



**A CONCISE BACKGROUND AND HISTORY OF THE
PUNTA COLONET MULTIMODAL PROJECT IN BAJA CALIFORNIA**

**by
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Brief Overview of Mexico's Evolving Development Strategy

"The Punta Colonet Megaport will represent one of the largest development projects in Mexico's history."

From the 1930s to the early 1980s Mexico adopted an inward-looking development model known as Import Substitution Industrialization (ISI). The ISI model focused on propping up national industries by producing more goods domestically and substituting these goods for Mexico's imports. In essence, the strategy was a long-term stimulus package financed by the government of Mexico to invest in capital and promote growth in the domestic economy. Following the implementation of ISI, it soon became evident that Mexico's domestic industries were unprofitable, leading to a large incurred debt, which soon became unsustainable. Mexico borrowed a substantial amount of U.S. dollars to finance the ISI strategy while the peso was overvalued. During the 1980s the U.S. Federal Reserve tightened monetary policy and increased the prime lending rate to almost 20%. Consequently, countries like Mexico that borrowed substantial amounts in U.S. dollars struggled to pay off their acquired loans. After Mexico announced that it was unable to pay its debt obligations in August 1982, the value of Mexico's peso fell precipitously, as foreign investors withdrew their money and reinvested in other currencies (Franko, 2007, p. 84-88). The depreciated currency worsened the financial crisis significantly, inducing Mexico to reevaluate its economic development strategy over the following years.

The implementation of the North American Free Trade Agreement (NAFTA) in 1994 manifested Mexico's transition from an isolationist to a globalized economy. NAFTA's role in transitioning Mexico to an outward-looking, export-oriented economy is well documented. Trade volumes and values among the three member countries – the United States, Mexico, and Canada – have increased dramatically since the advent of the agreement. Mexico has benefited tremendously from this economic integration due to its close proximity to the United States and its heavily consumption-oriented society.

It is in the context of Mexico's transition to a globalized, outward-looking, and trade-oriented economy fomented by the implementation of NAFTA that we understand the importance of the Punta Colonet Megaport Multimodal Project in Baja California. The Megaport was conceived as a response to the growing congestion experienced by the west coast Ports of Los Angeles and Long Beach, whose capacities to accommodate substantial trade increases have become strained. As such, the Megaport represents an extraordinary opportunity for Mexico to gain a substantial market share of trade cargo destined for the United States by capitalizing on the capacity limitations of major west coast U.S. ports. The Punta Colonet Megaport will represent one of the largest development projects in Mexico's history.

The Punta Colonet Megaport Site and Project Status

The site of the Megaport will be located in the community of Punta Colonet, which provides an extensive and easily accessible coastline for port construction. It resides about 65 miles south of Ensenada, Baja California and approximately 150 miles south of the U.S.-Mexico border. Punta

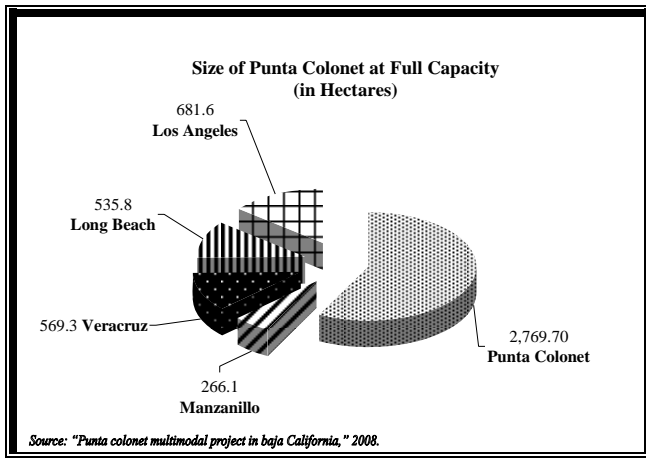
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Colonet currently houses a sparse population of approximately 2,500 inhabitants, who live as subsistence fisherman and farmers.

