



**The Bear Flag Revolution;  
California's Experiment in the New Federalism  
By Jonathan Taplin  
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“And yet here in this nation-state of California , people from all over the world live in harmony. I call California a nation-state because of the diversity of our people, the power of our economy and the reach of our dream. Every race, every culture, every religion has been drawn to California . The commerce and trade of the nations of the earth pass through our ports. The world knows our name. We are a good and global commonwealth.”

-Inaugural Address of Governor Arnold Schwarzenegger of California, January 5, 2007

## **Introduction**

Something important is happening in California. A profound experiment in Federalism, led by a Republican Governor and a Democratic legislature is taking shape and it is the first break with an American political culture that has been centralizing power in Washington since 1932. In four years the state has passed laws on auto emissions, CO<sup>2</sup> levels, stem cell research, personal data privacy and appliance energy standards all of which have clashed with the neoconservative agenda of the Bush administration. As the governor pointed out, the power and size of the California economy has allowed the state to create defacto national standards that the corporate

sector has been forced to follow. And although both the auto, oil and banking industries have joined with the Bush administration to sue for relief from the California standards, to date the courts have not struck down any of the state laws. Now California is poised to go farther in its quest for independence from a Federal government many feel is headed towards the rocky shoals of fiscal shipwreck. Since the election of Ronald Reagan in 1980 the American political ruling ideology has been based on the twin poles of the Neoconservative philosophy first elucidated by Irving Kristol in *The Public Interest* in 1965: in domestic affairs the national government should shrink its revenue base (by cutting taxes and business regulations) and in foreign affairs the government should grow its budget (by becoming the world's sole military superpower). The net result of this seeming contradiction is an America that is living beyond her means, spending more than she is earning. As our military commitments continue to rise our government and our people are on a global credit card binge, dependant on the "kindness of strangers" to not call in the loans. The day of negative real interest rates is over and the Japanese and Chinese who hold close to \$2 trillion of US debt will soon have domestic needs for their large pool of savings (for their aging populations) and the cost of our twin deficits (budget and current account) will rise dramatically. As Stephen Roach, Chief Economist of Morgan Stanley wrote recently, "In my view, the US economy is an accident waiting to happen. That's the message to be taken from a record shortfall in national saving, a record current-account deficit, record levels of household indebtedness, a record deficiency of personal saving, and outsize government budget deficits."

For a knowledge economy like California, whose entertainment, technology and software businesses are the major source of America's export economy, the rise of

America's aggressive military posture has led to a rise in Anti-Americanism in cultural goods as well. Retail consultant Lawrence McNaughton was quoted as saying "If you hate America, it's real easy to hate Coke, Disney or McDonald's. The two primary criteria for determining risk would be if you're in business internationally and you're a cultural icon." For California's Governor to pointedly separate himself from the Bush Doctrine by noting that the California "Nation-state" is a "prosperous, peaceful golden state" that will as the world's sixth largest economy, to do its part to cut CO<sup>2</sup> emissions, be a fair trading partner with the world and a welcome port for knowledge immigrants.

What the Governor and many in our state have concluded is that the only way forward for the American republic is a radical form of political devolution. I have called it The New Federalism in an earlier essay, and its principle comes from Jefferson's belief that "The true theory of our Constitution is that the states are independent as to everything within themselves, and united as to everything respecting foreign nations." Even Jefferson's archrival Madison expressed concern that if the nation grew too large, elites in the capitol would divide and overwhelm a widely dispersed population, producing "tyranny." While the idea of returning more power to the regions, states and cities has been discussed for years, it now has a national champion in California's Governor Schwarzenegger who is openly experimenting with The New Federalism. It is only fitting that this experiment is taking place in California, birthplace of this country's digital revolution. The tools built in Silicon Valley will prove to be the accelerator of this political devolution. For this we know: despite a new economic populism, the era of globalization cannot be contained and the devolutionary forces of the Internet are pushing power to the edges of almost every organization. The skeptics of the New Federalism are

legion. How can a country reverse seventy five years of moving political power to the Federal government from the states? And although the election of 2006 brought the neoconservative era to a close, it did not define “the new order” and so we find ourselves in a political interregnum.

