January 31, 2013

THE GEOPOLITICS OF ISLAMIC MILITANCY IN AFRICA: RISKS TO MINING AND ENERGY INVESTORS REMAIN HIGH

Bottom line: Bullish depictions of Africa as an untapped investment frontier have gained momentum in recent years. However, we believe the markets continue to underestimate the significance of several geopolitical challenges likely to weigh on African development over the short and long term. Islamic militancy – specifically Jihadi Salafism – represents one of the most significant of these challenges, most recently witnessed in the fall of Mali's north to Al Qaeda-linked rebels, and the Al Almenas hostage crisis in eastern Algeria. In this report we detail the geopolitical origins of this long-term challenge to African development, and outline the direct and indirect risks to investors. We believe risks are rising in Burkina Faso and Niger, and remain elevated in Mali, Mauritania, Libya and Algeria.

Introduction

In recent years, there has been an intensifying perception among investors that Africa represents an untapped frontier with significant growth potential. In many respects, this optimism is warranted. GDP growth averaged 5.2% in the 2003-11 period following the economic liberalization of the 1990s. FDI inflows – mostly in the budding mining and energy sectors – averaged $56,028 million 2005-10, supporting export growth of 7.9% a year 2006-10 (see Fig. 1). The middle class (i.e., per capita daily consumption of $2-20 dollars a day) grew to 34% of the population (350 million), up from 27% (126 million) in 1980.

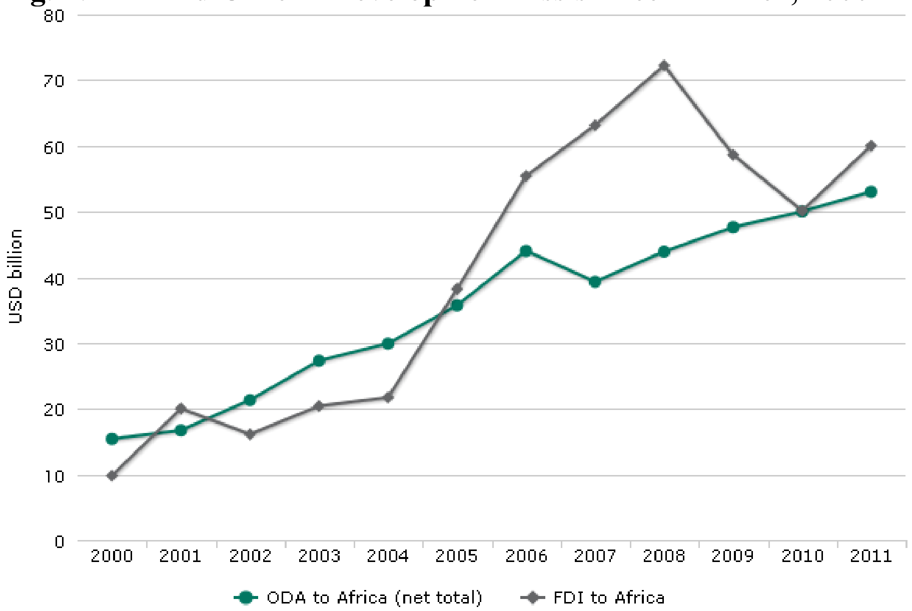
Despite these noteworthy gains, however, economic growth has not necessarily translated into African development.[1] The continent's Human Development Index (HDI) ranking is still the lowest in the world and has improved the least globally since 1980.[2] Dependence on foreign aid remains high, hitting a record $47,392 million in 2010, up from $35,833 million in 2005. Governments remain largely incapable of efficiently investing resource-derived wealth, most of which is instead co-opted to further the interests of a corrupt political elite. Diversification away from resource-dependency and into the more sustainable and job-producing sectors of manufacturing and services is in most cases minimal.[3]

[1] See, for example: Rowden, R. (January 2013), "The Myth of Africa's Rise", *Foreign Policy*

[2] The HDI is a measure of life expectancy, education and overall quality of life. Poverty (living on less than $1.25 a day) remains high at 47.5%, and average life expectancy is low at 54 years (vs. world average 68).

