TRANSCRIPT

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DWG: Our guest this morning is Vice Admiral Mark Harnitchek. He's the Director of the Defense Logistics Agency.

DLA [inaudible] finished its mission in Iraq [inaudible]. So if I can get a little of an overview from you about what you learned from the [inaudible] operation and how it applies to the [inaudible].

VADM Harnitchek: The final part of our mission was our disposition which I demilitarize all the equipment that we're not going to bring home. So after we left and [inaudible] residual sort of presence there was to support the [departure] and [inaudible] Baghdad and the various consulates. So we did that. We supplied all their food, all their fuel, and then to the extent there was still material there, we destroyed it. We have since turned all that mission over to the state Department because they were [inaudible], whatever was left in terms of [inaudible] would be destroyed. So we were prepared to do that in Afghanistan of course, and we [we hope to]take part in that and we'll support that for as long as we need to do that.

Right now we're focused on supporting operations there, of course, which increasingly for us anyway, includes the demilitarization of all that equipment that we will not bring out.

We're also working an effort here to sell stuff that doesn't need to be demilitarized to the Afghan folks and their economy and that's [inaudible] millions of dollars' worth of stuff that doesn't make any sense to ship back but [inaudible] clear user for it for the Afghan economy. So we haven't started that yet, but we're hopeful that we'll have the first sale of that material probably next week.

So many many similarities between the drawdown in Iraq and Afghanistan. It's just a function of the difference in geography and of course the governments there. But largely the same.

DWG: The disposition of excess equipment is inherently controversial, because no matter what you do, there's going to be criticism on how you [inaudible]. So how are you making the decisions on what to do? Leave behind what's destroyed, what's [inaudible].

VADM Harnitchek: We generally don't. The sort of owning service gets to decide what it is they're going to bring home in terms of what their requirements are and kind of the whole pot of I need this much but I have this much, no use transporting at enormous cost back to the States a lot of the material that we don't need. That's nothing new. You've heard that from OSD, you've heard that from the folks in CENTCOM.

So for me anyway, we're largely [inaudible], so from my perspective, doing that as economically as we possibly can, as safely as we possibly can, and then where the commanders have decided that there is a use for this other [white good] as we call it, that we figure out, we, DLA figure out a mechanism to inject that back into the Afghan economy.

There's a lot of that discussion going on on what we're going to bring home and what we're going to keep. That's been written about to a fair amount in the press, destroying vehicles that cost half a million dollars.

But I think in terms of the history of the military here, this is really no different than what you see at the end of every conflict. Certainly this isn't the 2nd World War in terms of scale, but there was a lot of stuff that we fundamentally just did not need at the end of that conflict and rather than spend more money storing it, maintaining it, training on it, it was more economical to look at this as a sunk cost just like a business would do and don't continue to expend money on requirements that you don't need.

So I think we've got it right as sort of the disposition czar that [inaudible].

I can also tell you there's a bit of a return, and it's not a huge return but all that stuff gets used for something over there. All that very precious metal that those armored vehicles are made of gets back into their economy. We got a little return on it. It's utilized [inaudible].

DWG: Admiral, Sidney [inaudible] with BreakingDefense.com.

Let me ask, looking forward, by the end of the year we will have our combat brigade presence [inaudible], [inaudible] presence, but you guys have gone down already from two of the world wars to one, now you're going from one to maybe 0.1. How does that change your mission going forward? And to what degree do you need to reinvent yourself as you reap the results from this conflict? There's a lot of focus on budget pressures, acquisition reform, services, [inaudible]. Looking to that "post war future" what should DLA be thinking about? How should DLA be changing itself? What do you need from OSD? [Inaudible] regulating [inaudible] level? And what might you need from Congress in terms of statutory changes to make you better adapted, more efficient?

VADM Harnitchek: Let me answer the easy part first, and that's what is DLA going to look like through the rest of the FYDP in FY19 for example.

We're going to be a lot smaller in terms of our people, our infrastructure, our inventory, our financial footprint, just by virtue of the fact that we're a service organization so the services across the board, the department's budget is less by 30 percent. I have to be less by 30 percent because they have 30 percent less money to buy stuff from me, the supply chain. Or more, since they're probably cutting the services more than -- It's hard to say. But when you're looking at this strategically at the end of every conflict, you're generally about 30 percent less.

So as we look at this from the DLA perspective, I'm asking my folks, we have to be ready to significantly improve support at a whole lot less cost. So we're working [inaudible] activity, you guys who are defense writers know what that is. We make lead time investments in things to have the right stuff at the right place when people need it. So that mission won't change.

So what I told my folks, our theme looking ahead here is to significantly improve performance [inaudible] customers, combatant commanders and the services, to find performance, and we're going to do that at dramatically reduced cost. So I've asked my enterprise [inaudible], told them, we're going to cut $13 billion out of the cost of our material and the cost of our operations. There are five lines of operation that we're going to do that with. We're going to take a lot of material cost out. We're about a $40 billion enterprise. Most of that is the cost of the material of things that we buy. So through a whole series of efforts, reverse auctions, long term contracts, performance based contracts. We're working very closely with what I would call [inaudible] supply chain, to help us take that $13 billion out. That's one effort.

The other way is to decrease the cost of operations. That's not the big cost in my business but it's a fairly significant one, about $5 billion. So we're getting a whole lot leaner in terms of the cost of our [mission].