The *Punta Colonet Multimodal Project in Baja California* is a tender document that was released by the Secretaría de Comunicaciones y Transportes (SCT) in August of 2008 to inform the general public about the Megaport project. The SCT forms part of the cabinet of Mexico’s federal government and is responsible for supervising the Megaport project and outlining the basic aspects and characteristics of its development. According to the tender document, the SCT plans to develop the relatively untouched coastline into a port extending 2,769 hectares or approximately 11 square miles (p. 14); the site is divided into 83 hectares of federally owned land and 2,686 hectares of territorial ocean water (p. 16). The tender document also estimates that developing the land to full capacity – including the construction of the terminal, railways, and other infrastructure – will cost approximately US \$5 billion (p. 13). At full capacity, the Megaport is expected to handle about six million twenty foot equivalent units (TEUs) by 2022 (“Potential economic effects on the local community of the proposed multimodal port at punta colonet, mexico,” 2009, p. 1). Figure 1 shows the estimated size of Punta Colonet relative to other ports on the west coast and in Mexico.

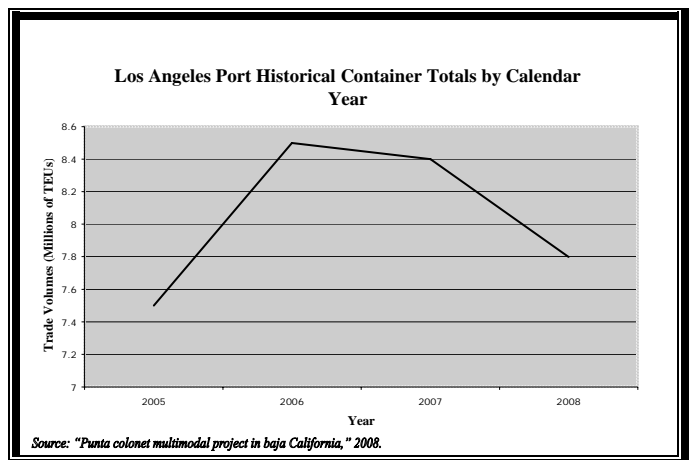
Figure 1



However, the recent economic downturn has conjured up speculation regarding demand for the port’s immediate construction. In January 2009, the federal government of Mexico postponed the bidding process for the Megaport’s development until the end

of the year because of the current financial crisis (“Potential economic effects on the local community of the proposed multimodal port at punta colonet, mexico,” 2009, p. 1). Lower demand due to the recession has resulted in the reduction of TEUs destined for the North American west coast. Figure 2 illustrates the considerable decline in trade volumes to the Port of Los Angeles from 2005 to 2008, suggesting that further declines in trade volumes will ensue should the economic recession continue. Such reduced trade volumes have lessened the originally problematic congestion within both the Los Angeles and Long Beach Ports. Consequently, the urgency for the Punta Colonet Megaport’s immediate construction has also diminished.

Figure 2



Despite the economic downturn and the corresponding decrease in trade volumes, planned port expansions in Canada and the United States are still underway. For example, the Prince Rupert Port in British Columbia, Canada is planning to increase its current annual capacity from 500,000 TEUs to 2 million annual TEUs by 2014 (“Evaluation of punta colonet multimodal project plan,” 2009, p.3 and Casey, N., 2009). Canada’s Vancouver Port also plans to increase its current annual TEU capacity by approximately 50% to 3 million by 2020 (“Vancouver port authority: Roberts bank container expansion terminal 2 and deltaport third berth,” 2003). And in the United States, the planned expansion of the Los Angeles Port will increase annual TEU capacity from about 8 million to almost 10 million by 2015 (Casey, N., 2009 and “Evaluation of punta colonet multimodal project plan,” 2009, p.3). Table 1 highlights the

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current capacity and planned expansions of the ports mentioned above along with their anticipated dates of completion.

Table 1

Planned Port Expansion Project	Current Capacity (annual TEUs)	Additional Capacity (annual TEUs)	Final Capacity (annual TEUs)	Date of Completed Expansion	% Change in Capacity
Canada's Prince Rupert	500,000	1,500,000	2,000,000	2014	300.00
Canada's Vancouver	1,600,000	1,400,000	3,000,000	2020	87.5
Los Angeles'	8,000,000	1,800,000	9,800,000	2015	22.5

Source: "Evaluation of punta colonet multimodal project plan," 2009. Casey, N., 2009 "Vancouver port authority: Roberts bank container expansion terminal 2 and deltaport third berth," 2003.