## **The Interregnum**

The notion of an interregnum has classically been tied to those periods when one king has died and there is no clear successor. But for our purposes, the notion of interregnum refers to those hinges in time when the old order is dead, but the new direction has not been determined. Quite often, the general populace and many of its leaders do not understand that the transition is taking place and so a great deal of tumult arises as we move into an era of profound experimentation as our country tries to reinvent its democracy. Supreme Court Justice Brandeis in one of his most famous dissents spoke to the power of experimentation in a democracy:

“Denial of the right to experiment may be fraught with serious consequences to the nation. It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”

These changes are painful but not new and have been experienced by other hegemonic powers, with imperial obligations that stretched their resources and new technologies that were disruptive to their elites. The clearest historical parallel would be to journey back more than 100 years to the beginning of an earlier era of globalization and the end of the last great empire, Great Britain.

On Saturday February 2<sup>nd</sup>, 1901 Prince Albert, Duke of Schleswig-Holstein, then 32 years old, waited behind the horse drawn caisson carrying the casket of his grandmother, Her Majesty Queen Victoria of the United Kingdom, Empress of India. Victoria had ruled for 60 years over the vast British empire “on which the sun never sets” and so Albert was surrounded in the cortege by two emperors, three kings, nine crown princes and forty princes and grand-dukes from across Europe. Although there was no question of the succession of Victoria’s oldest son, Edward to the English throne, Prince Albert and the other 50 royals in the procession did not realize that they were entering an Interregnum in which the Age of Monarchy and Empire would disappear within 20 years. Prince Albert lived confidently in a world where Kings and Princes ruled a globe with half of the world’s population under European colonial rule, where the horses that pulled the caisson were still the main mode of transportation and the radio had not arrived to proclaim the death of distance. Guarding the Royal Family was Sergeant Major John Roughan of Her Majesty’s Body Guard of the Yeoman of the Guard, ever mindful that Queen Victoria had endured seven assassination attempts during her reign. Roughan had returned to London in 1883 after the heroic March to Kandahar in September of 1880 to lift the siege of the British regiment near the end of the second Anglo-Afghan War. The final British surge had been but a prelude to defeat and the pain of the forced British withdrawal a year later from the searing heat of the Afghan plains after forty years of intermittent war troubled Roughan. For his part, Prince Albert served in the Prussian Army, confident that the code of war laid out by gentlemen was clear. The world had been generally at peace for 20 years and the machine gun and the aerial bomber had not yet been widely employed in a war and so the notion that 15 years hence more than 9

million men would die on the battlefield in a worldwide conflagration was unthinkable. And Albert walked in the company of men. As historian J.M. Roberts observed, “It is reasonable to say that (women’s) half of the human race was in 1901 for the most part in thrall to the other half.” All this would change spectacularly in a few short years.

On that same day in 1901, 300 miles to the west on the cliffs of Cornwall, a 27 year old Italian named Guglielmo Marconi was putting the finishing touches on the Poldhu Wireless Station; a set of two stone buildings perched above the cove at the end of the Lizard Peninsula. He was joined on the blustery cliff by Ambrose Fleming, the first professor of Electrical Engineering at University College London who had recently preached a sermon at St. Martin-in-the-Fields on scientific evidence for the resurrection. Fleming had designed a 20 mast circular antenna which Marconi had calculated would be powerful enough to reach across the Atlantic Ocean for the world’s first transoceanic radio transmission. Marconi worried aloud that the strong winds might bring down Fleming’s design, but the older professor expressed confidence in his plan. Inside, an assistant to William Preece, the Engineer-in-Chief of the British General Post Office wrote up a report to bear back to London GPO headquarters, the source of Marconi’s meager financing. Six months later on September 17 of 1901, Marconi’s fears about the antenna would be borne out as it was destroyed in a bad storm, but they quickly rebuilt a huge two-masted aerial of 200 feet in height and on December 12 transmitted the first transatlantic radio message to Signal Hill in St. John, Newfoundland.

Prince Albert and his royal cousins did not know or care of Marconi and his obscure notions of wireless radio transmission. They were not aware of another young scientist named Albert Einstein who was finishing his teaching diploma at the Federal

