CABINET

EARNINGS-RELATED SHORT-TERM BENEFITS

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

The Pensions and National Insurance Committee discussed on 11th June (I.N.P. (64) 6th Meeting, Minute 2) whether we should extend the principle of relating benefit to earnings to the short-term benefits of the national insurance scheme and, if so, whether we should publish the proposals in a White Paper (a draft of which as circulated to the Committee is attached). The majority of the Committee are in favour of doing both these things and I am, as Chairman, circulating this paper setting out the arguments. A minority of the Committee, consisting of the Chief Secretary to the Treasury and myself, take a different view and we shall be circulating a separate paper.

2. We should bear in mind the background to our considerations. N.E.D.C. in their report "Conditions Favourable to Faster Growth" nearly eighteen months ago referred to the advantages of earnings-related unemployment benefit and suggested that there was much to be said for a comprehensive earnings-related scheme. The question of financial provision for redundancy was considered last summer by the Minister of Labour's National Joint Advisory Council. Both the British Employers' Confederation (B.E.C.) and the Trades Union Congress (T.U.C.) came out in favour of earnings-related unemployment benefit. In subsequent discussion both bodies have reiterated their support for this development. The T.U.C. has said that earnings-relation should be extended to sickness benefit. There has been a series of detailed discussions at official level which have shown that a scheme is workable. There have been reports and discussions in the Press which have built up an expectation of Government action. We cannot defer making some statement of our views for much longer and it will not be easy in the present climate of opinion to say that we have decided to do nothing.

3. There is a growing feeling that the Beveridge concept of flat-rate minimum benefits for all is out-moded. The rapid growth of earnings in recent years makes it possible for the ordinary worker to pay more for better financial protection. Although proportionately the rise in benefits has more than kept pace with the rise in earnings, the absolute difference between standard benefits and average earnings has been widening considerably, so that the drop in income for the worker who loses his job or falls sick is serious. Prosperity has encouraged people to take on continuing commitments of various kinds. The onset of unemployment or sickness and the sudden drop from average earnings of £16 a week or so to £3 7s. 6d. a week for a single person and £5 9s. for a married man can cause real difficulties which we ought to mitigate. People no longer consider hardship in absolute terms; they assess it relatively to earnings and commitments, and argue that provision against the cessation of earnings should be related to those earnings. We took a first step in this direction with the introduction of the graduated pensions scheme in 1961. That scheme is now well-established and it would seem a wholly natural and sensible development, in tune with modern thinking, that we should take the next step and extend earnings-relation to the short-term benefits. Many overseas countries have already adopted it.
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4. There are powerful special reasons why unemployment benefit should be related to earnings. They are:

(I) We cannot have modernisation and faster economic growth without an increase in movement of workers not only within industries but from one industry to another. Earnings-related unemployment benefit is a necessary reinforcement of our other measures to deal with growth and its consequences, such as our training and re-training programme and regional development policies.

(2) Unless the worker can have reasonable protection against a sharp fall in income in these circumstances, he will resist strongly and will oppose every change that threatens jobs. Restrictive practices will continue to flourish.

(3) Equally, employers will be less reluctant to discharge redundant employees if better financial provision is made for them through the national insurance scheme. Overmanning is serious and may be widespread, and anything that will assist employers to eliminate it is of crucial importance.

(4) It will improve the atmosphere of industrial relations. This again will help to secure workers' co-operation in raising productivity.

(5) High unemployment benefit will act automatically as an anti-cyclical measure, helping to sustain purchasing power in those areas, and at those times, where this is desirable to encourage employment.

5. These economic arguments do not apply to sickness benefit, but the financial needs of many sick people are no less than those of the unemployed. The case on both economic and social grounds for introducing earnings-related short-term benefits and providing more adequate protection against a sudden fall in income in unemployment and sickness seems to be a compelling one.

6. If we improve the provision for the early months of unemployment and sickness, we should similarly improve the provision for the early months of widowhood. Improvements in parallel on all three fronts would mean a sensible and attractive advance in our social provision.

