militaristic bent as evidenced in Ukraine.

Given Estonia's population size of only 1.3 million people, relatively light population density and on-going maturation of their economies and internal governments; it will continue to remain imperative for Estonia to work on security and economic issues in order to achieve fiscal

and functional efficiencies. Estonia should increase partnership with Finland and Sweden militaries and expand trade into emerging markets. These recommendations will improve Estonia's security and prosperity for the future.

Given events in Ukraine and Crimea, this researcher was privileged to have the opportunity to conduct first-person research through the Department of Defense/State Department Embassy Immersion Program while assigned for six weeks to the US Embassy in Tallinn, Estonia as a Political-Military Affairs Strategist. This research paper attempts to examine political and economic factors influencing the Baltic States transformation of military capabilities to adequately defend against Russia. Much of the material and information contained in this research paper was obtained through a thorough examination of State Department unclassified Cables. Additional research was conducted using electronic and hard copy media from the Air University Library and a variety of other sources



## **Section 1: [Introduction]**

Never before has the US been engaged in as many conflicts across nearly every part of the world. The US Special Operations Command, one of the nine organizational units that make up the Unified Combatant Command is deployed to roughly 134 countries, where they are either involved in combat, special missions or advising, and training foreign forces.<sup>1</sup> After more than a decade of war dominated by US invasions and occupations of Iraq and Afghanistan, the US is now leading a multi-coalition to fight the Islamic State, who harbor in places all across the world. On the horizon, Russia's recent annexation of Crimea is creating unrest for European countries' sovereignty. Notwithstanding these serious military threats, economic experts argue that America is losing our place setting in financial standings compared to China and India.<sup>2</sup>

Internally, America's baby boomer generation is cashing in on social security, national borders remain a significant security issue, natural disasters due to global warming continue to devastate an unprepared nation and pandemic scares seem to proliferate on a regular basis. America faces enormous challenges to national security both externally and internally. Yet even with continued pressures, the US remains a steadfast contributor to NATO. Senior politicians and military leaders have argued that if the US continues to provide the overwhelming amount of contributions while other countries decrease funding amounts, "Europe's ability to be a stabilizing force even in its neighborhood will rapidly disappear. Without the strongest, most creative and most productive economy, the US cannot sustain national military capability on a worldwide basis."<sup>3</sup> In order to explore this argument, the following will describe the military capabilities of Estonia and economic data and present recommendations for Estonia to improve its strategic future and security.

## **Section 2: [Strategic Guidance]**



President Obama outlines in the 2015 National Security Strategy (NSS), the framework for the US in addressing global challenges while advancing our nation's interest, values, and vision for the future. A key element of this strategy is through “strengthening and growing our global alliances and partnerships, forging diverse coalitions, and leading at the United Nations and other multilateral organizations.”<sup>4</sup> He specifically goes on to state, “We will lead with capable partners. We and our partners must make the reforms and investments needed to make sure we can work more effectively with each other while growing the ranks of responsible, capable states.”<sup>5</sup> His remarks imply the US can no longer be the lead nation in every conflict but other partner nations need to make the necessary changes albeit financial or institutional. In an ever-changing world, the US cannot shoulder the responsibility alone to be the world’s police. Partnerships will continue to remain an important aspect in achieving collective security. At the same time, the NSS mentions the need for partners to make changes to their investments so cooperatives can work more effectively and nations can be capable.<sup>6</sup>

Moreover, Secretary of State John Kerry has also called on America’s NATO allies to increase their defense spending to the agreed two percent of GDP.<sup>7</sup> In reality, only Britain, Greece, and Estonia meet this level of contribution. European NATO members remain far from “serious and capable partners in their own defense.”<sup>8</sup>

In addition to politicians, the former most senior leader in the military also questioned the communal allocation of benefits when not all benefactors are contributing at the same level. Former Secretary of Defense, Chuck Hagel in 2014 called upon NATO countries to meet their agreed to levels of financial contributions.<sup>9</sup> Secretary Hagel said, the recent annexation of Crimea had, “reminded NATO of its founding purpose” and “presented a clarifying moment for

the transatlantic alliance.”<sup>10</sup> He articulated that, “US contributions to NATO far out surpasses other countries by as much as three times. He urged nations to re-evaluate their commitments.”<sup>11</sup>

### **Section 3: [Russian Threats to Baltic Region]**

According to The Heritage Foundation, the tensions in the Baltic Region are not getting any better. Tensions in the region are escalating from air, land, and sea. More specifically, “Russia’s aggressive posture against its neighbors has a profound impact on US allies in the Nordic and Baltic region. The Baltic States are on NATO’s front line, and view Russia as an existential threat. Nordic states, especially non-NATO members Finland and Sweden, have felt Russian pressure this year. Lately, three issues have kept tensions running high in the region: Russian air incursions, Russian maritime incursions, and incursions across the Estonian–Russian border.”<sup>12</sup>

To begin with, air sovereignty is at odds with Russian jets flying dangerously close to military and commercial planes. “A violation of national airspace is a violation of sovereignty. In 2014, NATO has scrambled planes 400 times to intercept Russian planes flying close to NATO airspace and in a few instances actually violating it, a marked increase since 2013. Estonia has registered six airspace violations by Russian aircraft in 2014, including an incident in October when a Russian Ilyushin-20 aircraft flew in Estonian airspace for a minute before being intercepted by Danish, Portuguese, and Swedish fighter jets. In another incident in February, coinciding with Estonian Independence Day, US F-15s intercepted a Russian spy plane that had violated Estonian airspace. In 2014, Latvia has so far recorded 180 incidents of Russian aircraft flying suspiciously close to Latvian airspace without identifying themselves.”<sup>13</sup>