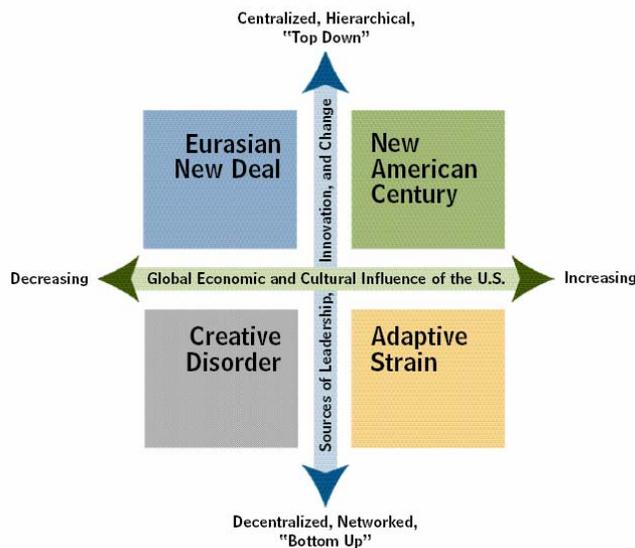
Polytechnic Institute in Zurich, Switzerland and had just published his first paper, “Consequences of the observation of capillarity phenomena” in which he put forth his first ideas about a unified physical law. And although Prince Albert had spent many a pleasant evening in the salons of Vienna, he was unaware that a local specialist in nervous disorders, Sigmund Freud had just published his first book, “The Interpretation of Dreams”. So at the very moment that the royal families of Europe were carrying on the ancient traditions of monarchy, they were blind to a scientific and cultural revolution that would doom their heirs to the status of a curiosity or worse, “pretender to the throne”.

Albert and his cousins would have studied the most famous interregnum in English history, when King Charles I was beheaded in 1649 during the English Civil War and Oliver Cromwell ruled as Lord Protector until the restoration of the monarchy in 1660. Those 11 years of interregnum were filled with religious strife, radical ideas (the Diggers and Levelers) and civil violence. It wasn't until the bloodless upheaval of the Glorious Revolution of 1688 that a true constitutional (and therefore, limited) monarchy was confirmed for all time. But the Interregnum he was about to enter, like the one we will see in the next ten years, would not end in the restoration of the “Ancien Regime”. In the same sense that the discovery of radio, physics, the automobile, the motion picture and the unconscious mind at the turn of the 20<sup>th</sup> Century was happening out of sight of the rulers of the era, I believe that the profound transformations of the digital revolution are equally unrecognized by the current occupants of the White House and many in power both in government and business. I believe that there is a “Knowledge Gap” in our understanding of the past/present/ future. Men and women who have spent a lifetime aspiring to the pinnacle of power have arrived at their destination with an understanding

of the world that is 10 years out of date. I call them the Industrialists and their understanding of the world is seen through the lens of the great British economist Baron Robbins who said “economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses.” To that end economic competition for these Industrialists has been always described in the metaphors of war: “creative destruction”, “price war”, “proxy battle”. They see the world as a constant battleground to control scarce resources like oil with massive military power. But oil is just a fungible commodity represented by the digital marks on the computer screens of oil traders around the globe. The Chinese and Japanese who have no investment in the Iraq Occupation that will cost America \$2 trillion buy that oil from those same traders at the same price Exxon Mobil pays.

On the other side of the Knowledge Gap are the Digitalists, whose world began when Gordon Moore wrote in 1965 that the number of transistors on the base price integrated circuit would double every 24 months and in an instant the notion of scarcity in the digital world was consigned to the dustbin of history. At its heart, Moore’s Law turn’s Adam Smith’s economics on its head and ushers in the possibility of building \$100 billion corporations like Google from scratch in four years. Digitalists capable of understanding the bottom-up networked power of the age will come to be the moving forces in next ten years although their ascent to power will be constantly hampered by the rear guard actions of the Industrialists. For instance, despite all of the possible innovations of the Digitalists, U.S. policy on energy conservation has been a captive of the Auto and Oil Industrialists for thirty years and will likely continue as such. Men like Vint Cerf, Tim Berners-Lee and Linus Torvalds have helped invent the Internet and yet it

is clear that Vice-President Cheney would not recognize their names or their contributions. Like many managers of today, he is not aware that the “Knowledge Gap” exists and so his years of experience as an Industrialist are actually an impediment to the country. GBN, one of the great Digitalist Think Tanks published the following matrix of four possible outcomes for the next ten Years:



When they surveyed a group of futurists for Fortune 100 companies, more than 70% believed that we would live in one of the two bottom quadrants in 2020, the only question being: would the U.S. be able to regain its global economic and cultural influence?