Publication of a White Paper

7. If the Cabinet decide, as the majority of the Committee recommend, in favour of this extension of earnings-related benefits, we must also decide whether we should publish our proposals in a White Paper. The majority view in the Committee is that we should. The Ministers who take this view argue as follows. There has been considerable interest in, and publicity for, our consultations with the B.E.C. and T.U.C. These have been going on in one form or another for the best part of a year and we should be subject to criticism if we could not show that we had carefully worked out the essentials of our proposals. A White Paper would be the natural way to do this, and can be expected to be widely welcomed. Pressure for too early legislation would have to be resisted, but this could be done on the grounds that there were still important details to be worked out and discussed with interested parties. Early publication might involve some embarrassment with the B.E.C. and the T.U.C., since our consultations with them are still continuing. But this is not thought to be serious. Thus, if the Cabinet decide in favour of the scheme recommended by the majority of the Committee, it would also be the strongly-held view of the majority that the scheme should be published in a White Paper before the Recess.

R. M.

Treasury Chambers, S.W. 1.
15th June, 1964.
Further development of the National Insurance Scheme

Short-term benefits related to earnings

Introduction

1. "Provision for Old Age - the Future Development of the National Insurance Scheme" (Cmd. 538) was issued in October 1958. It contained the Government's views on the future development of national insurance retirement pension provisions. The Government then decided that the existing flat-rate system should be preserved as the basic provision for old age but that its limitations in meeting the developing needs of the community in an expanding economy pointed to the need for a supplementary system of graduated contributions and retirement pensions related to earnings. The Government therefore put forward proposals to this effect and these were later embodied in the National Insurance Act 1959.

2. This was a major new development for national insurance in this country. The national insurance scheme had hitherto been based on the principle of universal compulsory insurance giving flat-rate benefits at standard rates for all the contingencies covered in return for flat-rate contributions. The graduated pensions scheme introduced a new principle by relating contributions and benefits to individual earnings. New methods of assessing, calculating and recording contributions had to be devised.

3. The inauguration of the new scheme posed many problems for employers and the Government Departments concerned. It was nevertheless launched successfully in April 1961 and has run smoothly since then. With this important new development in national insurance now firmly established in the pensions field, the Government has been considering whether an element of earnings-relation should be introduced into the present provisions for unemployment and sickness and, if so, how this might best be done. Such a development would be natural, but the pattern set for pensions would need considerable modifications before it could be applied to the quite different contingencies of unemployment and sickness. Recent discussion of these problems has been given an impetus by the search for better provision for transitional unemployment in conditions of rapid technological change. The Government welcomes the interest shown in this topic. In order to help further discussion, it has decided to set out its views on the main considerations involved (Part I) and its proposals for a system of graduated supplements to unemployment benefit, sickness benefit and widow's allowance (Part II).

PART I

The considerations involved in extending graduation to unemployment and sickness benefits

The present provisions

The national scheme

4. The national insurance scheme provides a uniform, flat-rate benefit to
compensate for loss of earnings during unemployment or sickness. The value of this benefit has been substantially increased in real terms since it was introduced. The rate of benefit is now £3 7s. 6d. a week for a single man and £5 9s. a week for a married couple. To this are added payments for children. One of the features of the present arrangements is the substantial weight given to family responsibilities. A married couple with two children thus receive £7 1s. a week, excluding family allowances; with four children £8 5s. a week, excluding family allowances. Unemployment and sickness benefits are not subject to income tax and those receiving them are not liable for national insurance contributions. For men with families and with wages below average the present benefits already amount to a substantial proportion of their take-home pay. But people with high earnings and with no or few dependents can suffer a substantial drop in income if they lose their jobs or fall sick.

Employers' schemes

5. National insurance benefits are often supplemented by payments under employers' schemes. Payments to employees who have become redundant are usually lump sums related to length of service; their main purpose is to give recognition for long service and some compensation for the disturbance and uncertainty which the loss of employment entails. It is estimated that about 4½ million workers (including 1½ million in the nationalised industries) are covered by schemes which include severance payments. Many other employers make severance payments even though they do not have a formal scheme. Except for the nationalised industries, however, employers' arrangements rarely include provision for continued weekly payments while the worker is unemployed. It is here that national insurance must play a predominant part.