A big effort here to right size our inventory and then right size the infrastructure that supports all those distribution chains.

We have taken probably over the past two years about five of our $50 billion in inventory out of the system. Stuff that don't need, excess to our needs. We've taken that out, got rid of it. And a like amount of sort of downward pressure on infrastructure that we have with that inventory. So if you don't need the inventory you certainly don't need the WWII vintage building that it goes in. So we've taken about $5 billion of inventory out; we've taken the equivalent of about 45 football fields of covered storage out. That's warehouses that are coming down. A big effort there to have less inventory and have inventory that just works harder, and then an infrastructure footprint that's right-sized for the amount of inventory that we're going to keep.   So that's the third one.

I talk about customer service. The great thing about DLA is that we measure everything. So we're talking to our combatant commanders in terms of what it is that they need to support their mission. We've agreed what that level of service is and we're aiming high and doing that.

Back to the inventory right-sizing, we're actually getting better inventory performance out of an inventory that's only two-thirds of the size it was about two years ago. That's sort of a relentless focus on basic business, blocking and tackling, and contract execution. Buying up, buying time and ensuring contractors [inaudible].

The fifth one is this notion of achieving audit readiness. You know the department has a tremendous effort here at the Secretary's level, [inaudible] comptroller's level, to ensure that we are audit ready. What I mean by audit ready is the rest of the federal government and private industry, can we withstand an audit by a third party that says that we're the steward of the nation's treasury the government gives to us, and so what we're finding is a lot of bad [inaudible] I guess I'll put it in terms of accounting. Unliquidated balances on contracts, a lot of contracts that aren't fully closed out. Once you put that focus on financial integrity and ensure that you can account for every nickel the way we do at home, you uncover a lot of sort of bad [inaudible] if you will, so that contributes to the $13 billion in savings as well.

So long story short, at the end of the [inaudible] year, we will have saved the department about $13 billion in operating costs, cost of material, and we will have significantly improved performance to our customers.

DWG: That's not $13 billion annually, it's $13 billion --

VADM Harnitchek: It's $13 billion for '14 to '19. So we're already putting money in the bank. We've banked about $3 billion already.

DWG: Talking about [inaudible] contracts, there are a lot of concerns in the force about the proliferation of IDIQ where we have 2000 qualified vendors on some things like [inaudible]. Are there practices that you need to cut back on that have grown up during the war? And are there practices that have been enshrined, perhaps even a statute where you need to ask for some relief as the department does in other sectors of [inaudible]. [Inaudible] working very hard on this.

VADM Harnitchek: As you know, Secretary Hagel's my boss, of course. I can tell you legislatively I think we're in pretty good shape. Other than some stuff on the margin that does not pop immediately to mind, I don't really need anything in terms of legislative relief that will make me any more effective or any more efficient, so I feel fully empowered to do everything we need to do today both from a policy perspective and from a legislative perspective. So I think it's really all about the [cost] now.

With regard to the proliferation of IDIQ contracts, we have some of those but we don't have a lot of those. Our focus there is to ensure that the industrial base stays vital, that our big contractors, and our little contractors because we do a lot of small business. About 38 percent of our business last year was with small business, so we want those folks to be making a fair profit. We want to get our warfighting customers the stuff they need, and we want to properly close out the contracts. So somebody's probably going to ask me about some of these [inaudible] pricing issues that you've read about. There's a big effort there to ensure the public has confidence that we're not paying for too much that government [inaudible].

DWG: Coming out of Afghanistan, much more [inaudible] situation than coming out of Iraq.

VADM Harnitchek: Yes.

DWG: Particularly [inaudible] marginal cooperation from the [inaudible]. How much are you relying on the [inaudible] relying more on air transport to get out of Afghanistan?

VADM Harnitchek: I am not the get out of Afghanistan [inaudible]. That's U.S. TRANSCOM. I would tell you it's much different in terms of geography that it was in Iraq. We had Kuwait there that served as sort of a parking lot, certainly, sort of an interim staging area [inaudible]. A much larger use of airlift in Afghanistan now. And not airlift all the way home, but airlift to a convenient airfield that's close -- Dubai, Oman, Azerbaijan, Jordan perhaps -- where you fly the stuff there, offload it, and then send it home by sea. Of course airlift is probably I think the old rule of thumb is it's about 30 cents a pound to ship it by sea and about $3 a pound to ship it by air, so roughly ten times more. So you obviously want to minimize that cost to the greatest extent that you can but still be [able to get it out] when we're supposed to.

So the logistics equation is quite a bit more complex; to the extent that we're using airlift it's quite a bit more expensive, a little more challenging. But I'm confident we'll get it done.

DWG: You talked about cleaning out the inventory. DLA has been notorious for years for having warehouses full of stuff that was ordered in the War of 1812 and didn't quite make it to the Civil War. It's still there. [Laughter]. In cleaning out, how much are you finding that people ordered, didn't know it was there or forgot about it?

VADM Harnitchek: We don't have a lot of that. It's generally not an issue of not knowing it's there, it's just our penchant to want to hold onto it. So we don't necessarily have a -- We have too many things that we're holding onto. We have too much [inaudible] things. So it's simply looking into the future here, understanding that your demand will probably be down by 30 percent. Do you really need to have 50 years' worth of something? Probably not. It costs money to hold that inventory in terms of just inventory holding costs and infrastructure costs. So yeah, we are relooking at the model here that tells us how much we need and how long to keep it.