[3] See: United Nations (2011), "Economic Development in Africa: Fostering Industrial Development in Africa in the New Global Environment", *United Nations Industrial Development Organization*

Fig. 1: FDI and Official Development Assistance in Africa, 2000-11



Source: African Economic Outlook 2012

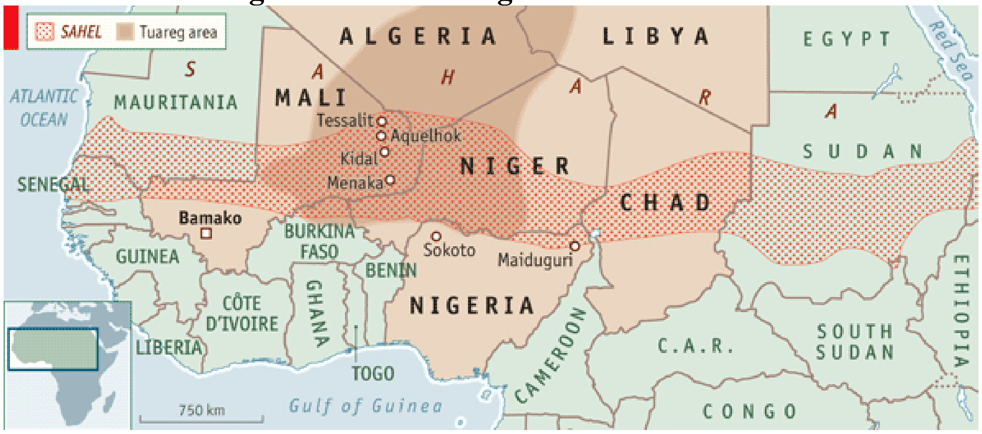
Compared with other developing economies with strong extractive industries (e.g., those in Latin America or Central Asia), we believe the geopolitical risks facing investors in Africa remain, for the most part, underestimated. As we detailed previously, these include: (i) political instability; (ii) lack of 'soft' infrastructure (e.g., low rule of law, widespread corruption); (iii) prevalence of tribal and ethnic-based conflict; (iv) rising competition from state-backed Chinese firms; and (v) underdeveloped hard infrastructure.[4]

Of all the geopolitical threats, we believe the steady rise of religious/ideological militancy – predominantly Jihadi Salafism – has been vastly underestimated, and will pose significant risks to foreign investors in much of Africa. If we have learned anything since the 9/11 attacks and the start of America's open-ended War on Terror, it's that this relatively small but growing number of fanatics have staying power, and can inflict significant damage to Western interests (see Fig. 5 below).

West, North and East African states have become particularly vulnerable to the rising influence of violent jihadist groups. This is due to their porous borders, weak central governments, limited military capabilities, expansive geography, widespread poverty and limited opportunities for marginalized youth – the main source of recruits (see Fig. 2).

[4] See our reports: "Beyond the Ongoing Turmoil in North Africa and the Middle East", April 2011; "The Geopolitics of Mining in Africa", August 2012