Such increases in capacity at these major west coast ports only further speculation regarding the demand for and/or utility of the proposed Megaport at Punta Colonet. Given these concerns, on October 19, 2009 the Secretaría de Comunicaciones y Transportes (SCT) published a change in the tender document, announcing that the initial Megaport design was not compatible with current market conditions. To ensure the Megaport's profitability and feasibility, the SCT has begun a consultation to reassess market conditions and reconstruct the design to respond to these conditions. While the SCT believes the initial stage of the port's annual TEU capacity will change from 2 million to 1 million, no official specifications of the project have been released. Once the proper analysis and estimations have been made following this consultation process, the SCT will move forward with the bidding process and the "re-launch of the Punta Colonet Megaport" will follow.

Reasons for Building the Megaport at Punta Colonet

Space for port expansion is extremely limited in highly urbanized areas on the North American west coast. Furthermore, stringent environmental regulations serve to deter port expansion projects in the United States. Thus, locating a Megaport at Punta Colonet is an opportunity for Mexico to provide a solution to these constraints while absorbing the anticipated growth in trade from China and alleviating congestion in US west coast ports. Due to its strategic location, the Megaport represents one of the shortest and most direct routes from Asia to the vast consumer market in the United States. Additionally, Chinese

manufacturers are seeking an alternative to the Los Angeles and Long Beach Ports to offset the growing costs associated with the United Transportation Union, U.S. Longshoreman Union, and other U.S. transportation unions whose higher wages drive up the costs of transportation.

The Bidding Process

The *Request for Proposal* which is found in the tender document defines criteria for the development of the port, terminal, railroad, and other necessary infrastructure. The federal government of Mexico seeks a business plan which can "react to market changes and ensure the port's international competitiveness" ("Punta colonet multimodal project in baja california," 2008, p. 19). The government concessions for the Port Authority and Terminal will last for 45 years and a third concession will be given for the Radio-Electric Frequency Band which will last for 20 years ("Punta colonet multimodal project in baja california," 2008, p. 19). The concessions may be renewable, depending on the terms of the agreement between the winning bidder and the federal government of Mexico.

Given the decision to delay the bidding process due to the uncertainty associated with the economic recession, the SCT is reexamining the Megaport's bid specifications. The SCT is currently collaborating with financial experts to define the conditions necessary for the port's success in today's market. Consultations with port construction and railroad operation experts will identify essential parameters for interested bidders to work within when creating their proposed designs of the Megaport. This information will be compiled in the new *Punta Colonet Multimodal Project in Baja California* tender document.

The federal government of Mexico will then assess the merits of new bids and their proposed designs before making its decision. In conjunction with financial experts, the SCT railroad and port departments will ultimately determine the winning bid through a close examination of the proposed bid's economic viability. While the federal government of

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Mexico has not disclosed any information regarding interested bidders, the government has confirmed that there are currently four bidders; and the SCT expects that the number of bidders will increase once the new tender document is released. The bidding process is expected to re-open in December of 2009.

Developing Infrastructure and City Planning

In order for the Punta Colonet Megaport to eventually handle an annual capacity of 6 million TEUs, large investments in infrastructure, land, related facilities, and equipment are required. The infrastructure required to make the Megaport fully operational includes a commercial port, airport, railroad

“Total expenditures necessary for the Megaport’s complete construction are approximately USD \$5 billion.”

station, and railroad lines. Land development also requires making utilities accessible to the currently underdeveloped region and transferring water, electrical power, and natural gas to Punta Colonet. Figure 3 identifies the estimated infrastructure expenditures from the tender document. Total expenditures necessary for the Megaport’s complete construction are approximately USD \$5 billion (“Punta colonet multimodal project in baja california,” 2008, p. 13).