Most of the inventory that has gone has not been sort of, we're going to get rid of all the stuff from the War of 1812 or [inaudible]. It's stuff that we bought recently that we just don't have a requirement for 15 years' worth of inventory, as an example.

Again, it's more of a mindset about what you keep and how long you keep it and why you keep it.

DWG: Can you give us a good example of one of the things you recently bought that needs to go?

VADM Harnitchek: I could probably off the top of my head, but let me get back to you with an example of what we're doing.

The other part, we manage a lot of things. About half of them are very easily forecast. Ten a quarter, ten a quarter, ten a quarter, ten a quarter. Right? That's about half of our active inventory. The other half is a challenge in that it can be demanded a lot but it's demanded in a quantity of two one quarter, 100 the next quarter, nothing for two more quarters, 1,000, two, that's sort of stuff is wildly sort of variable in terms of demand and it's difficult to manage.

The second category that's difficult to manage is stuff that's just demanded very very infrequently. We'll go for years without a demand and then we'll get a demand for five. We'll go another two years and get a demand for two.

So in terms of things that we're getting rid of, it's the inventory in those categories. What you have to do is sort of weigh the relative risk of getting rid of it and the fact that you may have to go buy it again.

DWG: The big thing in Congress, [inaudible] just in time logistics and what WalMart and those kind of people do. Is your [inaudible], other than saying [inaudible] and things like that, the things you do, you buy, how subject are they to just in time?

VADM Harnitchek: We have a lot of models here. I don't want to give you a [inaudible] lesson because I'm not a mathematician, but generally just in time, what you want to do is, and we operate a lot like business even though, everywhere we operate. So it's really a question of how much risk do you want to take? So I am very uncomfortable with taking a lot of inventory risk in a place like Afghanistan. Based on all the environmental factors, the place that it is, the sort of variability and sort of tempo and type of operation. So we generally keep 60-90 days' worth of everything in Afghanistan, even if it's things that's easy to get. I mean [inaudible] is relatively easy to get, but when Pakistan closes its borders or there's a snowstorm in the [inaudible] Pass or we're having trouble getting stuff between Kazakhstan and Uzbekistan, you need to protect yourself from those vagaries of the world, if you will, and [inaudible] just to account for those sorts of contingencies.

It's like when there's going to be a storm, everybody's at the grocery store stocking up on milk and bread and batteries because you're not sure what's going to happen, right?

So in places like Iraq out there in sort of the far reaches of the world here, we take a lot less risk. So we protect ourselves from sort of the vagaries of the world, more inventory. Back here in the States we don't have the same level of operational risk, you don't have the vagaries of the world that affect you as much. So you can stock less. So I guess it's not one of those simple just in time -- But we're governed by the same thing. We're [inaudible] taxpayers' money. If I don't need to buy inventory that I'm not going to need for three or four years, why would I buy it now? I'd rather either give that money back to the department or spend it on something else.

DWG: If I can vastly over-simplify one of the things that you said two years ago, the last time you were here, was that one of the [inaudible] too much stuff, too early, hold onto equipment too long. Now it's you as a service provider have reduced the inventory by one-third. How receptive are the services [inaudible] combatant commanders to this notion that you're not just going to stockpile stuff [inaudible]?

VADM Harnitchek: I will stockpile exactly the right amount that we need to meet the mission. This is a pretty vast enterprise that we run here and it's different everywhere you operate. Like I said, in a place like CENTCOM or out in the far reaches of the Western Pacific, we store a lot more than we store somewhere else. Some of it's a function of how long it takes to get there, some of it is in terms of what you think may happen so you, based on the operational requirement determines how much you store and how much you stockpile. But the key is, no matter where you're operating, and this is Logistics 101, is you want to buy enough, you want to buy it on time, and then you want to make sure it gets there. That's really the way it is. And it's no more complex than that. So hopefully that's a simple answer to your recollection of what I said last time.

That's all about what being a good steward is. So in DLA, our mission is to be effective. So to be effective is have the right stuff at the right place at the right time in the right quantity, so we let our customers define what that is, whether that's the commander at the Air Logistics Center in Oklahoma City or the Commander in CENTCOM. So they determine what success looks like. That's the effectiveness part.

But in back of that you have to be mindful how much things cost.

So writ large what DLA's mission is across all of our supply chains is to be effective to your customers. You let the customers define what effectiveness is. And you want to do that at the least cost to the government. That's not cheap. Sometimes to be effective you've got to spend a lot of money.

When we had Hurricane Sandy here in November of 2012, to be effective cost a lot of money because we were moving fast. We were putting gas in gas stations, we were [inaudible] hotels, we were putting generators in apartment complexes, we were pumping out people's basements. And there it was all about speed. To be effective we had to be fast, and that cost a lot of money.

Again, the bottom line is if you can boil down DLA's mission to its essence, it's to be effective to meet the needs of the department, but be mindful of how much that costs. I think John Q. Public expects us to do that, especially now with all the budget pressure not just the department is under but the government is under.

So to me it's all about warfighting effectiveness, and then stewardship.

DWG: Admiral, I have a question on Afghanistan but I want to ask you to go back to something I think you said at the beginning. Did I hear you say that you're close to a deal for some of the [inaudible] material in Afghanistan that's going to come up next week?