The failure of the Industrialists to understand that this basic Knowledge Gap exists, creates a kind of “cognitive dissonance”. This theory was first promulgated by psychologist Leon Festinger in 1956 after observing a UFO doomsday cult, whose leader, Mrs. Marion Keech, had prophesied the end of the world for Dec. 21, 1956. The members of the cult appeared at Mrs. Keech’s house to be borne off to space by aliens just before the earth perished. When the prophecy failed to come true and the anxious cult members

started to break down, Mrs. Keech delivered a new message saying that their collective energy had convinced God to spare the planet. In Festinger's theory, the failed message induced a state of cognitive dissonance in the believers which he equated to a state of uncomfortable anxiety. The only way to lessen the anxiety was to accept the new (false) prophecy that their actions had saved the earth. Festinger, after many other experiments, concluded that "human beings when asked to lie without being given sufficient justification will convince themselves that the lie they are asked to tell is the truth." A contemporary example of cognitive dissonance is clearly evident in a Harris Poll released on July 21, 2006 in which the respondents were asked the question, "Did Saddam Hussein's government have weapons of mass destruction in 2003?" Fifty percent answered "yes" to this question, despite the widely publicized findings of the U.S. Iraq Survey group two years earlier, that there were no such weapons. Clearly accepting the fact that we went to war in Iraq on false premises induces too much dissonance in the minds of the true believers, and so they cling to their belief despite all evidence to the contrary.

This sense that the nation's discourse has gotten disconnected from reason is a common aspect of an interregnum. Part of it can be attributed to the small cult of ideologues clinging to the "ancien regime" (as in the continuing evolution or global warming debates), but part is also a matter of ignorance of the technological revolutions taking place. For Adam Smith, the genius of capitalism lay in the fact that many market actors working for their own selfish reasons would be guided in their clash by "the invisible hand" of the market that would assure that the right balance of goods and services at the right price would always be on offer. But Adam Smith would have been

confounded by the contributions of the geniuses of the digital revolution who showed little respect for classic notions of self interest and property, putting transparency and sharing at the center of their work. The code for Cerf's TCP/IP, Berners-Lee's HTML and Torvald's Linux are all in the public domain and the continuous development by millions of programmers on top of these core free technologies gives a hint to the direction of the New Federalist Era. It is estimated that 25,000 man years has been invested gratis in the development of Linux. How does that square with Adam Smith's notions of self-interest? On a political level these same notions of cooperation vs. self interest are also playing themselves out in strange coalitions like Evangelicals and Progressives around global warming, poverty and health care. And in the culture, the rise of cooperative phenomena like My Space and You Tube has rewritten the rules of the media game. When Rupert Murdoch was asked recently what surprised him the most about his new acquisition My Space, he replied, "The speed at which it has grown. Not a penny has been spent marketing it before or after the purchase and it just grows faster and faster every week." Here is a media baron who has spent his whole life with massive marketing budgets and now--My Space. Clearly, Rupert Murdoch is a man who knows he is in an Interregnum and is willing to sell his Industrialist assets (the DirecTV satellite system) to concentrate on his Digitalist new world of My Space. He is not alone. *Business Week* wrote that many Fortune 500 companies "are using Internet-powered services to tap into the collective intelligence of employees, customers and outsiders, transforming their internal operations."

Perhaps most distressingly for the Industrialist worldview, the rise of bottom-up, networked forces has arrived on the battlefield, leaving top-down, hierarchical managers

like Dick Cheney and George Bush searching for ways to explain the failure of their war policies to a perplexed American public. As John Arquilla, professor of defense analysis at the Naval Postgraduate School recently remarked about the Mideast wars, “We are now in the first great war between nations and networks. This proves the growing strength of networks as a threat to American national security.” The inability of the current administration to explain what is happening in the world goes far beyond the War in Iraq.

Consider the evidence in the U.S.:

- All national polls show that more than 65% of the public feel the country is on the wrong track.
- Our education and health care systems rank below 20<sup>th</sup> in the world on real outcomes (test scores, mortality, etc) though we spend far more per capita than other developed nations.
- Neoconservative ideologies of preemptive war have 300,000 U.S. Military and 100,000 private military contractors tied up in asymmetrical war in which U.S. heavy weapon Industrialist competence is ineffective against the agile, mobile Digitalist networked forces of the insurgents.
- Our new role of “World Police” creates an unprecedented level of worldwide Anti-American sentiment. The ability of a computer literate, propaganda and Internet savvy opposition to exploit this anger is evident in many world capitols.
- In technology our commitment to the centralized Industrialist model has caused us to fall behind both Asia and Europe in Broadband diffusion and in high tech exports.

- Although economists have long pointed out the dangers of the “free rider problem”, our main commercial rivals (China, Russia, Europe, Japan and Korea) are free riding on our massive defense expenditures.
- The spread between wages of CEO’s and those of the average worker continues to widen as the rise in worker productivity has not been shared with the worker.