Russia has also decided to test sea sovereignty. In September, “a Lithuanian-flagged fishing vessel operating in international waters was detained by Russia for allegedly illegally

fishing within Russia's exclusive economic zone and towed to Murmansk, its crew temporarily detained. Russia has demanded bail for the ship of over \$2.7 million, more than its estimated value. The incident created a higher level of tension between Russia and Lithuania.”<sup>14</sup>

The Nordic states have experienced similar Russian aggression in recent months. “Finland and Sweden, neither of which are NATO members, have been the object of multiple air and maritime incursions by Russian forces. Consequently, a national debate about increasing defense spending and whether to join NATO has developed in both countries. Russian warships disrupted the work of Finnish marine research ships on two occasions. In both cases, Russian warships tried to prevent the Finnish ships from accessing international waters. In October, a suspected small submarine, widely thought to be Russian, illegally penetrated Swedish territorial waters, setting off a weeklong sweep of the nation's many archipelagos, the first such search since the end of the Cold War. Some reports indicate that, in fact, two submarines, one larger and one smaller, may have both been operating in Swedish waters, a tactic that would reportedly be consistent with actions by Russian Special Forces. Coinciding with Russian maritime incursions is the increasing number of Russian air incursions. In March 2013, a simulated strike by two Russian bombers and four fighter jets against Stockholm had to be met by Danish jets from Lithuania—because Sweden's air force did not react due to being on low alert over Easter. This was a wake-up call for politicians in Sweden.”<sup>15</sup>

More recently, this past September, “two Russian bombers entered Swedish airspace near the island of Öland in what the Foreign Minister of Sweden referred to as the most serious aerial incursion in years. Finland has also recorded an uptick in violations of its airspace by Russian aircraft, including three in one week in August. In June, Russia had carried out a simulated strike

against the island of Bornholm in NATO-member Denmark, hosting a music festival with 90,000 attendees at the time.”<sup>16</sup>

Just shortly after President Obama’s visit in September 2014, “Russian agents crossed the border into Estonia to abduct an Estonian Internal Security Service officer. Using communications-jamming equipment, smoke bombs, and stun grenades, Russian agents kidnapped Eston Kohvar at gunpoint on Estonian soil and then charged him in Russia with espionage. The abduction came fewer than 48 hours after President Barack Obama had visited Tallinn just before the 2014 NATO Summit.”<sup>17</sup>

Lastly, the border dividing Estonia and Russia is still not ratified. Specifically, “Estonia is the only Baltic country that does not have an officially agreed border with Russia. Both sides rely on a de facto border dating back to the time of the Soviet occupation. When Estonia enjoyed a brief period of independence between the two world wars, its border with the Soviet Union was based on the 1920 Treaty of Tartu. In 1945, after the Soviet Union annexed Estonia, Moscow re-drew the administrative border between the Soviet Union and the Estonian Soviet Socialist Republic in such a way that 10 percent of Estonian territory, as agreed in the Treaty of Tartu, was transferred to Russia. After Estonia regained its independence in the 1990s, officials in Tallinn, for the sake of peace, agreed to drop any territorial claims and keep the de facto border based on the 1945 border, even though this meant handing 10 percent of the country’s territory to Russia.”<sup>18</sup>

Minor wording is holding up the ratification, “while the Estonian parliament is set to ratify the treaty, the Russian Duma’s Foreign Affairs Committee Chairman Alexei Pushkov recently stated that he does not expect Russian ratification of the treaty due to current NATO–Russian tensions. While the failure of Russia to ratify the treaty does not impact daily use of the

de facto border, it does add another unfortunate dimension to Western relations with Russia in light of the Ukraine crisis.”<sup>19</sup>

#### **Section 4: [NATO]**

NATO is an example of one of the strongest global alliances. The origins of NATO developed during the time of the Soviet Union’s threat of invasion to other countries and have remained throughout recent history as a strong partnership between European countries. NATO countries actively participate alongside the US in major conflicts; most recently, an example of this steadfast partnership is NATO’s lead role in the War on Terror with the standup of the International Security Assistance Force (ISAF).

A key founding principle to NATO is Article 5 of the 1949 Washington Treaty. This clause states that, an armed attack on one or more [members] shall be considered an attack on all and those members will assist the victims of such an attack forthwith. This clause seemed to not be taken too seriously until recent events unfolded in Crimea. President Vladimir Putin is now testing the resolve of the clause through heightened aggression actions.

Prior to President Obama’s visit, Estonia outlined its expectation that NATO improve its rapid reaction capability, planning to support rapid reaction, and continued presence of NATO land, sea, and air forces until the regional security situation changes. Estonian leaders, to include President Toomas Hendrik Ilves, have been very direct and vocal about the Estonian assessment of the seriousness of events and Ukraine and the need for NATO to adjust to the new security reality. Estonian leaders are very pleased with the results of the Wales Summit, but await implementation details on NATO’s Readiness Action Plan agreed at the Summit.<sup>20</sup>

#### **Section 5: [Article Five]**

The heightened aggression in the Baltic Region has brought forth a closer interpretation of Article 5 clause of NATO. A key word in the clause is “assist.” Assisting could be in the form of training, education, providing equipment or even force but the phrasing is not specific.<sup>21</sup> “All that NATO actually promises is to take such action as it deems necessary to restore and maintain security. That could be anything from nuclear war to a stiff diplomatic protest. Three tricky considerations would determine the precise nature of any NATO response to foreign aggression. The first is geography, in places where an aggressor can quickly complete and consolidate an invasion; NATO's options are very limited. The Baltics, for instance, occupy a thin flat strip of land, which is indefensible. A Russian surprise attack could reach the coast within hours, and reversing a successful Russian invasion would be hard, even futile. Yet that was also true of West Berlin. The Baltics argue that an attack on them would mean an all-out East-West confrontation thanks to Article 5. If Russia believes that, deterrence is working. But Article 5 does not specify such a response.”<sup>22</sup>