Fig. 2: The Sahel Region of West Africa



Source: Economist 2011

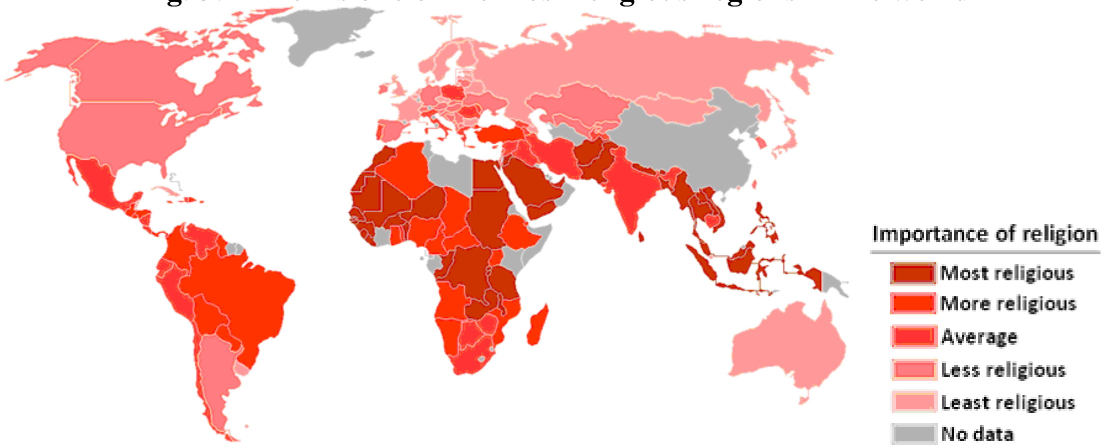
The market's current approach to Islamic militancy in Africa is largely dominated by short-term play-by-play analyses, which focus on individual terrorist attacks after they happen (e.g., the brief but intense assault on BP/Statoil's In Almenas gas facility in eastern Algeria). In this report we examine why Islamic militancy should instead be considered a long-term and open-ended challenge for development across much of Africa (see Section 2). We also detail why high-impact events targeting Western investment interests are likely to continue to increase in frequency and scale for the foreseeable future, and outline both the direct and indirect risks to investors (see Section 3).

1. Sources of Islamic militancy in Africa

Africa is one of the most intensely religious regions in the world (see Fig. 3). The divide between Muslims and Christians is particularly pronounced (see Fig. 4) and has fuelled violence and political instability across much of the continent, including: the civil wars in Ivory Coast (2002-07), Sudan (1983-2005), Somalia (1999-present), Liberia (1989-96; 2002-03) and Sierra Leone (1991-2002), among others.[5] Religiously-fuelled conflicts often last longer and display a higher intensity of violence than do strictly ethnic or territorial-based conflicts, and their effects are often felt in neighbouring trade partners, hampering development across entire regions.

[5] Basedau, M. et al (June 2011), "Do Religious Factors Impact Armed Conflict? Empirical Evidence from Sub-Saharan Africa", *German Institute of Global and Area Studies*, Working Paper No. 168. See also Horowitz, M.C. (2009), "Long Time Going: Religion and the Duration of Crusading", *International Security* (34) 2.

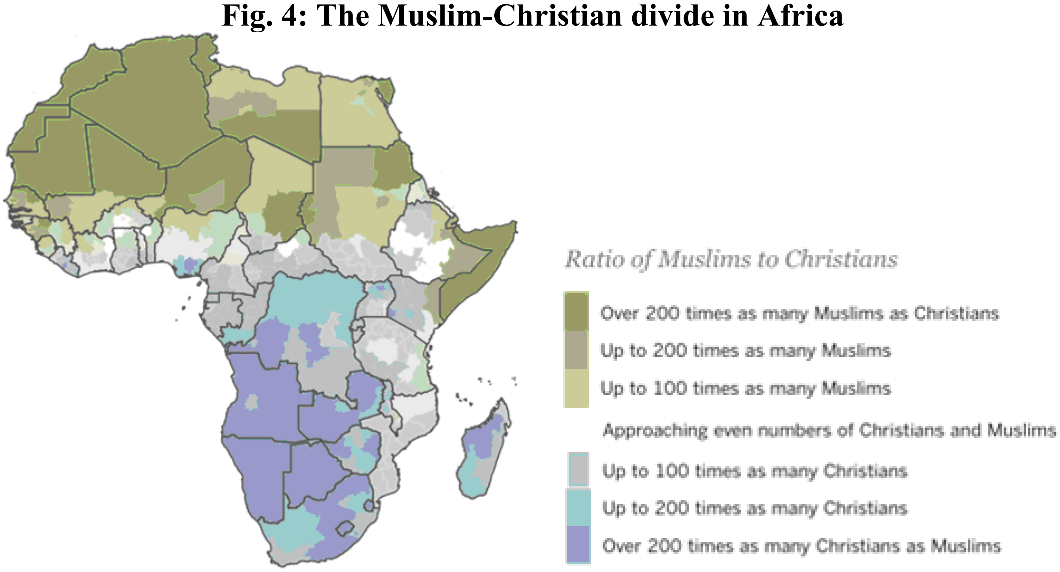
Fig. 3: Africa is one of the most religious regions in the world