If one accepts the notion that we are in a period of dynamic transformation, the question then turns to the nature of this interregnum; will it be violent and painful or will it be more benign. I believe that this coming age of reform will bring about a positive transformation of American society as we grapple with the meaning of “the end of scarcity”. The old guard of the defense and extraction Industrialists who have done so well with two of their own running the country (Bush-Oil; Cheney-Defense contracts) will work extremely hard to hold on to power and they have a commanding old style media megaphone run by interested parties to put out their story (the war is going well, the economy is great, etc.). But the Industrialist model of Big Media is failing in the age of the Internet and so the voices of digital democracy will be heard. The task is to redefine the notion of national security and purpose around two basic principles. The first is that in the networked society, U.S. influence will flow from our global economic and cultural power as opposed to our military power. The second is that as the sources of leadership innovation and change in this new world come from decentralized, networked, bottom-up forces of the Digitalists, the American political structure will have to adapt to a devolutionary notion of power. States and Cities will become the important sources of leadership and the Federal Government will start shrinking. What is happening

in the government of California as it seeks to set its own policies on global warming, stem cell research, broadband, privacy and other matters is just one example of that change.

## **The New Federalism**

The basic economic problem we will face in the next few years is that the Federal system no longer works correctly. In the early 90's George Kennan wrote that our vast federal bureaucracy was "contributing to the impression of remoteness and impersonality on the part of the government and of insignificance and helplessness on the part of the individual, and thus impairing the very meaning of citizenship." The States are without sufficient taxing power to provide basic services for their people, as many state governments are in a fiscal crisis. Our school systems are under funded and our basic infrastructure is broken. Since most of the concerns of citizens are local matters: Schools, Police, Housing, Power & Water, Public Transportation, and Health Care, these should be funded at the state level. Even though the Federal Government provides block grants to the States for these concerns, much of the tax revenue gets wasted in the Federal Bureaucracy. The New Federalist solution is to change the tax structure. Federal taxes should be radically cut, so that State taxes could rise to pay for the real needs of citizens. This would have two effects. The States would have sufficient taxing authority to pay for decent services, health care and infrastructure. Therefore local property taxes would not be hijacked by state governments and could remain at the county level to fund schools

and local infrastructure. The Federal Government would have to drastically shrink the departments of Education, Agriculture, Health and Human Services, Housing and Urban Development, Commerce, Transportation and Labor. However, the Federal taxes could more than adequately fund the needs of the Departments of Defense, State, Treasury, Veterans Affairs and Homeland Security as well as its Social Security and Medicare benefits.

Although the negative progressive reaction to the words “States Rights” was formed during the Civil Rights era, citizens uninterested in living in Dick Cheney World, should look to the heartening developments where state legislators and regulators are taking on corporate power in ways the Bush administration is unwilling to do. Whether it is the California Auto Emissions law (passed in the face of massive corporate lobbying by oil and auto companies) or the actions of former New York Attorney General Spitzer against Wall Street abuses; the states are asserting their right to create a just society for their citizens. And surprisingly the Supreme Court has backed this assertion of State Sovereignty in three recent cases. For a state like California, the world’s 6<sup>th</sup> largest economy, the ability to set national standards for auto emissions, appliance efficiency, clean air and water goes with its market power. What auto company would refuse to sell cars in California? Ironically we will see conservatives in the Bush administration reverse their 100 year long States Rights crusade and try to use Federal Law to force California to adhere to their anti-regulatory bias. Ultimately the citizens of the “Blue States” have a right to live with clean air, efficient automobiles, good schools, honest corporations and universal health care. Their desire to build a sustainable civilization is not a new quest.

In California we are only beginning to understand the import of the digital revolution on our overall economy and our state government is using new bond money to support this growing digital sector. The California experiment will demonstrate how the economics of Moore's Law, the cooperative strategies enabled by the Broadband Internet and the new Green Technology Revolution can guide us through the interregnum to a new era of Digital Capitalism. We have been convinced by modern economists that strategies of cooperation don't work in the real world—The Tragedy of The Commons. And even though, as Karen Armstrong points out, every spiritual practice in the world is based on the Golden Rule—the essence of cooperation--we believe that we are doomed to be Adam Smith's selfish economic actors. But as business leaders like Jeff Immelt of GE and Eric Schmidt of Google have embraced Digital Capitalism and the Green Revolution perhaps there is hope for a new path away from polarization. The pathway to economic and cultural renewal is clear and the alternative, as Warren Buffet points out is a "sharecropper society". The potential realignment of political forces where economic and libertarian conservatives work with social progressives to battle large centralized bureaucracies and create an economically sustainable networked form of local democracy is just over the horizon. The question before us all is; will it take an economic crisis to move us down the path of renewal or can we shake off our apathy and make the political choices now, before the catastrophe?