The current conflict over Ukraine is testing the resolve of the NATO alliance in that Putin is pushing the limits on “power politics.”<sup>23</sup> Hans-Peter Friedrich, a veteran German parliamentarian and former cabinet minister with a Ph.D. in law states, “Putin is teaching us the meaning of power politics, agreements, such as national borders, only mean something if they can be backed up by action. Europe must be capable of defending itself.”<sup>24</sup> Friedrich is daring to articulate an uncomfortable reality, though collective defense is the pillar of NATO collaboration, the American public’s “dwindling appetite” for involvement means the European allies will have to step up.<sup>25</sup> “I wish that we’d establish a European pillar of NATO,” he stated.<sup>26</sup> It has been tried before. More specifically, “back in 1999, NATO formally endorsed the EU’s European Security and Defense Identity, noting that the US may not be able to get involved in

every European security contingency. Such conversations are leaving the Baltic States alarmed.”<sup>27</sup> Baltic leaders are keeping relations open and positive with American diplomats. Recently, Latvian Defense Minister Raimonds Vejonis stated, “Thanks to NATO’s 150 soldiers on Latvian soil, we are not afraid of Russian aggression. Who wants to start a war against the US? That is what Russia would do if it attacked Latvia. Putin is not that stupid.”<sup>28</sup> If the US does not “assist” in the form of providing troops on the ground, the outcome could be drastically different. Estonia must invest in bolstering their defense and continue to export goods to emerging markets in case the US does not “assist” in a typical military fashion.

#### **Section 6: [US Commitments]**

Russia is ramping up its aggressive behavior in the Nordic and Baltic regions and the US has and will continue to provide financial and military resources but this trend might not continue indefinitely. A review of current commitments reveals that the US remains a steadfast supporter and ally to Europe, despite other NATO countries small GDP contributions.

According to US European Command, “The US continues to demonstrate its commitment to the collective security of NATO allies and support partners in Europe, in light of the on-going Russian intervention in Ukraine. All US efforts in support of NATO allies and partners in Europe fall under the umbrella of Operation Atlantic Resolve.”<sup>29</sup>

Furthermore, “the US took several immediate steps to demonstrate solidarity with NATO allies, such as augmenting the air, ground, and naval presence in the region, and enhancing previously scheduled exercises. Russia's aggressive actions have already led many to call for reinforcing NATO's readiness through Article 5 related planning training and adjustments to force posture. The US is also taking additional measures to enhance NATO military plans and

defense capabilities and remains committed to maintaining a persistent presence in Eastern Europe.”<sup>30</sup>

In 2014, Estonia marked the 10th anniversary of Estonia’s accession to the European Union and NATO and the 20th anniversary of the withdrawal of Russian troops from Estonian territory, widely seen as pinnacle achievements in the restoration of Estonian independence. Estonia’s integration into the European and international political and economic mainstream is a striking success story, and Estonia continues its efforts at “security through integration” by visible efforts to participate in a variety of key multilateral institutions, to include the European Monetary Union, as well as NATO, EU, and UN defense activities.

This past year has also seen intense political-military and military activity surrounding events in Ukraine. Estonian leaders were markedly impressed at the speed and quality of the initial US response to the crisis in April 2014: the deployment of additional troops to the Baltic Air Policing Mission in Lithuania and the deployment of an airborne infantry company to Poland and the three Baltic States, as well as Special Forces JCETs to the region. Since then, Estonia has welcomed additional NATO aircraft supporting the Baltic Air Policing mission from Amari Air Base (approximately 45 minutes west of Tallinn), hosted the largest multinational exercise in Estonia’s recent history (Estonian exercise Spring Storm/NATO exercise Steadfast Javelin I in May 2014), and finally participated in the historic visit of President Obama and the NATO Summit in Wales in September 2014, seen by many Estonian leaders as the most productive Summit in the last decade. The deployment of these mechanized forces for the first time in the Baltics has added to the strong sense of cooperation and US leadership in the region.

Estonia is a strongly pro-American and pro-European country. Estonia’s missions abroad reflect its staunch pride in itself as a NATO ally and its strongly felt obligation to support the



US, who for so many decades upheld Estonia's right to exist. Estonia has consistently had one of the highest per-capita contributions to international peace and security missions among NATO allies in Europe, and is dedicated to NATO's "Istanbul Criteria" of having 10 percent of its available forces deployed or prepared for deployment. Estonia continues to actively seek out deployment opportunities with US troops and with other key NATO allies.<sup>31</sup>

Soldiers from 2<sup>nd</sup> Battalion, 7<sup>th</sup> Infantry and the 173<sup>rd</sup> Airborne Brigade currently are training with Estonian counterparts as a part of Operation Atlantic Resolve. In October, 2014, a company of the 1<sup>st</sup> Cavalry Division supported by the 2<sup>nd</sup> Cavalry Regiment from Germany deployed for training to Tapa, Estonia for three months. Estonia hosted a US company from the Italy-based 173<sup>rd</sup> Airborne Brigade Combat Team (approximately 120-150 soldiers at any one time) from April to October, 2014. US Army Europe units have conducted extensive joint training, to include airborne and helicopter-borne training, as well as training for artillery and unmanned aerial vehicle units. Estonia strongly supports the continuation of these deployments and the Minister of Defense has underlined Estonia's readiness to pay host nation support costs from funds outside of the appropriated defense budget, to include substantial upgrades to the Central Training Area near Tapa in support of Estonian and Allied ground and air forces.

#### **Section 7: [Government of Estonia]**

Estonia's new Government coalition, led by Prime Minister Taavi Rõivas and his Reform-Party-led government, took office on April 8, 2015 following national elections and is expected to maintain continuity in defense and regional security initiatives. There was no leadership change in the Ministers of Defense, Foreign Affairs, and Interior. Rõivas last visited the US as the head of an Estonian business delegation in December 2014, while there he also met with Vice President Biden and congressional leaders.