Source: Gallup 2009

Islamic militancy (i.e., Jihadi Salafism) is of particular concern for investors as Western individuals, infrastructure and interests tend to be specifically targeted through kidnappings and calculated strikes.[6] Tribal, ethnic or territorially-based militancy, on the other hand, tends to lead to conflict within or between local groups and interests. Being driven by religious and anti-Western fanaticism, Islamic militants can be neither negotiated with nor co-opted like many of the strongmen that still dominate the majority of Africa's political systems.

Fig. 4: The Muslim-Christian divide in Africa



Source: PEW Research 2010

N.B. As the map shows, Islam is overwhelmingly represented across West, East and North Africa. Risks posed by Jihadi Salafism are therefore low in the predominantly Christian south, where influence and recruiting by militants are not viable, and anti-Western religious fanaticism much less prevalent.

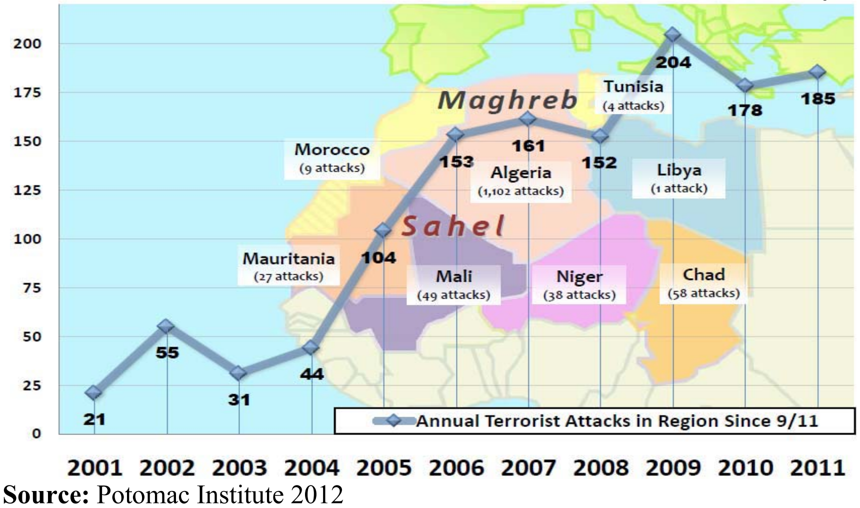
[6] See, for example, Ould Mohamed, M. (July 2012), "Purist Salafism in the Sahel and Its Position on the Jihadist Map", *Al Jazeera Center for Studies*

Al Qaeda in the Islamic Maghreb (AQIM) in particular has gained much attention of late following its involvement in the ongoing conflict in Northern Mali, hostage crisis at In Almenas in eastern Algeria and suspected links to the Sept. 11th attack on the U.S. embassy in Benghazi. Tracing its roots to the Algerian civil war (1991-2002), AQIM comprises a number of loosely-organized and semi-autonomous militant bands that seek to wage jihad on Western interests and the African governments that support them.[7]

AQIM cells have become increasingly active in a number of countries, regularly targeting Western interests and their supporters with suicide bombings, roadside bombs, kidnappings, assassinations and small-arms assaults (see Fig. 5). Other like-minded and strategically similar militant groups in West, North and East Africa include:

- **Ansar Dine ("Defenders of the Faith"):** Seeks to impose Sharia law over northern Mali
- **Movement for Unity and Jihad in West Africa (MUJAO):** Seeks to wage jihad against Western interests in Algeria, Mauritania, Mali and Niger.
- **Boko Haram:** Seeks to impose Sharia law over Nigeria's Islamic north; blamed for 1,400 Nigerian deaths since 2010.
- **Al Shabaab:** Seeks to destabilize the western-backed governments in Somalia and Ethiopia, although they are beginning to relocate elsewhere in the Sahel as the new Somali government continues to assert its power over the country.
- **Rafallah al-Sahati Brigade, the Libya Shield Force, and Ansar al-Shariah:** Libya remains vulnerable to several loosely organized rogue militias that initially helped oust Muammar Gaddafi, but now pursue their own interests (e.g., to impose Sharia law in Libya). In addition to AQIM, members of these groups are suspected of taking part in the attack on the U.S. embassy in Benghazi on Sept. 11th 2012 and attacking various energy installations.

Fig. 5: Terrorist attacks in North and West Africa rose substantially, 2001-11



Source: Potomac Institute 2012

[7] These semi-autonomous groups include, among others: The Masked Battalion (led by Mokhtar Belmokhtar, who orchestrated the In Almenas hostage crisis); The al-Furqan Squadron (behind most of recent years' attacks on Mauritanian targets); and The Tariq ibn Ziyad Battalion (based out of northern Mali and heavily involved in the current conflict). For an in-depth analysis of AQIM's origins and aims, see: Morgan, A. (Jan. 18, 2013), "Guns, cigarettes and Salafi dreams: the roots of AQIM", available at http://www.andymorganwrites.com/guns-cigarettes-and-salafist-dreams-the-roots-of-aqim/

2. Islamic militancy represents a long-term risk for investors

In the past, investors have generally viewed militancy on a case-by-case basis, placing emphasis on high-impact events (e.g., the Al Almenas hostage crisis) while generally underestimating the regional trends that underlie them (e.g., the rise of AQIM over the 2000s). It is also generally assumed the growing prevalence of violent non-state groups is attributable to a lack of military/security resources, and that militant jihadism will eventually be defeated. The jihadist threat is therefore generally thought to be readily solvable with 'quick fixes', i.e., if the West were to increase foreign aid or intervene militarily, such as France in Mali.

However, increased security or foreign military interventions alone do not represent a sustainable solution to the numerous fault lines that have allowed religious militancy to flourish in much of Africa. From a geopolitical perspective, several long-term structural challenges must also be considered:

a. *Weak governance and under-developed political and military institutions:*

This includes rampant corruption and the regular misappropriation of defence funding by government and military officials, as well as a lack of organization and leadership at both the military and political levels. This is to say that many African states not only lack the resources and training to maintain territorial sovereignty, but also lack the political will to do so due to corruption from within.

b. *Fragile political consensus within and between African states:*

Coordination between Mali, Mauritania, Algeria and most West and North African states is complicated by long-standing border-related and other grievances. The Economic Community of West African States (ECOWAS) has in its brief history repeatedly proven itself highly disorganized and incapable of putting lofty rhetoric into practical action. Additionally, regional powerhouse Algeria continues to resist both Western and African-led military intervention in the region.

Algeria prefers to address the region's militant threat unilaterally given the closed but controlling nature of the authoritarian government. This is in addition to its long history of engagement with extremist violence throughout the 1990-2002 civil war. This was recently demonstrated by the lack of cooperation and coordination with Western powers during the In Almenas crisis, which resulted in a high number of civilian casualties and the persisting confusion over what exactly transpired.

c. *Terrorism, militancy and smuggling go hand-in-hand, and are highly lucrative:*

An estimated $10 billion in cocaine bound for Europe and elsewhere is smuggled through West Africa each year, in addition to weapons, people and other illicit goods (see Fig. 6 below). While the lifeblood for many of the region's people over thousands of years, the smuggling trade is now mostly dominated by armed extremist groups, many of them Islamist.