VADM Harnitchek: You did.

DWG: Can you talk any more about what that involves?

VADM Harnitchek: It's not military equipment. It's the sort of stuff that the [inaudible] contractor would use [on base]. So it's construction material, it's knives and forks [inaudible] the base galley, it could be a pickup truck, it could be a bulldozer, generators, the sort of stuff that is very commercial in nature that we use to support our forces in Afghanistan. We got a request from the commanders there via their Afghan counterpart that we'd they'd like to have that. By regulation of the Afghan government we're not permitted to give it away because it came in with no duty on it. It came in duty-free. So the deal is essentially dealing with local Afghan contractors that they will give us a certain amount of the revenue that, let's say it's [inaudible] valued stuff, okay? The deal at Bagram, for example, is that a contractor will bid on it, we get a certain percentage of that. It's not a lot. This isn't a big money-making enterprise for us. But in order for the contractor to actually receive it, he needs to prove to us via the Afghan government that he's making use of it. So the Afghan government gets their customs duty, the contractor gets all the stuff, we get a little sliver, and all that stuff is then sold into the Afghan economy by the contractor that bought it.

DWG: Can you give us a sense about what the value of that deal is?

VADM Harnitchek: Gee whiz, I'd have to get back to you. I'd be guessing. But it's in the millions, not the tens of millions.

DWG: The question I wanted to ask was, on Afghanistan, General Dunford has a [inaudible] of the Afghan soldiers [inaudible] place to put a part in a vehicle. And [inaudible]. One of the challenges is getting to [inaudible] figure out what parts you want to order, do the contract for that part, buy the part, get it to the [inaudible]. Can you describe to what extent you guys at DLA do that for them or with them today?

VADM Harnitchek: We do really none of that. That's part of the [inaudible] training mission there that not only trains the soldiers, but then sort of teaches the Afghans how to set up a very rudimentary logistics center. So when the distributor in the Humvee, [inaudible] we're not waiting for weeks or months to get [a] distributor. So other than DLA buying a lot of the material that the Army has since ceded to the Afghans as part of the mission there, we're really not involved in it at all. But [inaudible], it's great if you can field the force, but if you can't sustain them then you're sort of a one-trip company there. That's [inaudible]. We had the same issue in Iraq. It's sort of creating not just the fighting force but all the back end infrastructure to support them.

DWG: Do you envision that you guys are going to be doing any more of that going forward in Afghanistan? Doing the back end stuff?

VADM Harnitchek: We start [inaudible]. We run fairly big logistics systems. We have some level of expertise doing that. Maybe not at a tactical level, but like I said, it's fairly rudimentary military logistics and a scale of complexity that, you know, the commodities and the type of weapon systems they're supporting. So we're delighted to help OSD and the CENTCOM commander on that [inaudible].

DWG: You've been around almost since the Pacific pivot was announced. [Inaudible] terms of prepositioning in the Pacific versus [inaudible], how much you store. Can you give us some sense of what [inaudible]?

VADM Harnitchek: For DLA obviously we have a presence everywhere. The big one for us, if you want to ask me what's the big thing for us in terms of the pivot in the Pacific, it's fuel. That is a big commodity there both because we use it in such great quantity there when you look at a lot of stuff, the [inaudible] fuel is obviously a big one. And then certainly the vast distances of the Pacific in terms of moving a large commodity that you need to move in sort of millions of barrels not gallons, if you will.

So fundamentally for us is, where is the fuel? How much do we store? Where do we store it?

So you're seeing a lot of moving chess pieces in terms of where we have fuel. Do we move it closer to the point of [inaudible] where it is? Do we put it in Alaska? Do we keep it in Hawaii? What level of fuel do we put in Singapore? The Philippines? How do we get stocks out of U.S. Central Command to the Western Pacific if we need them? So basically it's a relook at the entire network of fuel delivery that DLA has to support the PACOM Commanders. So for us, that is the big thing.

DWG: Has there been a lot of diversification [inaudible]?

VADM Harnitchek: We've moved quite a bit of fuel to the Western Pacific from [inaudible]. Again, that's based on consultation with the combatant commander and a sort of [inaudible] study on sort of what's best. There's a lot more stuff going in there.

DWG: I'm just curious --

VADM Harnitchek: The other thing, the Air Force has moved from military specification jet fuel to commercial jet fuel, and then we [inaudible] where we need to. That in terms of readiness and availability of fuel really is a game-changer in terms of how ready we are. If you don't have to use a military specification fuel you're a whole lot more flexible in terms of where fuel is, what sort of quantity [inaudible]. Lots of folks buying and storing jet fuel --

DWG: When did that happen? I missed that.

VADM Harnitchek: I would say last year, probably. So you actually get a better deal on fuel because you're using the fuel that everybody else is using so you save a couple of cents per gallon, and that's a big deal when you save as much fuel as we do. We use about the same amount of fuel as Northwest and Delta do, and the lion's share of that is Air Force fuel. Then it just gives you much much greater flexibility in where you store it. When you're using military specification jet fuel you have to store that fuel in military-only facilities. When you're using a commercially available product your availability of the fuel in a network that supports that fuel, it's balanced in terms of operational flexibility. So that will help us in the Pacific as well.

DWG: Organizationally do you have any say of how many pre-po ships the Navy buys? So they give you a number that this is how many we can have out there and you decide what to put on it?

