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## **The Geopolitics of Nigeria**

Due to my work as an energy analyst, I often am asked about the theory of Peak Oil. This theory suggests that the world's productive capacity for oil is reaching a peak and, going forward, the planet is doomed to expend more resources to extract less crude oil. There is evidence to support this claim. The fastest growing oil production in North America is coming from sophisticated horizontal drilling in North Dakota, deep water drilling in the Gulf of Mexico and tar sands extraction in Canada. All three sources would be considered unconventional. Without creating new technologies to extract oil deposits that were previously unreachable (at lower prices), this oil would not be available.

At the same time, there appears to be ample conventional supplies in other parts of the world. The hurdle in these nations is mostly geopolitical. Iraq, for example, probably has undiscovered deposits. However, the lack of government stability discourages investment.

My position on Peak Oil is agnostic. It is definitely occurring in the developed economies which have been drilling conventional oil for over a century. However, this may not be the case in the developing economies. Due to the lack of political and social stability, many of these regions have not been fully explored. Thus, in the developed world, Peak Oil is an issue; in the developing world, geopolitics is the problem.

This situation is why the topic of this week's geopolitical report is important. Nigeria is a member of OPEC, the world's 12<sup>th</sup> largest producer of oil and its 8<sup>th</sup> largest exporter. Last year, Nigeria supplied 10.8% of U.S. foreign oil supplies, the nation's 4<sup>th</sup> largest supplier. Recently, Nigerian exports to the U.S. have declined 61% due to those supplies being shipped to other areas, including Asia and Europe.

The loss of Libyan crude oil has boosted the demand for light, sweet grades of which Nigeria is a major producer. The potential for further supply reductions due to rising tensions in the Middle East means that non-Persian Gulf oil supplies are becoming increasingly critical.

Given the current situation, it is important to have some idea of the security of supply from these other nations. And so, in this report, we will discuss the situation in Nigeria. We will offer a brief history of the country with a particular focus on the divisions that have developed over time and how they affect the country today. As always, the reports will conclude with potential market ramifications.

## **The History of Nigeria**

The Nigerian region has had a long, rich history. Evidence of human inhabitation has been found as far back as 9000 BCE. Although there are numerous ethnic groups in Nigeria, the three most prominent are the Hausa, Igbo and Yoruba.

There are two primary religions in Nigeria, Islam and Christianity. The former religion mostly dominates northern Nigeria, whereas Christians are concentrated in the south. In the north, Islam came via trade routes that passed along the sub-Sahara. The Islam practiced in this area was Sufi-influenced. Sufi practice can be of either Shiite or Sunni; its adherents are mostly Gnostic in theology. Because of the individualistic nature of Sufi practice, reform movements usually press for a stricter adherence to Sharia, the law of Islam. Nigerian Muslims are 95% Sunni.

Prior to colonization, separate empires developed in the north and south. In the southwest, a series of Yoruba-dominated kingdoms developed. The southwest was mostly a loose confederation of cities. In the north, along the sub-Saharan trade routes, the Borno Empire was established. The introduction of Islam also brought the Sokoto Caliphate, which was created in 1805.

Europeans began contact with the region in the 15<sup>th</sup> century. Portuguese and Spanish exporters established trading posts mostly to acquire slaves. The British began to explore the region in the late 1800s and established a protectorate in southern Nigeria in 1901. A series of conflicts led to further expansion into the north. By 1903, the British conquered the Sokoto Caliphate, ending its political power. However, it did maintain religious influence.

Under British rule, Christianity became established in the south. Missionaries established schools which offered a strong western education. One of the characteristics of British colonization was the practice of using local sympathizers to control the colonial population. Supportive locals allowed the British to expand their

control in many states with a relatively small British population. Nigeria followed that pattern. Unfortunately, such behavior tended to create social divisions. These divisions made the colonies easier to manage but also created conditions of potential conflict. At the same time, the British were generally open to allowing local cultural customs to be maintained. This included education.

The north resisted Christian infiltration. Muslim schools were maintained and southern Christians that migrated into the north were generally segregated from Muslims. Unfortunately, the Islamic schools were generally inferior to the British-supported Christian schools. This meant that southerners were able to take positions of influence and power. While northerners could congratulate themselves on resisting the British until the end, they were generally losing influence compared to their southern compatriots.

The British allowed Sharia law to be practiced in the northern regions but steadily reduced its influence. By the time the British were preparing to grant Nigeria independence, the jurisdiction of Sharia law was reduced to an appeals court for personal issues between Muslims. The British and most of the southern Nigerians viewed Sharia law as incompatible with a religiously diverse society. However, most Muslims viewed the reduced scope of Sharia law as elevating Christian jurisprudence over Islam.

Nigeria was established in 1960 by Britain's decision to grant independence. The country was divided into three administrative districts, the northern, western and eastern. Right from the start, there was fierce competition between the

regions. This competition undermined the ability of civilian governments to function.

The lack of cooperation led to military governments taking power in 1966. The military was as divided as the country, which led to a series of coups and the tragic Nigerian civil war. The Igbo-dominated eastern province declared itself a country in 1967, sparking a civil war; the Biafra republic lasted until 1970 and was defeated in a war of attrition that led to mass starvation.

After the civil war ended, the northern military tended to dominate the government. Northern Nigerians also tended to dominate the military as a consequence. As each general retired, he found he needed a place to rule, and so the north was steadily divided into multiple administrative districts. As noted above, at independence, the country had three districts; by 1996, the country had 36. The goal of each leader was to acquire resources from the central government.