Kidnapping westerners has also proven a dependable source of financing, particularly following the successful ransoming of 32 western European tourists by AQIM in Southern Algeria in 2003. AQIM alone has reportedly collected $70 million in ransom payments 2006-11, and MUJAO is becoming increasingly active in this area.

d. *An abundant supply of weapons that shows no signs of slowing:*

It is very easy for militants to gain access to the huge supply of weapons that move through the continent, whether smuggled, stolen or supplied by foreign governments. British-based Conflict Armament Research recently found Iran in particular has been secretly supplying massive amounts of arms and ammunition to several conflict prone regions throughout Africa.[8] The fall of Gaddafi's Libya also resulted in substantial weapon stockpiles being distributed across the "rainbow nation" of jihadists based in and around the Sahel.[9]

e. *The challenges of geography (harsh terrain and porous borders) and lack of infrastructure (logistical challenges):*

From a tactical standpoint, any offensive against Sahelian-based militants is likely to simply push these groups into neighbouring states, from where they can conduct guerrilla attacks, their preferred strategy. AQIM, MUJAO, Ansar Dine, Boko Haram and other militant groups in the region are well adapted to the harsh terrain, are highly mobile compared to traditional armies within the largely infrastructure-less region, do not see territorial borders as a constraint, have demonstrable staying power and are not readily distinguishable from civilians.

f. *Influx of foreign militants with a long-term view of jihad:*

Pakistani, Afghani and other global jihadists have reportedly increased their presence in the Sahel region following U.S-led anti-terrorism efforts in Yemen, Pakistan and Afghanistan. They will likely continue to do so. As noted by terrorism analyst Sid Ahmed Ould Tfeil, Al Qaeda believes that "wherever the necessary conditions and circumstances of jihad are available, it becomes a duty for jihadists to move to that place to provide support". Jihadists have in most cases a longer-term focus than democratic states where "war fatigue" can drain domestic support for such interventions (e.g., America's war on the Taliban in Afghanistan). They also have little regard for human life – including their own – which makes them formidable opponents.

g. *Growing interconnectedness between militant groups, and the increasingly transnational nature of targets, recruits and support networks:*

Despite the multiplicity of Africa's extremists and their objectives, there has been a convergence in purpose towards resisting Western influence in the region and beyond. Increasing cooperation and coordination between AQIM, Boko Haram, Al Shabaab and even Al Qaeda in the Arab Peninsula (AQAP, based out of Yemen) has also been reported (see Fig. 6 below).

It should also be noted that these militant groups' support networks transcend territorial and even regional borders. The weapons used in the In Almenas attack, for example, are allegedly of Libyan origin. The hostage takers are also being implicated in the Benghazi attacks, and reportedly included Algerian, Malian, Nigerien, Mauritanian, Egyptian and even Canadian nationals.

[8] See: Conflict Armament Research (2012), "The Distribution of Iranian Ammunition in Africa: Evidence from a Nine-Country Investigation", *Conflict Armament Research*

[9] Morgan, A. (Jan. 23, 2013), "Desert is their land: 'French up against Mali guerrillas who don't observe borders'", *RT News*

h. *Increased and open-ended foreign military intervention in Africa will further inflame anti-Western sentiment and help legitimate these groups' call for jihad:*

Coordination between Islamic militants and attacks on Western interests are likely to accelerate following the French-led intervention in Mali, which is seen by most of the region's militant groups as driven by a neo-colonist and anti-Islamic agenda. From a geopolitical standpoint, the intervention was primarily motivated by a fear Mali could become a haven for militants to launch attacks against European energy interests in Algeria (supplies one-fifth of Europe's energy needs), and Niger (supplies France with 70% of its uranium).

Fig. 6: Africa's "Arc of Instability"

Source: Potomac Institute 2012

3. Regional, country and project-specific risks attributable to Islamic militancy

We believe the markets are underestimating the long-term risks associated with radical Islam across much of Africa. This is given the increasing scale and reach of extremist groups, the fact that Western individuals and interests are being specifically targeted, that an increasing number of energy and mining projects are situated in remote, hard to reach and thus vulnerable locations, and that tackling religious militancy represents a significant long-term challenge not readily solvable through intervention or increased military aid alone.