VADM Harnitchek: Actually we don't decide what to put on it. The services, pre-positioning that is there for the Marine Corps, the[inaudible], the Army pre-positioned forces, and then the Air Force has some level of pre-positioned stocks as well.

The one thing we're doing for the Army, for the consumable type commodities that they buy from us and put in their pre-po sets, we will take responsibility for that and fill the with DLA stocks that they don't need to buy with our stuff, and then when it comes time to refresh that we'll pull our inventory back and replace it in whatever quantity they need to have it in. But in terms of force structure, the end items, the tanks, the Bradleys, the bridging equipment, a lot of the sustainment force structure, we don't really decide what it is the services stock there. The services do that in consultation with the COCOMs and the Joint Staff, and then we just fill them up with other quantities of our stuff they need.

DWG: On fuel, are you involved in the Navy [inaudible] alternative fuel?

VADM Harnitchek: Yes, we are.

DWG: There's a big controversy over the fact that [inaudible]. Any clarity on the quantity you're buying and what kind of cost differential there is between the [inaudible]?

VADM Harnitchek: Obviously it's quite a bit more. I don't know exactly what those costs are, but they're quite a bit more.

I know the Navy has a Foreign Fleet Initiative. The folks in the Navy can probably give you a much better definition of that, but because we're the executive agent for fuel for the department, we buy that fuel. So we've just issued a solicitation last week for the Gulf and East Coast and I want to say it's in the neighborhood of about a $4 billion contract. And the solicitation states that some percentage of that fuel will be bio-fuel. The Navy can give you the details with regard to the funding sources. [Inaudible] DLA [inaudible] capital funding, but another source of that funding is Department of Energy. I don't know exactly what the details are. The Navy can probably give you that. But in terms of our role as the executive agent for fuel, we're linked very closely with the Navy in terms of both their requirements for fuel [inaudible] or for bio-fuel if you will, into our contracting. We just issued that solicitation this week and we anticipate awarding that contract probably in August.

So it all comes down to some percentage of [inaudible] pretty much the entire East Coast and the Gulf. Some percentage of that will be bio-fuel. But the Navy can give you the details or we can get you the mechanics of how that's going to work.

DWG: [Inaudible] winner take all [inaudible].

VADM Harnitchek: It will be a winner take all and it will be a best value [connotation] and it will all come down to price. As you guys know, there's no shortage of folks here that compete for the DLA fuel business. So it will be a normal contract. The only sort of difference will be this issue of the bio-fuel.

DWG: [Inaudible] most of the stories in the last three years. A year ago [inaudible] Boeing [inaudible] $13 million in [refunds]. A year later, what's happened?

VADM Harnitchek: Of course that was the GAO, excuse me, the Pentagon IG, the DOD/IG. They concluded their study and said, I think this was about a $350 million contract, a long term contract over several years. They indicated that we overpaid in some parts to the tune of about $13 million I think. Also in the [inaudible] report there was a passage that talked about stuff that we had underpaid, that Boeing lost money and then there was some universal part [inaudible].

So I can talk to my counterpart in the building, a guy named [inaudible] responsible for their logistics business for the DoD writ large, and so they are as concerned as we are in terms of the optics of overpaying [inaudible], so neither of us have a very good stewardship perspective.

When we got all done with sort of the puts and the takes, Boeing agreed to reimburse us about $3.3, $3.2 million worth of parts. So instead of getting the money back we're going to get sort of compensation in kind for contracts we already have. So they'll give us $3.2 million worth of parts for free, if you will.

That said, what can we do about all of that? One of the things we can do is just sort of better train our people in terms of what should things cost? If I'm going to buy this, I want my contracting officer to know that this is [butter, right], and it probably shouldn't cost a thousand dollars. [Inaudible].

Contracting officers have a responsibility to pay a fair and reasonable price, so that is a much -- That's [inaudible]. My folks [inaudible] yeah, I'm going to overpay this part of it, right? [Inaudible]. So it's up to me as their boss to ensure that they have all the requisite training, all that sort of should-cost training. So a much better [inaudible] work force across the board.

The other one is, believe it or not, in the 21st Century we did not have very good sort of access to the full range of what things cost, so we bought an off the shelf software program that basically searches the internet, if you will, for this. And remarkably, parts that Boeing sells, parts that Raytheon sells, they also sell to other people or it's available commercially somewhere. So that's just another piece in terms of being able to figure out how much that should cost.

The third one is, we used to have sort of a should-cost threshold that cost $5,000 [inaudible]. We've lowered that to $1,000. So that will assist the contracting officer with some technical help for things that now cost a thousand dollars the first time you buy it. Set the baseline. And probably the biggest thing is this notion of an agreement in writing in our contracts, for these long term, four or five year contracts, that we periodically review the cost basis of what it is that we're buying.

So these are fixed price contracts. In year one versus year five, the cost basis of that item can change based on economy, based on hey, we used to buy five, now Boeing's selling a thousand. That price ought to be less based on economies of scale. The raw material that goes into this [inaudible] is now quite a bit less, or quite a bit more. So essentially it's a long term contract, and most of our contracts [inaudible] to periodically review on an annual basis, every few years, the cost basis for why that thing costs what it costs.

So the IG report's triggered along these [inaudible]. Not [inaudible] all of them, but [inaudible] do some of that. That's why [inaudible] in the IG helping me out.

