

Economic Forecast

2014 GUAM-CNMI EDITION

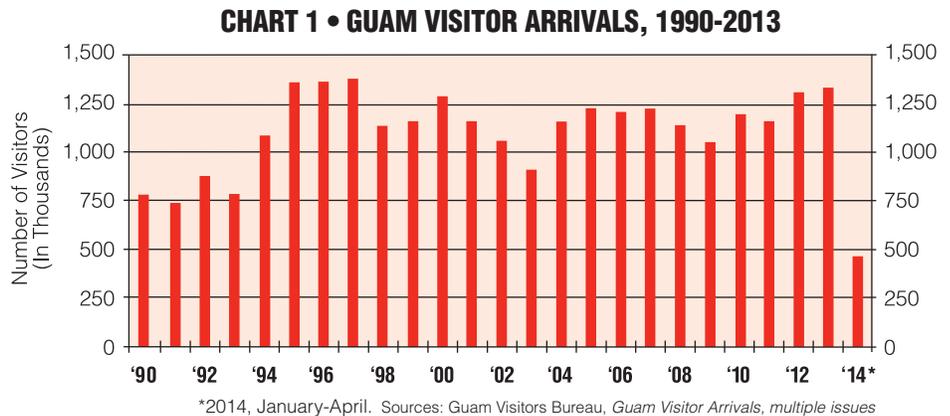
Guam: Stable, Resilient in 2013; Promising in 2014

Guam's tourism industry last year welcomed visitors in numbers not seen since the mid-1990s, and from an increasingly diverse list of markets. The long-awaited military realignment, which would transfer thousands of troops and dependents from Okinawa, is coming into clearer focus.

Thanks to these and other factors, 2014 is a promising year for Guam, whose economy has been stable and resilient since 2002.

EXECUTIVE SUMMARY:

- **Tourism:** 2013 was another solid growth year for tourism in Guam, with 1.334 million visitors, a level not seen since 1995-97. (Chart 1) This demonstrates the resilience of tourism, thanks in part to increased diversification; the lower Japanese visitor count was more than made up for by more visitors from other markets. For 2014, early data show arrivals down 0.6% from January-April compared to 2013.
- **Military Realignment:** Overall federal spending in Guam was down 12.9% in Fiscal Year 2013, no surprise due to U.S. government budget challenges. Military contract spending was off 20.4% from the prior year. While both totals continued to be low in the first half of Fiscal Year 2014, they are expected to increase for the rest of the year, given increased military spending for several projects, some related to the military realignment plan. These projects, along with release of the draft Supplemental Environmental Impact Statement on April 18,



indicate progress on the military realignment in Guam, though it would be at a reduced size and pace and pending resolution of the issue on how to protect wildlife near the Department of Defense's preferred location for building a firing range complex.

- **Inflation:** Guam enjoyed zero inflation in 2013, continuing very low into early 2014. Barring drastic hikes in global fuel prices, inflation is not likely to be a concern in the near future.
- **Real Estate:** Except for some "hot spots" in commercial sales, many driven by strong tourism, 2013 was not the best year for the Guam real estate market. Residential median prices were lower than in the last three years. In light of new information showing the reduced size of military relocations from Okinawa, it is not clear how much boost the real estate market will get from the realignment.

INTRODUCTION

As this report predicted last year, 2013 was as good as or better than 2012, thanks to favorable developments in Guam's main economic drivers: Tourism, Federal Government (including Military) and the Local Economy.

2014 is another opportunity to showcase Guam's economy as stable and resilient. Estimates show Guam's Gross Island Product (GIP) holding steady at around \$4 billion every year from 2002-2012 (the last figure available). Some local leaders see this as an economy that is "stuck" or "lukewarm" (*Guam Business Magazine*, 2013, September-October). Others see it in a positive light, i.e., the economy is "stable" despite recurring challenges, many caused by outside factors. That Guam holds its ground shows it to be resilient, indeed!

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ON THE INSIDE

6 CNMI Economy: Tourism Strong, Saipan Casino Planned

MACROECONOMIC ENVIRONMENT

Gross Island Product (GIP)

In December 2013, the U.S. Department of Commerce-Bureau of Economic Analysis (BEA) released its estimates of Guam's GIP, showing that the economy slowed in 2011 but regained momentum in 2012, back to the 2010 level of \$4.06 billion (in real terms, using 2005 prices). With BEA estimating Guam's population at 159,800 in 2012, this translates to a per-capita income of \$25,388.