Estonia maintains a full time professional force (The Estonian Defense Forces/EDF) of approximately 3,000 troops, which are predominantly in Land Forces units. Estonia still requires mandatory conscription for all males 18-25, and approximately 1/3 are called to complete 8-11 months of initial training followed by 3-5 years in the high readiness reserve, which forms the bulk of Estonia's territorial defense capability. Estonia's professional force includes one professional infantry battalion, the Scouts Battalion in Paldiski, which forms the basis for nearly all of Estonia's deployed forces and serves as the primary partner unit for US forces training in Estonia.<sup>32</sup>

Estonia deployed an infantry company to ISAF from 2006-2014, and twice deployed Special Operations Forces teams to Afghanistan, during which nine Estonian soldiers were killed and approximately 100 wounded. The Estonian government has reaffirmed its willingness to deploy troops to Afghanistan in support of the Resolute Support Mission if mandates are achieved, and included a deployment of a SOF team to Afghanistan as part of the most recent Parliamentary mandate for 2015. Estonian troops have also deployed to Iraq, Lebanon, Bosnia, Kosovo, and off the Somali coast, and will deploy as a part of a UN peacekeeping battalion in Lebanon.

Besides overseas deployments in support of NATO, Estonia is planning to be the lead nation for a joint Baltic infantry battalion serving as the NATO Response Force High Readiness Force in 2016. Estonia has committed forces to the Swedish-led EU Nordic Battle Group in 2015, has deployed trainers and staff officers to Mali as part of the EU and UN missions, and deployed an infantry platoon in support of the EU mission in the Central African Republic for four months in 2014.

The Estonian Navy is small, but focused on mine countermeasure missions and participates in the NATO Standing Mine/Countermine Group One in the Baltic. Estonia has a capable and experienced countermine force, which has a rotational participation in the NATO Standing Mine Countermeasures Group in the Baltic Sea. The Estonian Defense Forces and Ministry of Defense remain interested in contributing personnel to the Persian Gulf Combined Maritime Force. While Estonia continues its rotating commitment in the Standing Counter Mine Group in the Baltic, it is unlikely that Estonia would deploy a ship to the Persian Gulf, but Estonian military and defense leaders remain interested in developing a deployable countermine capability usable in multinational or bilateral deployments. More recently, the Estonian government supported the international effort against the Islamic State through donation of ammunition to Peshmerga forces in northern Iraq.<sup>33</sup>

#### **Section 8: [Cyber Security]**

Estonia has established a successful global “brand” for cyber and IT expertise, due to being the home of innovative tech firms, such as Skype; its success in establishing a high level of “e-governance” for public services; and its experience in the 2007 denial-of-service attacks following the “Bronze Soldier” incident. Estonia is known as one of the most “wired” countries in Europe and as having among the highest degrees of Internet freedom. Estonian leaders, such as President Ilves, are known internationally for their expertise in cyber policy and the President currently chairs the EU’s cloud computing council. Estonia has recently seen significant press mention as an outstanding place for start-up and high-tech business activity.

Estonia’s Cooperative Cyber Defense Center of Excellence is a major source of pride for the Government. NATO accredited the Center in October 2008. The US officially joined in November 2011 and maintains one US Naval officer position in the strategy department.<sup>34</sup>

## **Section 9: [Defense Budget/Procurement]**

Since 2011, Estonia has maintained defense spending at the NATO target of 2 percent of gross domestic product (GDP), the only NATO nation to consistently do. The GDP contribution has wide support across the political spectrum. As of this year, Estonia is contributing more than the requirement with host nation support to put the total at 2.05 percent. In addition, the Ministry of Defense has maintained a goal of using approximately 1/3 of the budget for procurement in support of Estonia's current 10 Year Defense Development plan. Estonia in 2014 concluded agreements with the Netherlands to purchase a battalion of Swedish-made CV-90 infantry fighting vehicles and with the US to purchase 80 Javelin anti-tank missile systems and 320 Block 0 missiles, Estonia's largest Foreign Military Sales purchase to date. Estonia is also seeking a self-propelled howitzer as its next major purchase. Estonia has also invested substantially in improving soldier pay and infrastructure for conscripts and professional soldiers.<sup>35</sup>

The Office of Defense Cooperation (ODC) has worked closely with the Estonian Defense Forces to support their operations. From 1995-2011 Foreign Military Financing (FMF) totaled approximately \$69 million, with another \$2.4 million in FY 12 and is currently executing \$2.3 million in FY 13 funds.

Estonia has received over \$21 million of equipment through "1206" funding FY10-12, primarily devoted to the development and preparation of Estonian Special Forces for deployment to Afghanistan. The FY 13 1206 funding allocation is \$7.6 million, with an additional \$1.2 million designated for Coalition Readiness Support Program funds (CRSP) for SOF training.

Estonia has been a prominent user of International Military Education and Training (IMET) funds, with IMET graduates occupying numerous key positions in the Estonian Defense Forces and Ministry of Defense, to include the Permanent Secretary of the MOD (National War

College), Deputy EDF Commander (Army War College), EDF Chief of Staff (Naval War College) and Air Force Commander (Air Command and Staff College and US Air Force Academy). Estonia will receive \$1.2 million in IMET funding in FY 2014.<sup>36</sup>

In addition, Embassy Tallinn is working with EUCOM and other partners to commit additional funding achieved through President Obama's European Reassurance Initiative.