DWG: [Inaudible] $13 million and you got $2.2. There's $10 million there. Why didn't you get more?

VADM Harnitchek: Because, as also was reported [inaudible], I'm not sure exactly what the number is, we had actually underpaid some of this. So sort of a quid pro quo there, we overpaid for some, underpaid for others, and the net was about $3.3 million. We [inaudible]. Clearly we have to do a better job. It's a big contract, but I think the taxpayers expect better. We do too.

DWG: Sikorsky [inaudible]. [Inaudible].

VADM Harnitchek: Yep.

DWG: So is it $3.3 sir, or $2.3?

VADM Harnitchek: $3.26. And change, probably.

DWG: When you do these annual reviews you're talking about, you can then go in and change the contract?

VADM Harnitchek: Sure. You have to do that in conjunction with the contractor because when you have a contract everything's a fixed price. So this costs $12. Two years later or three years later, whatever is the appropriate time period, you go in and you look at the cost basis that builds up to the cost to make it and some profit, 11 percent. The profits, you're probably not going to renegotiate that although you may, but you review the cost basis of all those components that makes this a $12 item. If it costs less you change the cost basis and the contracting officer [inaudible] and we'll have our contracting negotiations. And if the cost basis is less, we expect to pay less.

DWG: It doesn't seem like they have an incentive to get in on that though.

VADM Harnitchek: I give a lot of credit to private industry. They're good folks. We wouldn't have much of a Department of Defense without our great industrial base. And believe me, when I talk to my counterpart at Boeing or whatever. You know, they don't think they're pulling one over on us. So this looks just as bad for Boeing as it does for DLA. So at the strategic level they're very interested in getting a good report card, as are we. Again, that's at the highest levels of the guys that we deal with. They're good citizens. Just like us, just like you guys, they show up and want to do a good job, not take folks to the cleaners.

DWG: I'd like to build on John's question. He asked you about the Pacific pivot. But it's more than just the Pacific pivot. We're going to have troops that will be going into Australia, but we'll also have them going into, I guess now [inaudible]. We also have a lot of operations in Africa, incredibly unstable and not a place with a lot of infrastructure. So how does that change what DLA does? And [inaudible]. How does that impact your mission?

VADM Harnitchek: Again, I would tell you in terms of the uncertain nature of the world moving ahead, that's sort of [inaudible] instability, Southeast Asia and across India, Pakistan, Central Asia, the Middle East and sort of the trans-Sahara region, right? So I guess in terms of how I look at what it is that DLA does, we need to be ready all the time and we need to be quick. So for me anyway, all those areas you're talking about, it's all about access and infrastructure.

So you need to move -- If there was any sort of a plaguing thing for us in Iraq and to a much greater extent in Afghanistan, we have plenty of conveyance -- We have the machinery to move, to take the department to war. We have a huge fleet of organic airplanes with Air Mobility Command. Our Navy component, TRANSCOM, the Military

Sealift Command, the Maritime Administration have a huge force of sealift. Then you add to that our commercial partners in the Civil Reserve Air Fleet. That's about 1100 commercial wide body passenger carrying airplanes and cargo airplanes. Then on the commercial side you have the Voluntary Intermodal Sealift Agreement, and you have the Maritime Security Program. Hundreds and hundreds of ships, right? So there's no doubt that we have the conveyance to take the nation to war. The only wild card is can you get there? Can you get in? Do you have overflights? Some of these countries that we need to transit on the ground, do we have their agreement to have the commercial supply chain go through there? And then if you need land support forces in sort of a great number, what's the sea port look like? What do the roads look like leaving the port? Are there any railroads? Are the railroads the right gauge? Is that airfield in the middle of Africa, is that an air mobility friendly airfield? Will it take wide body airplanes or will it take F-16s only?

The key is as we look ahead in the Pacific, as we look at emerging requirements in Africa, as we look at sort of the traditional places that are involved in CENTCOM, it's all about where it is you think you need to go, what's the level of force structure you're going to have to involve there? Is it a battalion? Is it a brigade set? Is it a long haul counter-insurgency operation? What is that? What's the level of support that they need? Then look at do I have the access to get there and the infrastructure to support the force once it's there? That's sort of an amorphous grand statement here, but that's really, as you look ahead, that's really what it's all about. That has been the lesson of Iraq and Afghanistan. That's really the wild card.

Certainly not DLA's mission but probably a TRANSCOM mission. They have an assigned mission to be the global integrator for distribution and [inaudible]. It's these ,what did the infrastructure look like [inaudible] where it needs to go and do you have the access to get there.

And remember when they closed Pakistan, that was sort of a big deal. [Inaudible]. So in CENTCOM for the past 12 years it's all been about access, can you get in? Then infrastructure.

Look to '95. There's a reason that the traffic was bumper to bumper. If the infrastructure isn't sized for the level of the flow that needs to go through it. And talking about logistics at scale, that's really what you're talking about, is that it's just a flow problem and how big is the pipe to shove all this stuff through?

DWG: So CENTCOM pretty much gets it, understands it.

VADM Harnitchek: I think everybody gets it.

DWG: -- Africa Command or --

VADM Harnitchek: Absolutely. That's all we talk about, generally. We don't talk about do we have enough lumber, do we have enough fuel? It's all about can I get the stuff there? That's what it's all about.

DWG: So commodities don't really matter. It's just the access --

VADM Harnitchek: It's the access and then the throughput.