First Hawaiian Bank Business Activity Report

First Hawaiian Bank, largest local processor of credit and debit card transactions in Hawaii, provides merchant services to nearly 7,000 customers throughout Hawaii, Guam, and CNMI. The bank's Guam Business Activity Report (Chart 2), which tracks debit and credit card spending for 11 economic sectors, shows card spending in Guam flat in 2013 following three years of increases. This does not necessarily mean that residents slowed their purchases; they may be using more cash instead of cards.

For the first quarter of 2014, the bank's Guam Business Activity Report grew 5.08% compared to the first quarter of 2013.

2013 Guam Job Count Flat; Unemployment Rate Down

Employment on Guam (Chart 3) was flat in 2013, with a small growth of private sector jobs almost balanced by a decrease in the Federal and Local (GovGuam) government sectors. In 2013, the private sector made up nearly 75% of all jobs, with the Federal Government (6.47%) and GovGuam (18.71%) the remainder. Chart 4 shows unemployment dating to 2011; the most recent (September 2013) rate of 10.0% was the lowest during that period.

CHART 2 • FIRST HAWAIIAN BANK GUAM BUSINESS ACTIVITY REPORT

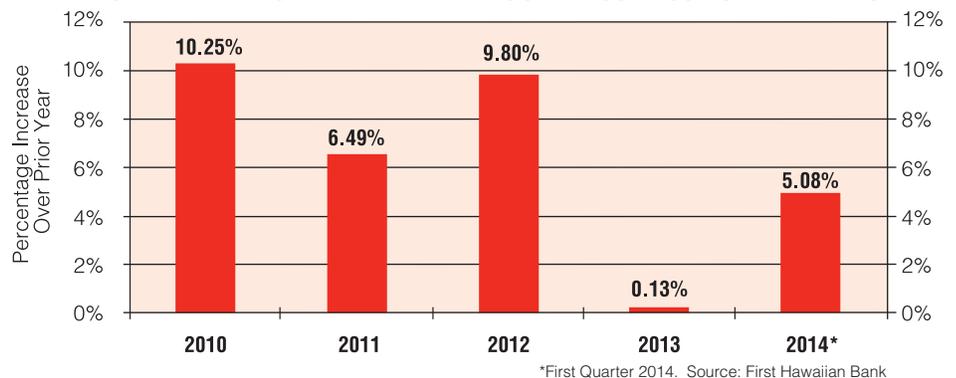


CHART 3 • GUAM JOB GROWTH, DECEMBER 1993-2013

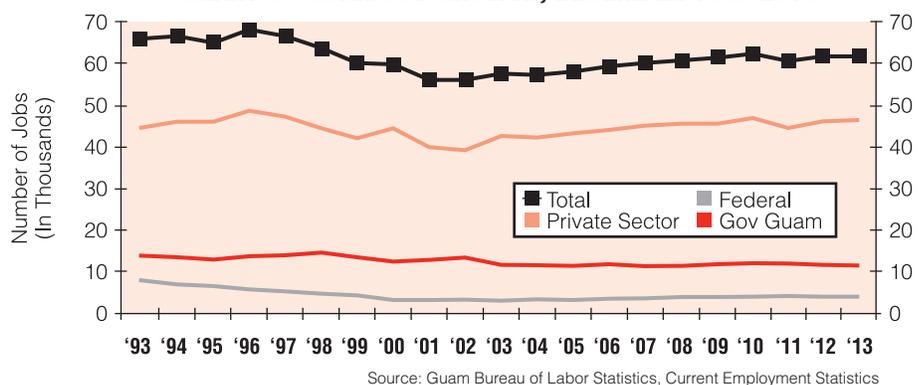
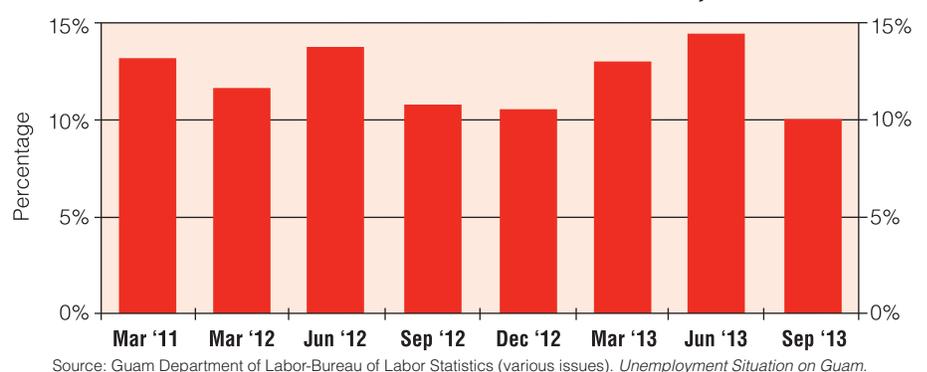


CHART 4 • GUAM CIVILIAN UNEMPLOYMENT RATE, 2011-2013



No Inflation in 2013

Guam enjoyed no inflation (Chart 5, page 3) in 2013, following relatively low Consumer Price Index (CPI)-based annual inflation the prior four years. Barring drastic increases in fuel prices, there is little threat of inflation in 2014.