6. Employers' sick pay schemes, on the other hand, cover a large proportion of the employed population, particularly during the early weeks of sickness. An enquiry into the incidence of incapacity for work has provided detailed information about the extent and nature of such schemes. In view of its importance this information [has been published] [will shortly be published] as a separate report. It shows that in 1961 56.6 per cent of male employees and 59.5 per cent of female employees insured for sickness benefit were covered by employers' sick pay arrangements. There are wide variations in the extent of cover in different occupations and industries. The nature of the cover provided also varies considerably. The amounts range from full pay (or full pay less national insurance benefit) down to quite small sums; and the duration of payment may be long or short. The Government attaches great importance to the part that employers' sick pay schemes can play, and a Committee of the Minister of Labour's National Joint Advisory Council was appointed.
last autumn to study information about employers' sick pay arrangements and to consider the expansion and improvement of these arrangements by voluntary means. This Committee's report will shortly be considered by the National Joint Advisory Council.

Private insurance

7. The Government recognises the valuable part being played by individual voluntary insurance against sickness, either through the friendly society movement or through private insurance companies, and believes there will always be a place for supplementary provision of this sort.

The need for graduated benefits

8. The principle embodied in the graduated pension scheme is that retirement pensions should be more closely related to individual earnings and so help to reflect the standard of living the worker has attained in his working life. By the same token it may be argued that the worker on higher wages who can afford to pay higher contributions than are practicable under the flat-rate scheme should be able to receive a rate of benefit more in keeping with his normal standard of living when his earnings are temporarily interrupted by sickness or unemployment. Workers today generally enjoy higher wages than ever before. Many are buying their homes and have taken on other continuing commitments. A sudden illness or loss of a job frequently causes a substantial drop in income which makes things difficult for the worker until such time as he can get back to work. The Government considers that, with increasing prosperity, the principle of relating national insurance benefits to earnings should be extended to short-term benefits.

Unemployment benefit

9. Although unemployment benefit and sickness benefit exist to serve the same social purpose and are closely linked at present, interest has been concentrated recently on the extension of earnings-related unemployment benefit. If we are to sustain a high rate of economic expansion and to achieve a modernised and competitive economy, we must be ready to redeploy resources to meet technological change and changes in demand for our products. We must expect greater movement of workpeople not only within industries but from one industry to another. But the interests of workers must be safeguarded. Unless this is done, resistance to change and to mobility may act as a brake on the whole process. The Government is meeting the situation in a number of ways - by encouraging and helping industry to plan its manpower requirements ahead so that unnecessary redundancies can be avoided and to make plans in advance to deal with possible redundancies in consultation with representatives of the workers who may be affected; by greatly expanding the facilities for re-training redundant workers; and by legislation which has prescribed minimum rights to notice before employment is terminated. But it is also important to make reasonable financial provision for those who lose their jobs.
10. Provision for redundancy has been considered by the National Joint Advisory Council of the Minister of Labour. A special sub-committee agreed that there were two main problems – the alleviation of hardship if redundancy is followed by unemployment and compensation to a redundant worker for the loss of a job after long service. In the Government's view, earnings-related unemployment benefit would relieve the financial hardship for those who cannot find a new job immediately and would thereby help to remove the fear of redundancy. In recent years there has been a considerable extension of arrangements for compensating redundant workers through severance payments by employers. The Government has encouraged this and attaches great importance to the further development of such arrangements.

Sickness benefit

11. These special arguments in favour of earnings-related unemployment benefit have no relevance to sickness benefit, but the financial needs of many sick people are no less than those of the unemployed. A substantial proportion of them are not covered by any employer's sick pay scheme; some of those who are covered can only benefit after a period of qualifying service, and others can expect only small amounts for short periods. In some occupations, illness lasting for more than a short time may mean the loss of a job. Workers in these occupations and those who fall sick after losing their jobs suffer the double misfortune of being out of a job as well as sick.

12. The Government has therefore decided that the strong social reasons for extending graduation to sickness benefit as well as to unemployment benefit should be recognised and that there should be graduated supplements to both benefits, payable for a limited period, related to the claimant's previous earnings. In this way the worker who loses his job or is ill can be given additional protection against too severe a drop in income. The same need does not however arise with short spells off work and it is not therefore proposed to pay graduated supplements to workers on short time or during the early stages of a spell of unemployment or sickness. There are compelling reasons, explained later in paragraph 22, why the initial period for which no supplement would be paid with sickness benefit must be longer than with unemployment benefit.