DWG: Once you're on the ground you guys are responsible for keeping them fed, keeping them fueled and all that.

VADM Harnitchek: Exactly.

DWG: Do you have people who have gone through and sort of looked at possible places that there could be a contingency?

VADM Harnitchek: Absolutely.

DWG: Here's what we can get here, here's what we --

VADM Harnitchek: Yep. I [inaudible] all the time.

The other big thing is what can you buy local? We bought probably at its height close to $2 billion worth of material in Central Asia and the South Caucasus. A, because it helps our relations with those nations if we're buying concrete in Uzbekistan instead of shipping it all the way from New Jersey.

DWG: I still remember shipping sand to Saudi Arabia in the Gulf War.

VADM Harnitchek: They have a lot of sand there. Again, --

DWG: -- country.

VADM Harnitchek: That was a DLA-led effort. So we bought a lot of fuel, a lot of food, a lot of bottled water, a lot of construction equipment, a lot of construction supplies from the Central Asian states. So it's good logistically. You don't have to move it nearly as far. You don't have all the issues with access and infrastructure because you're buying it locally so there's an incentive there to let the host nation allow you to move it. There's a whole lot of moving parts.

But I will tell you that the big challenge [inaudible] ahead is access and infrastructure. They're the two big things.

DWG: To follow up on that, is there a review going on, looking at all this stuff? Is there a consensus already?

VADM Harnitchek: I think there's a consensus that there are two big issues, and DLA -- I'm concerned because a lot of my supply chains are completely commercial in nature. So all the fuel that we consume in Afghanistan, I'm writing contracts with fuel brokers and I require them, I want half a million gallons on the ground in Afghanistan every day. They have to tune that supply chain to ensure that they're buying fuel in the right place and they have all the necessary permits and customs deals to ensure that those rail cars across that border in Uzbekistan and Afghanistan can get to all of the places that we consume fuel. So we do that all the time. That's my mission, if you will.

TRANSCOM is a big player there. They can talk about what they're doing to [inaudible] in terms of this issue of access and infrastructure. So I would tell you the department writ large from a logistics perspective, both the department and the combatant commanders and the services think a lot about that.

DWG: How closely do you work with TRANSCOM?

VADM Harnitchek: Very closely. I'm the guy that has to [inaudible]. So all the time. All the food, for example, that we consume in Afghanistan, and frankly everywhere in the world [inaudible] talk about moves and [defense] transportation. So a steak is sourced out of Sysco here in the western part of the state, or if it's eggs [inaudible] to make omelets in Afghanistan, TRANSCOM moves that for me. I buy it. I figure out where to buy it, where to source it from, the contractors, and then we give that requirement to TRANSCOM and they put it in the defense transportation system and they move it.

That's the other great thing about our system here. Not only do we have a lot of machinery in industry to move things, you also get access to all these networks that these guys have. They're great at it. So we set up that Northern Distribution Network a long time ago, in 2008, 2009. And [inaudible] probably 14 or 15 nations -- Europe, Central Asia, and the Caucasus. [Inaudible] set the network up.

The first mission was ours, our government's. The second issue was commercial transportation. So in a matter of weeks they had a network stitched together that started in the Baltics and ended in Afghanistan. So a huge network in terms of taking us where we need to go. And all commercial, completely commercial. No military footprint whatsoever.

DWG: With regard to the military footprint, do you think as the U.S. leaves, is there likely to be a spike in supply of weapons on the black market in Central Asia? And what steps are being taken to prevent that? We're leaving a lot of material there.

VADM Harnitchek: You're probably above my pay grade on that one. I don't have -- We're bringing all the weapons home.

DWG: All of them?

VADM Harnitchek: Yeah.

DWG: There's a lot of stuff, I mean the Afghan government is pretty corrupt.

VADM Harnitchek: They may be, but -- That's sort of beyond my pay grade here in terms of spikes of weapons on the black market. Somebody obviously is concerned about that. Security of weapons. You need to account for weapons. That's kind of what [inaudible], but I'd just be [inaudible].

DWG: Michael Bruno, Aviation Week Space Technology.

We've heard for a few years now about concerns in the industrial base regarding the health of the supply chain. From your viewpoint, what do you think the health is and where do concerns lie for you?

VADM Harnitchek: From my perspective, and we have a whole host of supply chains. We don't have a lot of worries about the fuel supply chain. We don't have a lot of worries about the medical supply chain. We don't have a lot of worries about the food supply chain. We sort of feed off the existing commercial supply chain there and so we consume a lot of fuel, we eat a lot of food, we use a lot of medicine, so we're sort of the star of that big [inaudible].

[Inaudible] textiles. We are required by the [inaudible] to buy every thread that I'm wearing -- buttons, zipper, you name it, from a company here in the United States. Well we have gone through 12 years of an enormous amount of spend in the clothing and textile industries, to the tune of about $4 billion or so. That will probably be about half of what it is that we're spending now.

So our mission there, to the extent that I can create more requirement, how do I spread that $2 billion we spend across an industrial base that used to make $4 billion to keep as many of those -- and most of them are small businesses -- how do we spread that money to keep as many of those folks in business as we possibly can because if we need them they'd be nice to have around. That's a big one.