All these indicators point to the Guam economy (GIP) continuing to be stable at \$4 billion in 2014, with possible slight growth from increased spending in tourism and military, as well as by local residents.

This year, the local economy will continue to see higher spending from the effect of the \$49.8 million in tax refunds already released, including \$20 million mailed out on Good Friday, which covered taxpayers who filed error-free returns up to February 7 (*Marianas Variety*, 2014, April 17) and from pay increases recommended by the Hay Study for thousands of Government of Guam employees. These increases in consumer purchasing power will boost demand for a wide array of goods and

services and perhaps create more jobs in retail and other service industries.

The recent proposal by Guam Legislature Vice Speaker Benjamin J.F. Cruz to raise Guam's minimum wage, similar to President Obama's proposal for the U.S., has the island community engaging in lively discussions (*Pacific Daily News*, 2014, April 14). If this becomes law, there are questions about whether or not jobs would decline as employers adjust to the higher minimum and its potential effect on other wage levels.

TOURISM SECTOR

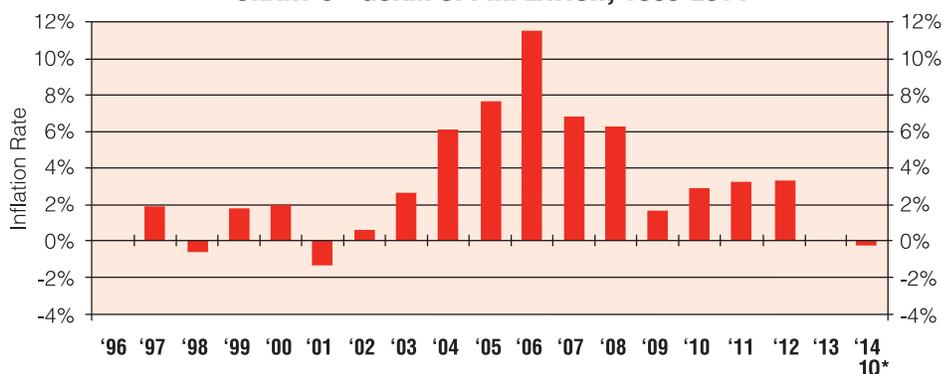
The 2013 count of 1.334 million tourists visiting Guam is higher than any year since the mid-1990s, showing the industry's resilience in weathering the effect of the weakened Japanese yen. The weaker yen since September 2012 reduced Japanese visitors to Guam by 3.9% in 2013 compared to 2012. But the industry held strong by welcoming more visitors from other markets, especially Korea. Indeed, Guam tourism is more diversified and less dependent on Japanese visitors than it has been in decades.

For 2014, although visitor arrivals between January and April were flat compared to the same period last year, it is too early to predict the overall figure for the entire year. With stepped-up efforts by the Guam Visitors Bureau (GVB), plus support from the government, business sector and island community, 2014 is likely to see another increase in visitor arrivals — from a larger number of countries, further diversifying the market.

The Guam Visitors Bureau's new strategic master plan (*Tourism 2020*) aims to boost visitors to two million by 2020 while continuing to reduce reliance on Japan through diversification. (Find details of the GVB strategy at <http://www.guamvisitorsbureau.com>)

Chart 6, comparing tourist arrivals between 2012 and 2013, shows the striking 34.4% growth in visitors from Korea, which now accounts for nearly one-fifth of all visitors to Guam,

CHART 5 • GUAM CPI INFLATION, 1996-2014



*Compared to 2013 First Quarter.
Source: Guam Bureau of Statistics and Plans

CHART 6 • SOURCES OF GUAM VISITORS, 2013 VS. 2012

| Calendar Year | 2013 | 2012 | Growth | 2013 Share |
|-----------------------|------------------|------------------|-------------|---------------|
| Japan | 893,118 | 929,229 | -3.9% | 66.9% |
| Korea | 245,655 | 182,829 | 34.4% | 18.4% |
| U.S. Mainland | 48,836 | 51,321 | -4.8% | 3.7% |
| Taiwan | 48,653 | 49,144 | -1.0% | 3.6% |
| CNMI | 16,154 | 16,717 | -3.4% | 1.2% |
| China P.R.C. | 11,225 | 8,939 | 25.6% | 0.8% |
| Philippines | 10,920 | 10,483 | 4.2% | 0.8% |
| FSM | 9,842 | 10,069 | -2.3% | 0.7% |
| Hawaii | 9,746 | 11,297 | -13.7% | 0.7% |
| Hong Kong | 8,857 | 8,609 | 2.9% | 0.7% |
| Russia | 8,084 | 4,040 | 100.1% | 0.6% |
| All others | 17,671 | 15,964 | 10.7% | 1.3% |
| Total Arrivals | 1,334,497 | 1,308,035 | 2.0% | 100.0% |