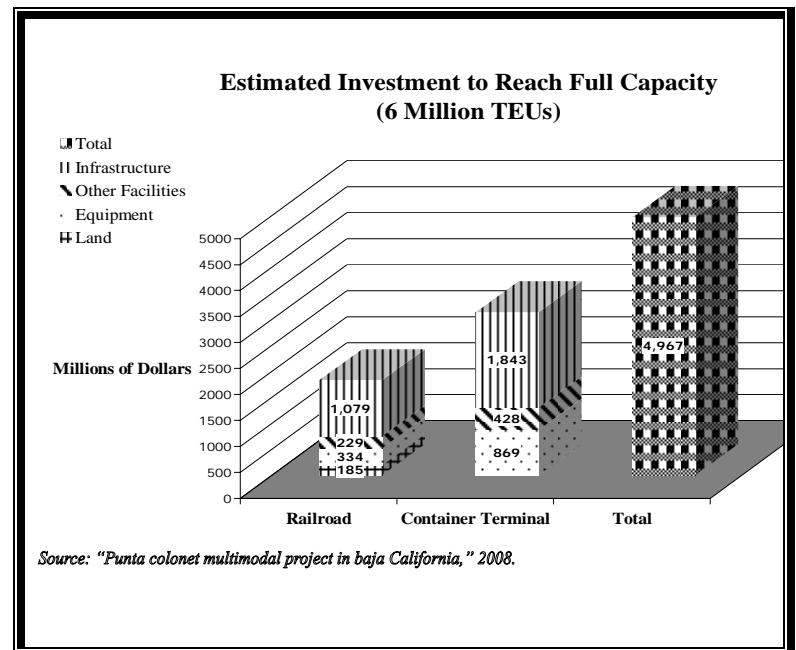
Furthermore, the port’s construction and operation will generate a significant increase in employment and investment opportunities, which will spur the development of a large city. However, plans for a city in conjunction with port construction are tentative and contingent on the port’s design. The *Program for the Urban Development of the Population Center of Punta Colonet* outlines objectives for orderly urban growth and land-use regarding the Railway Project and Port Development Zone. For example, the plan contemplates water, electrical power, and sewage systems, as well as services pertaining to housing, education, and health for a city whose population is estimated to exceed 200,000 people (“Potential economic effects on the local community of the proposed multimodal port at punta colonet, mexico,” 2009, p. 2). To ensure that the city planning efforts are adequately met, the winning bidder will allocate resources to develop a trust fund,

which will contribute to the urban development plan and construction. The Secretaría de Desarrollo Social, the government of the State of Baja California, and the City of Ensenada are all involved in the planning process associated with the development and urbanization of the Punta Colonet community.

Transportation of Goods from Punta Colonet to the United States

After the new tender document is released, the plans for transporting goods from the port via railroad to the U.S. border will be decided by the winning bidder. Currently, there is no defined route but several rail pathways are being considered. Ferromex, a subsidiary of Grupo Mexicano, currently operates an existing railway whose path could be connected to run north from Punta Colonet to the city of Mexicali. Ferromex also operates a second route, which could connect with Punta Colonet and travel northeast into Nogales, AZ. Other options being considered include constructing a railway to Yuma, AZ, which would extend northeast approximately 155 miles from Punta Colonet. The SCT is currently assessing possibilities for a federal and state highway program to facilitate movement of goods via truck.

Figure 3



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Economic Impacts to the Region and Investment Opportunities

“The Megaport will essentially serve as an economic engine for the local Punta Colonet community.”

The opportunities created by the construction and operation of the Megaport and its associated infrastructure will have a significant economic impact on Baja California. The SCT estimates that the construction of the railway, port, and other

urban infrastructure will create approximately 24,000 jobs (“Punta colonet multimodal project in baja california,” 2008, p. 14). According to the SCT, a total of USD \$125 million will be earned in wages for these construction services. During the operation phase, there will be an estimated 59,000 jobs required to operate the port and railway every year (“Punta colonet multimodal project in baja california,” 2008, p. 14). However, this does not contemplate the creation of jobs that are not directly related to port activities, but which nevertheless will arise due to the demand for other goods and services resulting from the population center in and around Punta Colonet.

In addition, opportunities for foreign investment have been emphasized by REMAX and other real estate companies who see a large return on purchasing land in Punta Colonet. This return is triggered by population growth in the area, which will increase demand for the land, thereby driving up the price of real estate. The Megaport will essentially serve as an economic engine for the local Punta Colonet community and its effects will reverberate throughout Baja California and the border region.