The other ones are the guys who supply me parts. Boeing, Raytheon, all my big defense contractors. So we have to make sure that we're giving them a good requirement and they're giving us the requirement on the back end. So they're having to do a lot of stuff on their end to get smaller like we are. But again, we will figure that out. I don't want to be sort of cavalier here, but when you've been doing this a while like I have, this isn't the first time we've been through this. And we don't have it all figured out yet but at DLA we have a lot of folks working on it.

The other thing is, we just meet with industry. Twice a year I meet with guys I call the captains of industry. This is sometimes 40 company CEOs, sometimes it's 50, sometimes it's 100, and we talk about this. This is how much money we have to spend, this is what we think the level of DLA spending will be over the next couple of years. I want to take $13 billion of cost out of the material side. Help us do that. And these guys are interested in doing this as well. So lots and lots of initiatives going on there to ensure that to the extent that we have less to spend, we're spending what we do have as wisely as possible to ensure that that industrial base stays as viable as it possibly can.

DWG: I have two clarifications. Can you quantify how much -- You said you're going to shrink. How much you grew in the last decade with the wars and then --

VADM Harnitchek: Prior to 9/11 -- Some of this is we've taken on new missions here so this is going to seem like a big number. I want to say prior to 9/11 we were in the neighborhood of $18 to $20 billion in sales. So we buy stuff and then we sell it. $18 to $20. Our biggest year was either FY12 or 11, we were at $46 billion. That is quite a bit of growth.

Now some of that is mission growth, so we have got the missions that somebody else was doing that we now have, but some of it is just the increased level of demand for the big commodities that we sell.

Last year I want to say we were about $41 or $40 and I think we'll end this year probably in the neighborhood of about $35 to $37. So as you'd expect, as the demand goes up, the funding goes up, so goes our business; on the tail end here, the slope has gone from up to down.

DWG: Is there an estimate on how much Hurricane Sandy cost totally?

VADM Harnitchek: I'll have to get you a number. There's what did it cost writ large and then what did DLA spend, but we can get you that.

DWG: I heard you speak in April and you noted that you wanted to cut down contract time by about 7 percent.

VADM Harnitchek: Exactly?

DWG: I'm just wondering what kind of steps you were taking to do that and what the status of that goal was.

VADM Harnitchek: We buy a lot of things. We buy things that cost $50; we buy things that cost billions of dollars in terms of contracts.

What we found was it takes too long to buy them. You've all heard about if you can just get the forecast right, life would be great, and we're pretty good at forecasting stuff but when it takes you -- the forecast today, [inaudible] six months or a year, that forecast isn't very good. So it's all about taking the white space out of that contracting process and pulling that from identification of requirement all the way to the last, to 30 percent of what it is now. Some of it is just basic business. It's fundamentally process control, looking at the whole process, looking at the stuff that is value added activity and the stuff that's not value added activity. Get rid of the non-value added activity and get rid of all the white space, the dead time. And the dead time, the white space is what happens between value added events. So you connect all those value added events, you take a lot of the white space out, the dead time activity, and you take out all the non-value added time. So some of that is just fundamental business process reengineering that business does all the time.

The other one is ensuring that our contracting officers are exercising all the authority they have. We have gotten a little sort of overbearing in terms of contract review. I have folks that are fully trained to do that, they have contracting warrants, I trust them to make the right decisions. So we're taking out a lot of that sort of what we think is unnecessary review time. And some of it is just production control. You're a buyer that's making awards for things that cost less than $10,000. You've got to do ten of those a day. Not two of them a day, ten a day. So some of it is metrics, process control, and empowering our employees to do the right thing.

The other thing we found is there was not a lot of correlation between the time it took to award a contract and whether it was a good contract or not. So we think we can award contracts really quickly and get good contracts out the door. Again, it's all about speed.

DWG: Do you have a status of where you're at --

VADM Harnitchek: We're not there yet but I think we've taken about half the time out that we need to take out. It's tough.

DWG: About 35 percent down from where you were?

VADM Harnitchek: Probably. Thirty-five to 40.

DWG: Admiral, at the end of the FYDP when you cut out all this fat, $13 million, what are your concerns going forward if we do have to launch a major combat operation somewhere in the world? Do you have any concerns about being able to surge your abilities, all other things being equal?

VADM Harnitchek: I don't want to sound sort of cavalier or sort of like [inaudible]. When you've been doing this a long time like I've been doing it a long time, you just have a sense of what it is that we can do. I was at TRANSCOM for five years. I was the Deputy Commander there. We and all of our partners in private industry, [inaudible] combatant commanders, I mean it's a big sort of logistics nation and transportation nation, if you will, pulled off some miraculous feats of military logistics while helping out the people in Haiti, while pivoting to Japan after the tsunami and earthquake, countless surges in and out of Iraq, similar issues in Afghanistan. The loss of Pakistan. So we have a sort of battle tested, combat hardened group of logisticians in all the services. So I really don't worry a whole lot about that. I'm not saying that because I'm lazy or I'm not paying attention. I have tremendous confidence in our ability -- not just the DoD certainly, but all our commercial partners here, to meet any requirement that comes our way.

DWG: You mentioned the 45 football fields of infrastructure that you cut out. Was that storage space that we needed in 2008? Or was it superfluous even then? Are you going back and cutting back --

VADM Harnitchek: There's probably some stuff we could have gotten rid of before. But again, the threat, the strategy is constantly evolving and we need to evolve with that. That's what you've got to do.

DWG: We're out of time.

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