Source: Guam Customs Declaration Forms, Customs and Quarantine Agency. Processed by the Guam Visitors Bureau.

following many years of efforts by GVB to expand that market. For Fiscal Year 2014 (October 2013-September 2014), GVB projects another 20% increase in Korean visitors (*Marianas Variety*, 2014, April 16).

The Chinese tourist market posted 25.6% growth in 2013. GVB plans aggressive marketing in China, with incentives for airlines and travel agents. GVB leaders consider the increase in Chinese visitors to be a game-changer, possibly attracting five-star hotels to Guam. While the Four Seasons and Shangri-la hotels are currently not interested in Guam, GVB Board Chairperson Mark Baldyga stated that these chains would reconsider once the Chinese visitor count increases. (SBPA Dean's Lecture Series, 2014, April 16)

Russian visitors to Guam doubled in 2013 to 8,084, showing the continued benefits to Guam of the inclusion of Russia in the U.S. Visa Waiver program since 2012. However, the conflict between Russia and Ukraine could pose a risk to this part of Guam's tourism.

The fast-growing markets combined to more than make up for the lower number of Japanese visitors.

Hotel data (Chart 7, page 4) show a mixed picture in 2013. While the weighted hotel room rate rose (\$134 per night in 2013 vs. \$123 in 2012), hotel occupancy rates dropped to 75% compared to 81% in the previous year. Hotel taxes collected nearly \$38 million in 2013, up 1.31% over 2012.

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Tourism (continued from page 3)

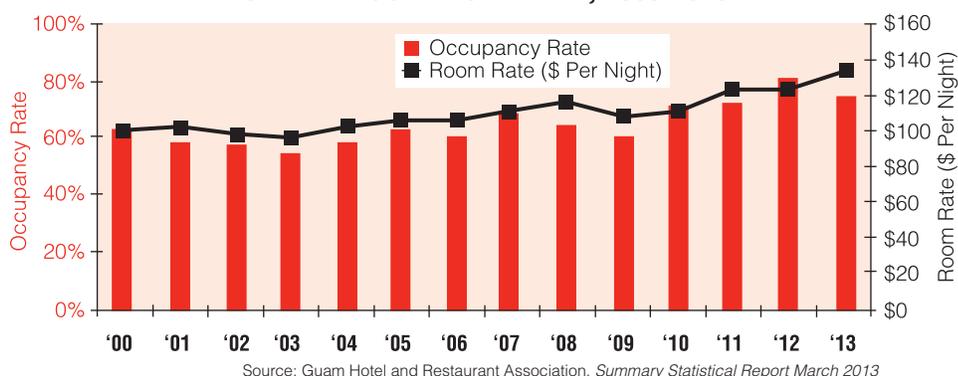
Forecasting Guam's tourism sector for the rest of 2014 depends on a number of factors, with tourists' incomes and the U.S. dollar cost of visiting Guam a good starting point. The Asian Development Bank (ADB) recently forecast stability in countries supplying the majority of Guam's visitors (Chart 8). Japan's economy is expected to grow at a slow pace of 1.3-1.5% per year through 2015, although this forecast might be affected negatively by the increase of consumption taxes from 5% to 8% in April 2014.

(Comment from GVB General Manager Karl Pangelinan, SBPA Dean's Lecture Series, 2014, April 16)

ADB forecasts higher growth for the U.S., Korea, Taiwan and Hong Kong for this year and next, which would have positive impact on Guam's tourism. The growth of China's economy has been in the 7.5%-per-year range, slow by China's historical experience but still relatively healthy to generate higher incomes that would make travel to Guam (and elsewhere) affordable.

The U.S. dollar's exchange rates against currencies in Guam's tourism markets have been relatively stable, with a few larger changes that have been favorable to Guam. The Japanese yen stabilized within the JPY100-103 range in the past few months and posted only a 4.48% weakening against the U.S. dollar in the past year (to April 2014). The Chinese yuan has been relatively stable. Lastly, developments in the Korean won, not only in the past year (where it strengthened 7.34% against the U.S. dollar), but possibly since 2009 (where it strengthened in excess of 14% against the U.S. dollar), have lowered the cost to Korean visitors to Guam.