#### **Section 10: [Amari Air Base]**

Amari is a modern facility capable of hosting a variety of NATO aircraft and has command and control facilities, which can and do provide command and control for NATO's Baltic Air Policing mission. Estonian leaders were very pleased by President Obama's September 2014 announcement that Amari would likely host US-led regional air training, and further legislation that could provide as much as \$25 million for further upgrades through the European Reassurance Initiative. Estonian taxpayers provided approximately 2/3 of the funds for base reconstruction to modern standards. The US annually has deployed combat and support aircraft to Amari as a part of US Army Europe's regional exercise "Saber Strike" and the NAVEUR exercise "BALTOPS." A Spanish contingent of four Eurofighter aircraft currently provides the quick reaction force for Baltic Air Policing, and US Air Forces in Europe have already begun execution of an aggressive exercise schedule in CY 2015.<sup>37</sup>

#### **Section 11: [Economic Analysis]**

Estonia has been a member of the EU since 2004 and a Eurozone member since 2011. After two years of robust recovery in 2011 and 2012 the Estonian economy faltered in 2013 with only 1.6 percent GDP growth, mainly due to continuing recession in much of the EU. Growth in 2014 was about 1.9 percent reflecting the slow uptake in major export markets and tensions with Russia. GDP is expected to be about 2 percent in 2015.

Estonia's labor market and domestic consumption have remained strong because of extraordinarily low inflation and salary increases higher than the Eurozone average. Thanks to decreases in energy prices, inflation dropped to -0.1 percent in 2014 and is expected to be about 0.8 percent in 2015. At the same time the average wage in Estonia is forecasted to rise 5.4 percent in 2014 and 2015. Total unemployment stands at about 7.5 percent. The government is continuing efforts to boost the economy with a focus on developing Estonia's innovation and e-governance sectors. Estonia is the birthplace of Skype and internet technology remains a vital part of the economy.<sup>38</sup>

The EU's budget for 2014-2020 has set aside €3.37 billion for Estonia under the EU Cohesion Policy. Investments will be concentrated on four key priorities: innovation and research; the digital agenda; support for small and medium-sized businesses; and the low-carbon economy. From 2007-2013, Estonia was allocated more than €3.40 billion in structural assistance, which was channeled to energy projects, entrepreneurship, administrative capability, education, information society, environmental protection, and regional and local development. Scandinavian countries are the largest foreign direct investors in Estonia. In 2014, Estonian exports to the US made up about 3.8 percent of total exports while only 1.1 percent of Estonia's imports came from the US. The principal US exports are computer and electronic products, machinery, chemicals, and transportation equipment. Estonia is a strong supporter of an ambitious and comprehensive Transatlantic Trade and Investment Partnership agreement, and is encouraging support with EU members in Brussels.<sup>39</sup>

Trade with Russia accounted for about 8 percent of Estonia's overall foreign trade in 2014. Russia sanctions and Moscow's retaliatory sanctions on the EU have impacted the

Estonian economy, particularly in the dairy and seafood sectors. Analysts predict Moscow's sanction could potentially cut Estonia's GDP by 0.3 percent.<sup>40</sup>

In terms of actual trade figures, Estonian exports are down 15 percent in 2014 but imports are up 8 percent points, according to the Estonian Statistics Office. The decline in exports is mostly tied to re-export items rather than Estonian produced exports. However, the dairy and fisheries sectors have been adversely impacted by Russian counter-sanctions. Tourism, which comprises approximately 10 percent of Estonia's GDP, has also been impacted, though most people believe the decline in the value of the ruble rather than sanctions are to blame for reduced numbers of Russian tourists in Estonia. The increase in imports from Russia is almost exclusively in oil and oil products.<sup>41</sup>

Swedbank, the largest bank in Estonia, has stated that it expects that the ruble decline/sanctions and the worsening the economic situation in several of Estonia's main trade partners (primarily Latvia, Lithuania, and Finland) will amplify the negative impact on Estonia's export possibilities in 2015.<sup>42</sup>

**Table 1: [Main Foreign Trade Partners of Estonia 2014]**

Country of destination	Exports, meur	Share %	Change compared to the previous year %	Country of consignment	Imports, meur	Share %	Change compared to the previous year %
<b>TOTAL</b>	<b>12084.9</b>	<b>100</b>	<b>-2</b>	<b>TOTAL</b>	<b>13725.4</b>	<b>100</b>	<b>-1</b>
EU-28	8729.8	72	0	EU-28	11386.0	83	-1
Sweden	2173.6	18	5	Finland	2094.7	15	1
Finland	1848.1	15	-7	Germany	1583.3	12	9
Latvia	1294.7	11	2	Sweden	1475.5	11	6
Russia	1187.3	10	-15	Latvia	1172.6	9	-10
Lithuania	636.9	5	-11	Lithuania	1133.7	8	-7
Germany	589.7	5	5	Poland	1043.4	8	-4
Norway	469.3	4	5	Russia	852.2	6	8
USA	452.3	4	26	Netherlands	486.7	4	7

Source: Statistical Office of Estonia

**Table 2: [Trade with Russia in 2012-2014]**

<b>FT09: FOREIGN TRADE by Country, Year and Indicator</b>				
	<b>Exports, euros</b>	<b>Share of total exports, %</b>	<b>Imports, euros</b>	<b>Share of total imports, %</b>
2012	1 511 546 429	12.07	1 003 710 767	7.12
2013	1 403 639 032	11.42	787 268 256	5.7
2014	1 187 250 238	9.82	852 245 910	6.21

Source: Statistical Office of Estonia

Despite some limited impacts, the GoE remains fully committed to sanctions and a strong unified EU-US response to Russia actions in Ukraine.

### **Section 12: [Recommendation #1: Bolster collective defense with Finland and Sweden]**

A robust and coherent response to Russia’s hybrid war is needed to counter and neutralize Russia’s aggression. This requires more political will, but also more resources and more effective instruments. In the era of less US military spending, Estonia should partner with other Baltic states to respond to the scale of Russia.