Widow's allowance

13. A similar need for additional protection against a sudden drop in income arises during the early months of widowhood. This is the purpose of the present widow's allowance, which is paid to widows for the first thirteen weeks after their husband's death at a level higher than the standard rate of other flat-rate benefits. The Government's policy has always been to give preferential treatment to widows, and it has therefore decided that graduated supplements related to the husband's previous earnings should also be paid with widow's allowance.
When the graduated pensions scheme was introduced, it was decided that it should not apply to the self-employed. People who are self-employed do not have the advantage of an employer's contribution to supplement their own and there would be great practical difficulties in assessing and collecting graduated contributions from them. The self-employed are in any case not eligible for unemployment benefit. For these reasons they are not included in the Government's proposals for extending graduated contributions and benefits.

Scope of the Government's proposals

The Government's proposals which follow in Part II deal with the essential features of a system of earnings-related short-term benefits. A great deal of detailed work remains to be done before these proposals can be put into effect and the consequences for other benefits, notably the benefits payable under the Industrial Injuries scheme for people injured at work, need further study.

PART II

The Government's proposals

The Government proposes that graduated supplements, related to previous earnings, should be paid with flat-rate unemployment and sickness benefits, and with widow's allowance, in order to provide additional protection during the difficult period of adjustment that follows a severe and unexpected drop in income. The following paragraphs show what the earnings-related benefits would be, on the basis of the present rates of flat-rate benefit.

The amount of the graduated supplements

The extra graduated contributions required to finance the supplements would be collected on the same band of earnings as for graduated pensions (at present £9 to £18 a week). The supplements would be related to earnings in that band. It would be wrong for the second £9 of earnings to attract more benefit than the first £9. Therefore, on present figures, the supplement for those earning £18 a week or more should not be more than £3 7s. 6d. On this basis the maximum rate of benefit for a single man would be twice as much as the present flat-rate benefit. For those earning between £9 and £18 the supplement would be three-eighths of their earnings over £9. This is the proportion which the maximum supplement bears to £9. People earning £9 a week or less do not pay graduated contributions and would not be eligible for any supplement. But a single man with earnings between £9 and £18 would not receive a higher proportion of his gross earnings than the man on £9 a week. For those earning more than £18 a week the proportion of gross earnings would be smaller.

The following tables illustrate the benefits which would be payable at different levels of earnings and for different families under the Government's proposals for graduated supplements amounting to three-eighths of gross earnings between £9 and £18 a week.

/Table 1
### Table 1

**The amount of benefit**

<table>
<thead>
<tr>
<th>Present flat rate benefit</th>
<th>Gross earnings of £10 a week</th>
<th>Gross earnings of £12 a week</th>
<th>Gross earnings of £16 a week</th>
<th>Gross earnings of £18 a week</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Graduated supplement benefit</td>
<td>Graduated supplement benefit</td>
<td>Graduated supplement benefit</td>
<td>Graduated supplement benefit</td>
</tr>
<tr>
<td></td>
<td>Total benefit</td>
<td>Total benefit</td>
<td>Total benefit</td>
<td>Total benefit</td>
</tr>
<tr>
<td></td>
<td>£ s. d.</td>
<td>£ s. d.</td>
<td>£ s. d.</td>
<td>£ s. d.</td>
</tr>
<tr>
<td>Single man</td>
<td>3 7 5</td>
<td>7 5 3 15 0</td>
<td>1 2 6 4 10 0</td>
<td>2 12 6 6 0 0</td>
</tr>
<tr>
<td>Married man</td>
<td>5 9 0</td>
<td>7 6 5 16 6</td>
<td>1 2 6 5 11 6</td>
<td>2 12 6 8 1 6</td>
</tr>
<tr>
<td>Married man with 2 children</td>
<td>7 1 0</td>
<td>7 6 7 8 6</td>
<td>1 2 6 8 3 6</td>
<td>2 12 6 9 13 6</td>
</tr>
<tr>
<td>Married man with 4 children</td>
<td>8 5 0</td>
<td>7 6 8 12 6</td>
<td>1 2 6 9 7 6</td>
<td>2 12 6 10 17 6</td>
</tr>
</tbody>
</table>