CHART 7 • GUAM HOTEL DATA, 2000-2013



Source: Guam Hotel and Restaurant Association, Summary Statistical Report March 2013

CHART 8 • ECONOMIC GROWTH IN GUAM'S TOURIST MARKETS

| | U.S. | Japan | Korea | Taiwan | China | Hong Kong |
|-------|------|-------|-------|--------|-------|-----------|
| 2011 | | | 3.7 | 4.2 | 9.3 | 4.8 |
| 2012 | 2.8 | 1.4 | 2.0 | 1.5 | 7.7 | 1.5 |
| 2013 | 1.7 | 1.5 | 2.8 | 2.1 | 7.7 | 2.9 |
| 2014 | 2.8 | 1.3 | 3.7 | 2.7 | 7.5 | 3.5 |
| 2015* | 3.0 | 1.3 | 3.8 | 3.2 | 7.4 | 3.6 |

*Forecast Source: Asian Development Bank

CHART 9 • U.S. FEDERAL, MILITARY CONTRACT SPENDING IN GUAM



*FY2014-to-date. Source: <http://www.usaspending.gov>

FEDERAL GOVERNMENT AND MILITARY SECTOR

2014 marks an important year in developing a better understanding of the upcoming military realignment plan and its impact on Guam. The National Defense Authorization Act (NDAA) of 2014, signed in December 2013, projected \$494 million spending in Guam, including \$85.6 million that Guam Congressional Delegate Madeleine Bordallo identified as “directly support(ing) the (military) realignment” (*Pacific News Center*, 2013, December 28). The NDAA also allowed for the release of Government of Japan (aka Mamizu) funds to support the military realignment on Guam.

This provided a “go” signal for solicitation for the North Ramp area in Andersen AFB in Guam, a \$114-million project. Looking forward, Bordallo stated that “the President’s Budget for fiscal year 2015 contains \$128 million in funding for Guam military infrastructure. That is a significant amount of investment in a year where the total military construction budget saw a 40% reduction,” reflecting Guam’s role in the U.S. plan to rebalance forces in the Asia Pacific. (Bordallo Congressional Address, 2014, April 3)

In January, the U.S. Navy completed two projects totaling

\$180 million, the first of several military realignment projects to come. These included Government of Japan-funded utilities improvements and the Marine Corps Welcome Center and the Marine-funded wharf improvements at Apra Harbor. (*Marianas Business Journal*, 2014, January 26)

One of the most important developments with regard to the military realignment was the release of the draft Supplemental Environmental Impact Statement (SEIS) on April 18, 2014. Following a public comment period, the Navy “anticipates issuing a Record of Decision in 2015.” (Joint Guam Program Office Press Release, 2014, April 17).

The Draft SEIS of 2014 is summarized in Chart 10 in comparison to the prior Final EIS of 2010. The SEIS draft reflects favorable resolutions to many concerns expressed by Guam residents four years ago:

- A smaller surge in military population, dependents, and foreign construction workers;
- A reduction in demand on Guam’s civilian infrastructure;
- Acquisition of more lands in Guam is projected to no longer be required; and
- Pagat, a cultural site of large significance to Guam, is no longer among alternatives considered for the live-fire training range complex (LFTRC).

However, the draft SEIS revealed the Department of Defense’s preferred location for the LFTRC to be within the Andersen Air Force Base in the Northwest Field, which is an area that sits above the Ritidian Wildlife Refuge. Discussions are on-going on options to protect this refuge, including the possibility of establishing a Surface Defense Zone (SDZ). This issue is currently the main obstacle to proceeding with the Record of Decision in March 2015, which would affect funding for Fiscal Years 2015 and 2016 in support of the military realignment in Guam.

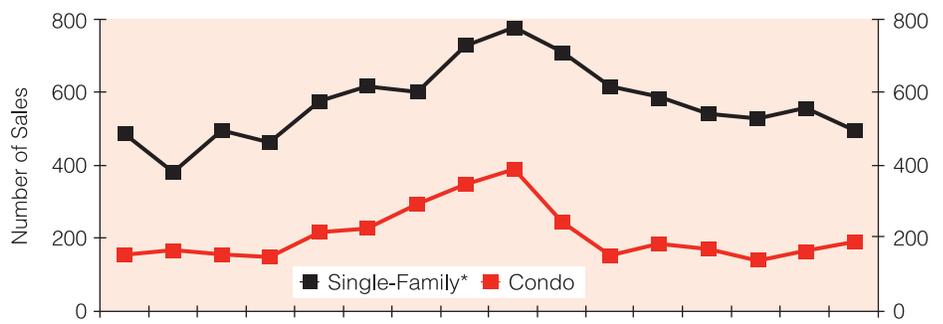
The implied cost of the military realignment, estimated at \$8.1 billion