The direct risks posed by such militancy are by now well known. They include kidnapping of skilled Western workers, assaults on mining and energy operations and the sabotage of critical infrastructure (e.g., pipelines, roads and power supplies). However, several additional indirect risks must also be considered, including:

1. *Increased input costs*, such as higher security costs to protect remotely located projects, higher insurance premiums, difficulties securing financing and higher labour costs (both foreign skilled and domestic unskilled) due to the "fear premium" of working in at-risk locations.

2. *Delayed projects/investment plans due to security concerns:* For example, IAMGOLD announced Jan. 23rd it was suspending exploration activities at its Sadiola and Yatela mines in Mali as a security precaution following France's intervention in the country. The stock traded down 14.5% following the announcement, alongside revised production and cost guidance.

3. *Increased security and military outlays are a long-term drain on already scarce public resources*, which could otherwise go towards infrastructure development (e.g., lower input costs), improving bureaucratic efficiency (e.g., reduce project delays), tackling corruption (e.g., reduce political risks) and improving the quality of life for domestic populations (e.g., reduce social risks). Prolonged instability in one country can also impact neighbouring economies, creating obstacles to development across entire regions. Burkina Faso, for example, imports 26% of its goods from neighbouring Ivory Coast. The 2010-11 religiously-fuelled violence there led to food shortages and price hikes, and eventually social unrest and small-scale mutinies in a number of Burkina's urban centres, forcing President Compaoré to flee for fear of a coup.

4. *Political instability, as already fragile political systems dominated by a strongman can unravel if senior officials are assassinated or forced to resign, or unpopular pro-Western policies pursued in Islamic states.* Several elaborate, if unsuccessful, assassination attempts by AQIM have been made on President Aziz in Mauritania due to his aggressive anti-extremist rhetoric and policies. Furthermore, these policies are being pursued in an attempt to generate goodwill with the United States and increase foreign military aid, which in turn helps him consolidate his grip on power. As a consequence, Aziz is increasingly criticized in Islamic Mauritania given the West is viewed with a high degree of skepticism. Mauritania has subsequently witnessed a spike in social protests seeking to oust Aziz from power.

4. Geopolitical risk profiles relative to African peers

As we noted in our report, "The Geopolitics of Mining in Africa" (August 2012), it is impossible to entirely avoid the numerous geopolitical risks to which investors in Africa are exposed. However, some countries are demonstrably more vulnerable than others, particularly with respect to the direct and indirect risks posed by Islamic militancy.

Following the French intervention in Mali, increased aggressiveness and coordination between jihadist groups throughout the region, and the open-ended and long-term nature of this militant threat, we believe geopolitical risks are rising in Burkina Faso and Niger, and remain elevated in Mali, Mauritania, Libya and Algeria.

- **Burkina Faso:** We reiterate our view that President Blaise Compaoré's authoritarian government – in power since a 1987 coup – remains vulnerable to political instability. In recent years, protests calling for his ouster have been rising in frequency and scale, a significant trend given the traditionally passive nature of Burkinabés in political and social life. Compaoré dissolved his government in 2011 after several hundred soldiers mutinied and demanded higher wages, forcing him to flee the capital for fear of a coup. The government lacks the democratic political institutions necessary to govern the country in his absence, which would create a substantial power vacuum. Burkina is also landlocked, making it vulnerable to external shocks (e.g., goods shortages or abrupt price increases), which also raises the risk of further social and military unrest. Compaoré's aggressive stance on Islamic militant groups in the region (particularly following the downfall of Mali's north), and the proximity of a number of remote mining projects to the porous Malian and Niger borders suggest the country could also become a target of militant attacks going forward.

- **Niger:** The dominance of the military and weak democratic institutions underlies Niger's exposure to political conflict and instability (the last coup occurred in 2010). The country has also been hit by a number of terrorist attacks in the past, mainly perpetrated by AQIM. Following France's Mali intervention, the country could be vulnerable to future attacks given the level of French investment interests in the region (70% of France's uranium is sourced from Niger).