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Smoking out a major flaw in Obamacare

By: Paul Mulshine – March 28, 2013

Here's a New Year's resolution a lot of people might consider taking next year: I will start smoking.

Jan. 1 is when the much debated individual mandate to buy health insurance takes effect. At that point, people will have a big financial incentive to light up and avoid big tax penalties.

That may sound crazy, but it's true. I learned about it the other day when I called Michael Cannon at the free-market Cato Institute in Washington to discuss an underreported aspect of Obamacare, a rise of up to 50 percent in premiums for smokers. Bad news for smokers? It may look that way at first. Actually it's bad news for Obamacare.

That's because smoking — or simply saying that you smoke — can put you beyond reach of the individual mandate to buy health insurance that is cornerstone of the entire plan. The mandate is backed up by a tax penalty. By 2016, a typical penalty will reach \$695 for a single taxpayer who doesn't have health insurance and \$2,085 for a family of four. That's a lot of money. But there's a loophole that lets you avoid paying that penalty. In September 2009, New York Sen. Chuck Schumer introduced an amendment to the Affordable Care Act that would exempt from the individual mandate anyone whose premiums exceed 8 percent of annual income.

At the time, that looked like a lot of money. But as the bill progressed, Schumer's fellow Democrats larded it up with many other mandates. The cost of a typical policy now hovers around 8 percent for those who don't qualify for subsidies on those insurance exchanges that start up next year. The smoking surcharge would put most people over the limit.

"If you want to avoid the tax, just say, 'I'm a smoker,'" Cannon said. "They will charge you a higher premium and then you will not pay any penalty."

Let's assume you're a young and healthy 30-year-old getting by on \$27,000 a year. You can barely pay your rent, college loans and car expenses. The last thing you need is a mandatory \$2,029 health insurance premium that will consume 7.5 percent of your income. Just say you smoke and you're off the hook.

But what happens if you break your leg skiing the following year? No problem. You just sign up for insurance then. Under Obamacare, the insurance companies can't hold pre-existing conditions against you.

This is what's known as "adverse selection" — and it can send an insurance company into a death spiral. If sick people buy insurance but healthy people don't, the cost of coverage skyrockets. The premiums then push even more people out of the market.

The mandate was designed to prevent that. But thanks to that 8 percent ceiling, the mandate will be unenforceable on most of its intended targets.

Let's assume that 30-year-old makes \$50,000 a year. He's exactly the sort of "free rider" the mandate was designed to bring into the system. But the \$4,128-per-year premium he'd be charged is already in excess of 8 percent even if he doesn't lie about smoking. Let's imagine a family of four headed by a 50-year-old with an annual income of \$250,000. They can certainly afford the \$20,229 premium they would be charged according to the Kaiser Health Insurance Subsidy Calculator. But the premium exceeds 8 percent of their annual income.

When you run the figures through that calculator, you quickly find out that the people who fall below that 8 percent ceiling are almost entirely people who will be getting big subsidies from the government. Theoretically, the cost of those subsidies would be offset by premiums from wealthier people. But thanks to Schumer's little-noticed amendment, those people can opt out of Obamacare — at least until they get sick.

Do the math and it adds up to financial disaster for those insurance exchanges. Perhaps the wisest move Gov. Chris Christie made recently was to veto that bill that would have had New Jersey run such an exchange. Now the Obama administration has to do so — and figure out how to fund it.

Here's one thing they can't do: Raise that 8 percent ceiling. They no longer have the votes in Congress to do so.

That means those wishing to avoid that mandate can raise a glass to Sen. Schumer on New Year's Eve. They'll have a happy New Year — even if federal health care regulators won't.