CHART 10 • KEY DIFFERENCES BETWEEN 2010 FINAL EIS AND 2014 DRAFT SEIS

| 2010 Final EIS | | 2014 Draft SEIS |
|--|---|--|
| Approximately 8,600 Marines and 9,000 dependents relocating over 5 years | Relocated Population | Approximately 5,000 Marines and 1,300 dependents relocating over 12 years |
| 7-year intense construction boom followed by sharp decline | Construction Period | 13-years of moderate construction activity with gradual phase out |
| More than 79,000 new Guam residents at peak | Peak Population Increase | Less than 10,000 new Guam residents at peak |
| More than 33,000 additional Guam residents | Steady State Population Increase | Approximately 7,400 additional Guam residents |
| 2,580 acres at Finegayan preferred alternative | Project Area: Cantonment | 1,452 acres at Finegayan preferred alternative |
| Acquisition of 688 acres of non-federal land at Finegayan preferred alternative | Land Acquisition: Cantonment | No land acquisition at Finegayan preferred alternative |
| 5,529 acres for Route 15 preferred alternative (4,439 acres in SDZs, mostly over ocean) | Project Area: LFTRC | 3,966 acres for Northwest Field preferred alternative (3,701 acres in SDZs, mostly over ocean) |
| Acquisition of more than 1,000 acres of non-federal land at Route 15 preferred alternative | Land Acquisition: LFTRC | No land acquisition at Northwest Field preferred alternative |
| 20 megawatts | Power Demand | 5.7 megawatts |

Source: U.S. Department of the Navy (2014, April). Executive Summary, Draft Supplemental Environmental Impact Statement: Guam and Commonwealth of the Northern Mariana Islands Military Relocation (2012 Roadmap Adjustments), page ES-3.

CHART 11 • NUMBER OF REAL ESTATE TRANSACTIONS



*Includes one-family to four-plex residential units.

**First Quarter 2014 number of transactions annualized (estimated for the entire year 2014).

Sources: Captain Real Estate Group of Companies (1999-2007 statistics); Cornerstone Valuation Guam, Inc. (2008-First Quarter 2014 statistics)

in this report a year ago, now appears to be an understatement. To date, no new cost estimates have been released, including the cost that the realignment would impose on Guam’s civilian infrastructure. As many will recall, the U.S. Senate (particularly Sen. John McCain) has taken issue with using federal funds toward this end.

REAL ESTATE SECTOR

Referring to Guam real estate transactions (both commercial and residential), Siska S. Hutapea, President of Cornerstone Valuation Guam, Inc., said “flatlining with few hot spots would be the best way to describe real estate activity in 2013.” Hutapea said the

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CNMI Economy: Strong Tourism, Saipan Casino Plans, Worries About Impact of 'Federalization'

Key economic developments affecting the CNMI in 2014 include:

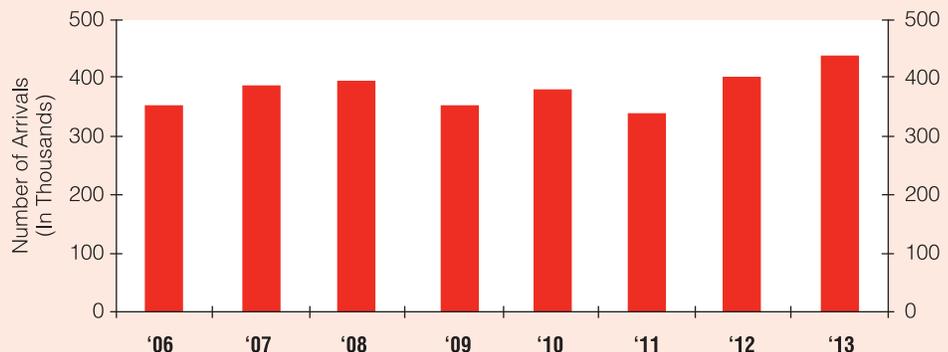
- Continuing solid growth in tourism;
- Settlement of a lawsuit concerning the underfunded CNMI Retirement Fund;
- A new law authorizing a casino on Saipan; and
- A pending minimum wage increase and changes to U.S. visa requirements for foreign workers and foreign investors.

Growing Visitor Arrivals Since 2011

The Commonwealth of the Northern Mariana Islands (CNMI) continues to attract an increasing number of visitors. After a 10% decline in visitor arrivals in 2011, CNMI saw a 17% growth in 2012, and another strong year (9.6% growth) in 2013, with 438,775 visitors. (Chart 1) Data for 2014 show promise, with 82,992 visitors arriving in January and February, up 6.75% from a year earlier.