“Russia’s aggressive posture against its neighbors has a profound impact on US allies in the Nordic and Baltic region. The Baltic States are on NATO’s front line, and view Russia as an existential threat. Nordic states, especially non-NATO members Finland and Sweden, have felt Russian pressure. Lately, three issues have kept tensions running high in the region: Russian air incursions, Russian maritime incursions, and incursions across the Estonian–Russian border. Estonia must set in place a robust, long-term strategy to bolster the collective defense of NATO member states and help secure the Nordic and Baltic region.”<sup>43</sup>

Russia is continuing to threaten the sovereignty of NATO nations. The Nordic and Baltic regions and Estonia needs to act accordingly. “Estonia should improve the security relationship with Finland and Sweden. Although not NATO members, Sweden and Finland have an important role to play for regional security. Access to Swedish and Finnish territory and airspace



will be crucial if NATO is called on to defend the Baltic States. Sweden and Finland have an important role to play for regional security.”<sup>44</sup>

According to leading experts and NATO Secretary General Jens Stoltenberg, “Moscow’s rhetoric about the region and NATO’s role there rightly has Nordic and Baltic states on edge. With the security situation deteriorating, an increasing number of Swedes and Finns, but not yet a majority of them, find NATO membership an enticing proposition. While the benefits and drawbacks of NATO membership for Sweden and Finland are quite clear, bringing the two Nordic countries into the alliance would have implications for NATO as well.”<sup>45</sup>

NATO could gain tremendous benefits if Finland and Sweden join in terms of military capabilities, regional security and geo-political power. However, “Swedish and Finnish membership could also worsen NATO’s long-standing free-rider problem, an issue already made worse by declining defense budgets across the alliance in the wake of the great recession and the European debt crisis, and could potentially further anger Russia. On balance, however, the alliance would stand to gain more by allowing the two nations into NATO, and it could find ways to manage the drawbacks.”<sup>46</sup>

Even though Finland and Sweden do not have a huge military force, their capabilities are highly effective and fit within the current structure of NATO’s arsenal. “This is no small matter, as many other recent NATO members, from Estonia to Croatia, had to work hard for years to get their forces to approach NATO standards before joining the alliance. The two Nordic countries would also bring a set of capabilities that would serve as meaningful contributions to NATO’s combat power. The Swedish and Finnish air forces, operating JAS-39 Gripens and F-18 Hornets, respectively, are especially strong and would do much to bolster NATO air power on the alliance’s northern flank. To boot, Finland recently acquired JASSMs, a long-range strike

weapon, from Lockheed Martin, and Sweden is eyeing a similar capability, which would be a real contribution to NATO's conventional deterrence. Swedish and Finnish NATO membership would therefore bring new, well-equipped forces and high-quality capabilities into the NATO fold, albeit of modest size."<sup>47</sup>

The additions of Finland and Sweden would put to rest any question of who side each State's allegiances are derived. Without this, Russia might try to "exploit this gray zone, if it seeks to bring the Baltic States and the Nordic-Baltic region to heel. While Sweden and Finland are both close operational partners of NATO, and now members of a smaller group of enhanced partners, this counts for little in a collective defense and deterrence scenario. Both Sweden and Finland are crucial to the defense of the Baltic States, now on the frontline in NATO's renewed confrontation with Russia. Their membership would once and for all remove any doubt of Sweden and Finland's roles if the security environment in northeastern Europe were to deteriorate further."<sup>48</sup>

The enlargement of Finland and Sweden would also provide a powerful signal to Putin that The West is rising. "Swedish and Finnish NATO membership would also do much to reinvigorate NATO's now stalled enlargement, a process that had been underway since the end of the Cold War until Russia gave the alliance pause with the war in Georgia in 2008. That conflict, and now the Ukraine crisis, has largely stopped the enlargement process in Europe's east for now, but Swedish and Finnish membership in the near future could ultimately make it easier for Ukraine and Georgia to also join the alliance one day. Enlargement in NATO's north would signal that NATO's door remains open and that the alliance is intent to continue to play its role to advance Euro-Atlantic integration."<sup>49</sup>

Looking at the overall investments of military spending in Sweden and Finland leave more to be desired. Specifically, “even though their armed forces are capable, Stockholm and Helsinki spend only modest amounts on defense, far below the 2 percent of GDP that the alliance has set for itself as a benchmark, although most current members fail to reach that level too. The NATO summit in Wales in September gave a new impetus to increasing defense spending across the alliance, which now closely watches members’ spending levels and trends. Given their current levels of defense spending, bringing Sweden and Finland into NATO could be seen as letting in additional free riders, thereby lessening the pressure on current allies to increase their own defense spending. Furthermore, some current NATO members in central and Eastern Europe would probably worry that bringing in Sweden and Finland would further provoke an already irate Russia, which could result in more aggressive military, political and economic prodding by Moscow along NATO’s eastern flank. Sweden and Finland themselves may be subject to provocations during the membership process, which would further test NATO’s resolve in its approach to both expansion and Russia.”<sup>50</sup>

In totality, there appears to be more to be gained than lost with enlarging NATO to include Finland and Sweden. Most likely, “shoring up the northeastern flank, while also sending a message that enlargement is alive and well, could very well prove a decisive factor in overcoming the challenge posed by such an assertive Russia, especially in a global context of increasing geopolitical competition. NATO members can quietly support and prod Helsinki and Stockholm toward this outcome, but for now, the question of eventual NATO membership must first be answered in Stockholm and Helsinki.”<sup>51</sup>