Environmental Impacts

Since environmental impacts depend on the design of the multimodal Megaport project, no environmental impact study has been released. Once the winning bidder has been determined and the design of the Megaport finalized, an environmental assessment will determine the environmental risks before construction of the Megaport actually begins.

However, Energy and Environmental Research Associates – a private consultant – released a report on April 6, 2009 which identified several environmental concerns related to the port development in Punta Colonet. The most significant

issue identified by the report was water scarcity, given that the Punta Colonet region has traditionally been an agricultural economy dependent on farming and fishing. Since water resources are already severely strained in Baja California and water delivery infrastructure is alarmingly deficient, many environmental researchers are questioning the logic and feasibility of constructing a major port and city of approximately 200,000 people. Therefore, the provision of an adequate water supply to fuel the operation of the Megaport and to support the surrounding city of at least 200,000 people will be an extraordinary challenge for the Megaport’s developer and governmental authorities.

In order to meet the demand for water, the Secretaría de Desarrollo Social of Mexico is investigating the possibility of introducing a water desalination plant to remove excess salt and other minerals from the water, making it suitable for human consumption. However, desalination plants are typically much more expensive than freshwater extraction and require an inordinate amount of energy to operate. As such, a desalinization plant has been deemed inefficient and “uneconomical for the Baja California Region” by Energy and Environmental Research Associates (“Evaluation of punta colonet multimodal project plan,” 2009, p.12).

The construction and operation of the port and city will also augment intermodal traffic within the region, exponentially increasing water and air pollution. Ballast water and sewage discharge from ships represent a significant threat to marine life and human health. Moreover, as urban precipitation runoff reaches the ocean, the pollutants will have adverse effects on marine ecosystems. Ports also emit large quantities of air pollutants and greenhouse gases including sulfur oxide (SO_x), particulate matter (PM), volatile organic compounds (VOCs), nitrogen oxide (NO_x) and carbon monoxide (CO) (“Potential economic effects on the local community of the proposed multimodal port at punta colonet, mexico,” 2009, p. 19). Not only do these contaminants contribute to climate change, but they are also responsible for a variety of health-related problems such as asthma, heart disease, and lung cancer (“Potential economic effects on the local community of the proposed multimodal port at punta colonet, mexico,” 2009, p. 20).

Punta Colonet’s environment houses many of Baja California’s unique plants not found anywhere else in the world. According to the website Project

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Punta Colonet, habitats at risk include vernal pools, coastal dune communities, coastal sage scrub and maritime chaparral (“Protect punta Colonet,” n.d.). Given this diverse habitat, port construction and operation may adversely effect the environment if meaningful measures to mitigate such effects are not implemented.

Conclusion

Once the global economy recovers and consumption patterns rebound, the need for an alternative port to handle increasing trade to the United States will again become a priority. The Punta Colonet Multimodal Project in Baja California is a potential option to serve this need because of its strategic location on the Pacific Rim and its proximity to the vast United States consumer market. As such, the Megaport will create a multitude of economic linkages between Asia, Mexico, and the United States, thereby strengthening Mexico’s presence and role in the global economy. Not only will the Megaport raise

Mexico’s trade profile, but it will also stimulate the development of a formidable local economy on the US-Mexico border.

However, there remains a high degree of uncertainty regarding the Megaport’s bidding process, its construction, operation, and local community and environmental impacts. The SCT will continue to collaborate with financial experts to gain more insight and information about forecasted market conditions, which will serve to inform and define new bid guidelines meant to ensure the Megaport’s profitability and success as a development tool. Nevertheless, planning efforts will need to cope with a variety of issues and concerns that have not been sufficiently considered. Water scarcity, other environmental impacts, and growing pains associated with the urbanization of the Punta Colonet community will have to be addressed in an effective, coherent, economical, and responsible manner.

Author Biography

Ryan Forster is currently a junior at the University of San Diego pursuing his B.A. in Economics with a minor in International Relations. He authored *A Concise Background and History of the Punta Colonet Multimodal Project in Baja California* while interning at the Trans-Border Institute during the Fall 2009 semester. Ryan aspires to gain experience in the fields of economic development and foreign policy.

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