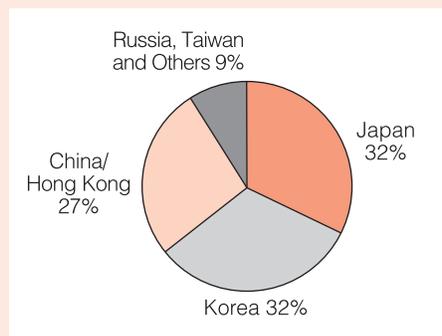
As Chart 2 shows, more than 90% of CNMI visitors come from Japan,

CHART 1 • SAIPAN VISITOR ARRIVALS, 2006-2013



Source: Marianas Visitors Authority, Saipan Visitors

CHART 2 • SAIPAN VISITORS BY COUNTRY OF ORIGIN, 2013



Sources: Marianas Visitors Authority, Saipan Visitors

Korea or China/Hong Kong. Compared to 2012, the share of visitors from Japan decreased from almost 38% while the share from China and Hong Kong increased from 21.5%. The share from Korea held steady around 32% of the total in both years.

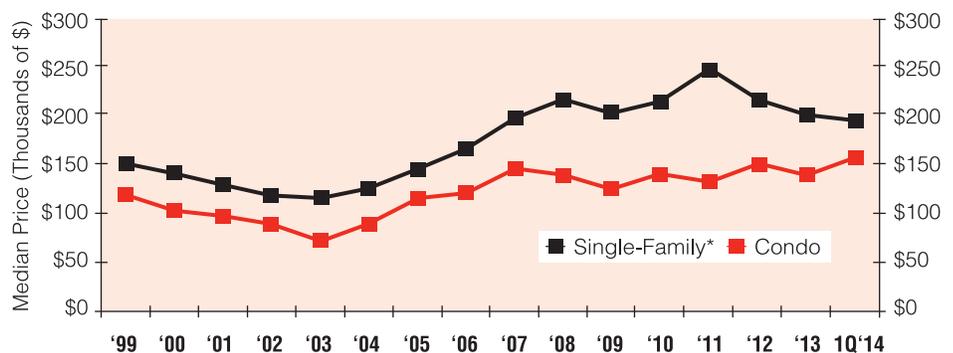
The increase pushed hotel room rates up and increased occupancy rates. For example, average daily hotel rates increased to \$115.63 during the First Quarter of 2013 compared to \$108.19 a year earlier, a 7% increase. During the Second Quarter of 2013, the average room rate was \$103.63, up from

Real Estate (continued from page 5)

residential market experienced “another quiet year, with pressure on prices that reduced the median price.” (Guam Business Magazine, 2014, January-February)

Data provided by Cornerstone Valuation Guam, Inc. (Chart 11, on page 5 and Chart 12, at right) show the median price on all residential units sold in 2013 was \$191,350, down 4.8% from \$201,000 in 2012. Contributing to this was a 7.19% decrease in the median price for single-family dwellings from \$215,500 in 2012 to \$200,000 in 2013. Median prices of condominiums decreased by 6.73%, from \$150,000 in 2012 to \$139,905 in 2013. The number of units sold increased in 2013 for both single-family dwellings and condos.

CHART 12 • MEDIAN RESIDENTIAL PRICES

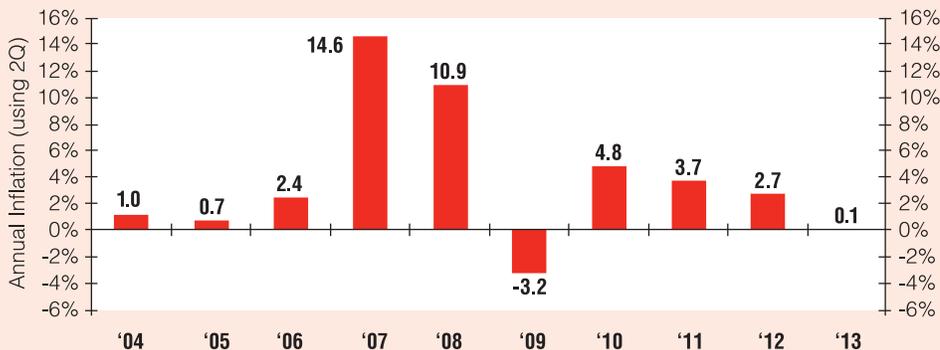


*Includes one-family to four-plex residential units.
Sources: Captain Real Estate Group of Companies (1999-2007 statistics); Cornerstone Valuation Guam, Inc. (2008-First Quarter 2014 statistics)

For 2014, data for the first quarter show median prices for single-family dwellings at \$193,500, higher than \$185,000 for the same quarter of 2013. Similarly, median prices for condominiums rose to \$156,200 for

the First Quarter 2014 compared to \$125,750 during the same period last year.