**Section 13: [Recommendation 2: Continue to diversify export markets]**

The Estonian Government has continued to be a strong advocate and supporter of maintaining EU sanctions against Russia. Unlike many former Soviet countries, Estonia pivoted its market towards Western Europe after sharp downturns in trade after it regained independence, significant losses during the 1997 Russian ruble crisis and again during tension around the re-location of a Soviet War Memorial in 2007. However, the tourism, agricultural and logistics sectors remain more closely tied to the Russian market and were predicted to see sharp declines in revenue and bankruptcies after Russia imposed its embargo eight months ago. After meeting with representatives across these sectors, US Embassy-Tallinn has found that the reality indicates Estonia has diversified into other markets, yielding a positive trade balance and strengthening overall support for continuing sanctions.<sup>52</sup>

In 2014, Estonian exports are down 15 percent in 2014, but imports are up 8 percentage points, according to the Estonian Statistics Office. The Head of Economic Analysis Unit at the Ministry of Economic Affairs and Communications, Meelis Kitsing, told US Embassy-Tallinn, “The Russian countersanctions had a negative impact on the Estonian exports to the Russian market. However, the economic impact of countersanctions was relatively insignificant on the whole.” He highlighted that most of Estonian exports to Russia are re-exports where relatively little value-added is being produced in Estonia. “Re-exports make up more than  $\frac{3}{4}$  of Estonian exports to Russia in 2014. Significant role is played by re-exports of machinery and equipment originating from UK through Estonia to Russia.” He argued that trade statistics measuring exports of the basis of final value of goods overemphasizes the importance of Russia as an export destination for the Estonian goods. Further, the increase in imports was solely tied to an increase in the importation of oil and oil products.<sup>53</sup>

Russian countersanctions primarily impacted exporters of dairy and fish products in Estonia with dairy seeing the largest decrease (66 percent decline between 2013 and 2014). However, a strained trading relationship between Estonia and Russia existed prior to the 2014 sanctions when the Russian veterinary service (Rosselkhozadzor) implemented a ban on eleven Estonian dairy and fish exporters in January 2014 due to a perceived inspection failure. Ministry of Agriculture experts indicated the ban was driven primarily for political reasons adding to the propaganda. Russian inspectors had already subjected several Estonian dairy producers to sanitary inspections in the beginning of 2014. These inspections effectively closed the Russian market for dairy producers and forced new export destinations. Therefore, the impacts to dairy already existed prior to counter-sanctions. The decline in the total value of exports (all markets including Russia) of dairy products was 1 percent and 6 percent in fish products in 2014 in comparison with 2013. For a small market like Estonia, these percentages are relatively small. According to GoE experts, Estonian producers started to export dairy products to 19 new countries in 2014 increasing the total number of export destinations to 51 countries.<sup>54</sup>

**Table 3: [Change in Dairy Exports]**

Export Destination	Export (Euro)		Change (%)
	2013	2014	2013/2014
Russia	50.2	17	-66
Latvia	52	40.6	-22
Lithuania	62.3	79.7	28
Finland	26.6	24.7	-7
Others	18.8	45.8	144
Total	209.9	207.8	-1

Source: Statistical Office of Estonia

The Head of Market Regulation and Trade Bureau at the Ministry of Agriculture, Hannes Ulmas, told US Embassy-Tallinn that the embargo is being felt on most acutely on small farms in Estonia because these farms are least prepared to find new markets. Ulmas shared that dairy

sector revenue actually increased 0.3 percent last year, but export value decreased. Dairy exports to Russia fell from 20,000 tons in 2013 to 9,000 tons in 2014. The milk procurement price dropped from 38 cents a liter to 20 cents. Overall, 800,000 tons of milk was produced in Estonia in 2014, a 4 percent increase from 2013. Herd numbers decreased slightly, but productivity per cow increased. Fish exports to Russia decreased from 36,000 tons in 2014 to 28,000 tons in 2014. Representatives at the 2015 Agriforum (Estonia's major agricultural conference hosted by the Ministry of Agriculture), stated that almost across the board that diversification to other markets has enabled Estonia to offset the Russia bans on dairy and fish. In particular, presenters highlighted that Ukraine's demand for Baltic hearing increased as well as China, Vietnam, and African countries.<sup>55</sup>

While, flexibility exists in supplying fish to the global market, the dairy sector is more constrained in limiting throughput, according to the Ministry of Agriculture. The size of Estonian dairy herds was reduced by approximately 10 percent in 2014. Impacts to small dairy farmers in Estonia are felt on a larger scale since the herd sizes in Estonia are larger than other countries to include the United Kingdom and the Netherlands. A dairy farm in Jõgeva County, central Estonia, decreased its dairy cattle herd from 1,300 to 220, local newspaper Vooremaa reported. Head of the company, Alo Teder, said that the company would have finished with a 600,000-euro loss in 2015 in its current size.<sup>56</sup>

The GoE has made it clear it will support escalating economic sanctions against Russia for its aggression in Crimea despite some negative repercussions for the Estonian economy. Russia is currently Estonia's third largest trading partner. Major exports include machinery and food products. However, Estonia's tumultuous relationship with Russia has spawned a group of pragmatic entrepreneurs who often hedge their bets when conducting business with their eastern

neighbor. Press surveys of Estonian entrepreneurs conducting business in Russia have clearly shown a measured reaction to escalating sanctions with some concern that Russia may nationalize foreign companies. Yet, overall, there remains a large consensus within both the business community and population at large to support EU and US actions.<sup>57</sup>

Estonia's economic relationship with Russia has seen a number of economic friction points since Estonia regained its independence. These events have encouraged Estonian companies to take a cautious and measured strategy when doing business in Russia. In 1991, Russia was Estonia's largest trading partner, accounting for 92 percent of Estonian international trade. The GoE quickly reduced tariffs and non-tariff barriers after re-independence and abolished all export restrictions. This boosted competitiveness and foreign direct investment (mainly from Scandinavia) helped to re-orient Estonian companies towards the West, substantially decreasing Estonian dependence on Russia. This switch was further solidified when in 1995 the Russian Federation implemented double tariffs on Estonia (only finally removed in 2004 after Estonia joined the EU). Further, Estonian enterprises were negatively impacted by the devaluation of the Russian ruble that wiped out their competitiveness in the Russian market (for example, the export of food products fell by 44 percent in 1998).