Those resources became available through oil. The British had discovered commercially viable oil fields in the late 1950s and granted rights to private companies. Most of the oil centered around the Niger River delta. Due to persistent strife, oil production was irregular; in fact, Biafra included the Niger River delta, which probably explains why the rest of Nigeria fought so hard to prevent secession. In 1971, the Nigerian government nationalized the oil industry and joined OPEC.

The term “resource curse” was developed by economists after watching what happened to the Dutch economy after 1959 when large natural gas deposits were discovered. Essentially, when a large natural resource field is discovered and is exported, the exchange rate appreciates. This tends to

make other industries in the country uncompetitive. The problem is exacerbated if natural resource exports become the primary provider of government revenue. The goal of businesses and households is to claim part of the economic rent that comes from natural resource revenues.

For Nigeria, the exploitation of oil reserves did indeed become a curse. The juntas that governed the country became infamous for controlling the massive fund inflows from oil sales. Although oil reserves were located in the south, the local population saw little of the benefits but reaped the bitter fruit of environmental degradation. This led to an insurgency in the Niger River delta that has only recently been contained through increased benefits to the region.

Since the generals that ruled Nigeria were from the north, one would assume that this region benefited from the wealth flowing into the country. However, the generals kept the money for themselves and the north suffered from the resource curse. Cotton and other agricultural exports, which were produced in the north, became uncompetitive as the exchange rate appreciated. As agricultural livelihoods were lost, these former farmers moved into urban areas. Unfortunately, these rural citizens usually lacked the skills to prosper in an urban environment. This led to simmering social tensions as these immigrants from the countryside tried to assimilate.

The other problem with the resource curse is that the economy becomes dependent upon the price of that commodity. Boom periods become busts when the commodity price declines. For Nigeria, petroleum accounts for 40% of its GDP and 80% of government revenue. With the high importance of oil, no other industry can really compete. So, as

we noted above, the road to riches in Nigeria is to somehow capture some of the fund flow that comes from oil sales. Most Nigerians believe that getting a government job is the best way to get these flows. Thus, there is little incentive to start a business or create new industries.

The military governments that ruled Nigeria after 1966 all promised to return “soon” to democratic civilian governments. It wasn’t until 1999 that this actually occurred. Since 1999, there have been three presidents, Olusegun Obasanjo, Umarau Musa Yar’Adua and Goodluck Jonathan. The unwritten rule has been that the presidency should rotate between a southerner and a northerner. So far that has been followed, as Obasanjo and Jonathan are southerners and Yar’Adua was a northerner. However, Jonathan took power after Yar’Adua died in 2010 and some northerners argued that his finishing the term of the deceased president represented the south’s “turn.” Jonathan disagreed; in 2010 he announced he would run for president in 2011. He won handily, although there were accusations of voting irregularities.

### **The Nigerian Divide**

The north-south divide in Nigeria is the primary separation, although the country is also split by tribal and inter-religious divisions. Northern Nigerians, due to their inferior educational systems and the undermining of local industry due to the dominance of the petroleum industry, live in deep poverty. The Nigerian central bank has observed that the highest levels of poverty are in the north. The bank says that 95% of northerners are classified as “impoverished” with 76% living on incomes of under \$1 per day. Literacy rates are lower than in the south; national examination scores decline the further one moves north. The only real

source of income is what can be received from the government.

The frustration for many northerners is that, for most years since independence, one of their own has been in power. And yet, they remain poor. This factor has led to the belief that these Muslims in power have been corrupted; had they remained faithful to their religion, conditions would improve. And so, this belief has led to the emergence of insurgent groups, described as the “Nigerian Taliban” and “Boko Haram.” The latter is an insightful name, meaning “Western education is a sacrilege.” These insurgent groups, which have been responsible for a recent series of bombings and attacks, are trying to create a Salafist government in the north, one that completely relies on Sharia law. We doubt the movement will be successful, but it does have the potential to disrupt the economy and political system and, potentially, oil flows.

### **Ramifications**

The point of this report is to show the tenuous nature of the political and social stability of Nigeria. Historical divisions between north and south have flared into civil war in the past and the potential for conflict is always high. To a great extent, oil revenues are used to smooth out these divisions. Unfortunately, oil also carries the resource curse, which tends to undermine other economic activity.

To paraphrase Tolstoy, “well-run nations are all alike but crisis-ridden countries are troubled in their own ways.” Virtually all the OPEC nations are troubled in one way or another. It is important for investors to understand how they are troubled. This allows an investor to have some context for which to place reports of strife. For example, despite reports that terrorist acts by

Boko Haram are tied to al Qaeda, it is more likely that the insurgency is home grown. In other words, Nigeria's history would suggest that the divisions between north and south and the relative poverty in the former would tend to support unrest. The fact that it is coming from a Salafist perspective probably reflects disappointment with the corruption found in the Muslim generals.

Nigeria has the potential to fall into civil conflict at any time, but it is most likely to occur in a period of falling prices. In such an environment, it will be difficult for the government to smooth out the nation's differences due to the lack of funds. As long as oil prices are strong, Nigeria should be able to maintain production.

Essentially, we don't think the world is running out of oil. However, we do believe that most of the conventional oil is going to be produced in geopolitically risky places. As such, there will always be a risk premium built into oil prices. Part of establishing a correct risk premium will depend on understanding the specific risks in each oil producer.

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