CHART 3 • SAIPAN CPI INFLATION, 2004-2013



Source: CNMI Department of Commerce (2013, November), 2nd Quarter of 2013

\$94.48 during the same period of 2012 (Hotel Association of the Northern Mariana Islands (HANMI), reported in the CNMI Department of Commerce, Economic Indicators, 1st and 2nd Quarters 2013).

The growth has generated a strong demand for accommodations. HANMI President Nick Nishikawa said the CNMI needs 1,000 more rooms. (*Pacific News Center*, 2014, March 21).

Retirement Fund Challenges

For years, solvency issues faced by the CNMI Retirement Fund have added uncertainty to the island economy. The CNMI government has not been able to meet its obligations to the fund, which was forced to liquidate its investments to meet its benefit payments; if nothing changed, the fund would have become insolvent this year. In 2009, retiree Betty Johnson represented a group of retirees and filed a class-action lawsuit against the government and fund.

In 2013, a settlement agreement was reached, paving the way for retirees to receive 75% of their pensions beginning October 15, 2013. The agreement also allowed fund members who are not yet receiving benefits to withdraw from the fund and receive refunds for their contributions. The amount required to pay for the settlement, along with annual payments that the government must pay to the settlement fund, required revision of the CNMI government budget, created pressure to legalize casino gambling in Saipan,

and authorized the Commonwealth Development Authority to float a pension obligations bond.

The bill to legalize casino gambling in Saipan (it is already legal in the islands of Rota and Tinian) was signed into law on March 21, 2014 despite opposition from the Saipan Chamber of Commerce. Provisions of the law include awarding to investors the exclusive license to operate a casino hotel in Saipan in exchange for a \$1-million application fee that was due by April 5, 2014, and a \$30-million payment for license fee that was required to be in escrow by May 5, 2014. CNMI Governor Eloy S. Inos vowed to use this \$30 million to restore the 25% cut in retirement benefits called for by the lawsuit settlement. The law also requires a \$2 billion total investment to pay for construction of 2,000 hotel rooms and related facilities.

By the deadline, two applications (from Best Sunshine International, Ltd. and from Marianas Stars Entertainment Inc.) were received, along with a \$1-million fee from each applicant. However, to date, only Best Sunshine remains in consideration since Marianas Stars did not pay the required \$30 million into escrow. Recently, Best Sunshine revealed its four-phase business plan for its casino hotel, with a grand opening in 2020. The first phase includes a 401-room hotel and casino and will be built in 2017-2018. (*Saipan Tribune*, 2014, May 14).

2014: 'FEDERALIZATION' DEADLINES

The CNMI has been transitioning since 2007 toward a tighter relationship with the United States, a process referred to as "Federalization." This year marks another round of increase in CNMI's minimum wage effective September 30, 2014. More important is the approaching deadline for the use of CNMI-specific foreign labor and investor visa categories, which will be aligned with U.S. immigration laws after December 31.

Minimum wages in the CNMI have increased from \$3.05 per hour in 2007 to the current \$5.55. The next \$.50 increase is expected in September 2014.

The CNMI economy continues to hang on a balance, with the pending minimum wage increase and the deadline with regard to CNMI-specific visa categories for hiring foreign workers (CW-1) and attracting foreign investors (E2-C). This deadline can be extended by the Labor Secretary (for CW-1 visas), a decision that was already made but not yet announced, or by Congress (for both CW-1 and E2-C visas).

Inflation Decreases

Inflation (Chart 3) continues to decline in the CNMI and was almost non-existent in 2013. Overall CPI prices in Saipan rose a mere 0.1% during the Fourth Quarter of 2013 compared to the Fourth Quarter of 2012 (CNMI Department of Commerce, 2013, November).

Gross Island Product (GIP)

Estimates for GIP show the size of the CNMI economy declining every year from 2003 to 2009, then a 1% growth in real GIP in 2010, followed by a decline of 6.8% in 2011 and finally a more definitive 5.33% growth in 2012. Although estimates for 2013 are not yet available, last year's edition of this report pointed to a growing CNMI economy in 2013, judging from the strong performance of its main economic driver, tourism.

ACKNOWLEDGMENTS

The following individuals (in alphabetical order) are acknowledged for providing useful information and insights and administrative assistance.

Ms. Dorothy Carlson
Administrative Assistant, University of Guam-School of Business and Public Administration

Ms. Lillian R. Chargualaf
Administrative Officer, University of Guam-School of Business and Public Administration

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