In 2007, after the controversial relocation of the Bronze Soldier memorial from the center of Tallinn to the Tallinn Military Cemetery, Russia prohibited the transit of oil via the Estonian rail network. Further, trade between Estonia and Russia has also suffered from the implementation of questionable non-tariff barriers (such as health and safety certificates requirements on food products) on a relatively frequent basis. Most recently, on January 9, 2014 products made by five Estonian dairy companies and six fish processing companies were banned from the Eurasian Customs Union (the Russian Federation, Belarus and Kazakhstan). The

Russian inspectors who visited Estonia concluded that these dairy companies did not have complete control over raw milk and that the existing control system did not cover all of the antibiotics prescribed by Customs Union control regulations.<sup>58</sup>

There are worrying signs of further slowdown in 2015. Estonia's main trading partner and second biggest foreign direct investor after Sweden, is Finland. Finland's economy has contracted for the last two years and the growth forecast for this year is modest, around 1 percent. Any additional impact on Estonian foreign trade would likely swing Estonian GDP into negative territory. There would also be multiplying effects as other large Estonian trading partners such as Sweden, Latvia, Lithuania, and Germany are impacted by trade sanctions with Russia.<sup>59</sup>

Estonian companies doing business with Russia are not as concerned about possible sanctions as they are about a rapid devaluation of the Russian ruble and resultant impoverishment of Russian consumers. Several companies exporting to Russia, mainly those exporting building materials, sporting goods, toys, etc., have already reported a loss in 2014. Companies, who operate in Russia for the Russian market and operate in rubles, are in a more stable position. Companies like Premia Foods, a holding company listed on Nasdaq consolidating various food companies, has reported no loss from its plant in St. Petersburg in 2014 as it buys raw materials in rubles and sells in rubles. All companies agree that doing business with Russia is not getting easier and the companies have to prepare for the worst.<sup>60</sup>

The GoE is committed to escalating sanctions in line with EU and US policy despite any harm to its GDP growth. The business community, based upon a long history of disputes with Russia, is maintaining an even keel so far, although the length of sanctions or nationalizations could impact attitudes in the longer-term. Although not captured in trade figures, Estonia has



seen an increase in tourism from Russia over the last few years that would surely decline as sanctions bite. Estonia is also a major transshipment point for autos and auto parts headed to Russia. In the end though, the GoE and the vast majority of the business community are prepared to weather the storm but should continue to diversify into emerging markets as well as increase efficiencies. The bigger concern for Estonian companies is a sharp slowdown in Finland, which could have severe impacts for the Estonian economy. Enhanced diversification into emerging markets such as Africa and Asia is needed.<sup>61</sup>

The GoE has focused much of its efforts to find new markets in Asia. In January, Estonian dairy producers signed their first contracts with Marubeni Corporation of Japan for the sale of Estonian skimmed milk powder and cheese. Estonian dairy producers have started production, which complies with the requirements of the buyer, and the first deliveries of milk powder have arrived in Japan. Cheese deliveries are expected before the summer. According to the US Department of Agriculture in 2014, Japan was the fifth most important global importer of dairy products and the second most important cheese importer. A close Ministry of Agriculture contact also reported “China expressed interest in acquiring Estonian farms and establishing trade agreements. Estonian farmers are hesitant however in allowing foreign investment in terms of Chinese providing direct labor and resources to farm the land. Instead, Estonian would be interested in sharing best practices in growing blueberries” In January, China established a Memorandum of Agreement with Estonia to strengthen trade cooperation. Close cooperation is necessary to begin exporting meat and dairy to China, which is currently not allowed. Estonia is developing necessary food control certifications to open this market and trade is expected to begin by the end of 2015.<sup>62</sup>

#### **Section 14: [Conclusion]**

Today, the US faces enormous threats to our national security. Strategically in the end, the US has to continue to foster global partnerships with capable states as stated earlier in the NSS. If the US does not, in 30 years from now, we will not be able to compete with China or India; it will not be relevant what our great debates are since we will not have the capacity to defend our interests. The US will literally have fallen out of the game. If the U.S does not have the strongest, most creative, and most productive economy, we will not be able to sustain a national military capability on a worldwide basis.

Russia's recent actions at sea and in air are a constant reminder that the US and NATO must remain vigilant. Russia has been able to exploit the security situation to its own benefit, calculating that the US will not respond in any significant way. It will be far easier to deter future threats and defend the region from Russia than it will be to liberate it. With this in mind, Estonia and NATO should enhance their effectiveness by cooperating with other Baltic States such as Sweden and Finland. This enhanced partnership will offset the substantial losses from other countries contributions to NATO. Military actions alone involve substantial resources and President Obama repeatedly pledges that an attack on a NATO ally is an attack on the US NATO allies are looking to the US to defend their sovereign territory in the advent of an attack from Russia. However, 13 years of fighting the war on terror has left the American public with fatigue in engaging in conflicts.

Estonia has had, through history, one of the most vulnerable geopolitical positions in the world. Over the last 800 years, conquerors have come and gone. Today, Estonia seems perhaps more secure than it has ever been. The country has worked hard to be accepted as a full member of NATO and contributes to international missions. The inherent vulnerabilities are, however, still there. Estonia has to deal with cyber warfare and propaganda attacks. While continuing to

support EU sanctions on Russia there has been impact on Estonia's dairy and fish sectors. While the losses are minimal, Estonia should continue to enter new and emerging markets. Diplomacy can take many years to influence behavior so even though initial data reveals Estonia's economy is still thriving, diversification would be a wise insurance policy.



## End Notes

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