### Table 2

**Benefit as a proportion of take-home pay**

<table>
<thead>
<tr>
<th>Gross earnings of £10 a week</th>
<th>Gross earnings of £12 a week</th>
<th>Gross earnings of £16 a week</th>
<th>Gross earnings of £18 a week</th>
</tr>
</thead>
<tbody>
<tr>
<td>Take-home benefit</td>
<td>Total benefit (2) as a percentage of (1)</td>
<td>Take-home benefit</td>
<td>Total benefit (2) as a percentage of (1)</td>
</tr>
<tr>
<td>Family pay plus allowances (1)</td>
<td>Family pay plus allowances (2)</td>
<td>Family pay plus allowances (1)</td>
<td>Family pay plus allowances (2)</td>
</tr>
<tr>
<td>£ s. d.</td>
<td>£ s. d.</td>
<td>£ s. d.</td>
<td>£ s. d.</td>
</tr>
<tr>
<td>Single man</td>
<td>8 10 1 3 15 0</td>
<td>43.9</td>
<td>12 12 2 5 0 0</td>
</tr>
<tr>
<td>Married man</td>
<td>9 2 6 5 16 6</td>
<td>63.8</td>
<td>14 16 2 8 16 6</td>
</tr>
<tr>
<td>Married man with 2 children</td>
<td>9 15 3 7 16 6</td>
<td>80.2</td>
<td>16 11 10 10 16 6</td>
</tr>
<tr>
<td>Married man with 4 children</td>
<td>10 15 3 10 15 6</td>
<td>85.1</td>
<td>16 9 7 12 5 6</td>
</tr>
</tbody>
</table>

*Gross pay less national insurance contribution and income tax, if any.*
19. These tables show that a single man with earnings up to £18 a week would receive benefit amounting to almost half his take-home pay. For the married man the proportion would be well over half; for a man with a family it would be two-thirds or more according to the number of children.

Duration of graduated supplement

20. The purpose of the supplement will be to cushion the impact of unemployment, sickness and widowhood by providing higher benefits during the period following a sudden drop in income. The present widow's allowance, which has always existed for this purpose, lasts for three months. For the unemployed the period should be long enough to tide them over the initial difficulties of what may be a major upheaval in their lives but not so long as to discourage mobility. It can be argued that three months is a suitable period for these purposes. The Government considers that there is merit in adopting the same period for all three contingencies but that a rather longer period than three months is needed. It has concluded that the graduated supplement to all three benefits should be paid for six months. This means that the flat-rate widow's allowance will also run for six months.

21. The question of when payment of graduated benefit supplements should begin involves different considerations for different benefits. Account must be taken of the amount of work required to determine the rate of supplement payable, and the number of claims involved. In all cases, enquiries about a claimant's previous earnings would be necessary. These enquiries would inevitably take time and it would be difficult to avoid some delay in putting the supplements into payment. For unemployment and sickness benefits, the sheer weight of numbers would make it impracticable to pay graduated supplements for short periods; to try to do so would place an impossible burden on employers and the local offices of the departments concerned. The Government therefore proposes that graduated unemployment benefit supplements should not be paid to workers on short time or for the first week of a spell of unemployment.

22. In the case of sickness benefit, the payment of graduated supplements would present an even greater administrative problem. Each year there are over nine million new claims to sickness benefit, compared with about three million unemployment benefit claims. The bulk of sickness benefit claims are for relatively short periods. One-quarter are for spells of a week or less, over half two weeks or less, and over three-quarters four weeks or less. Dealing with all these claims is not easy, particularly during the winter months when the influx of new claims is at its highest and the staff to deal with them is itself often depleted by sickness. At such times it is difficult enough to maintain flat-rate benefit payments; it would be out of the question to expect large numbers of graduated supplements to be paid as well. Neither local offices nor employers, who would have to assist in establishing details of previous earnings, would be able to cope with the extra work. Another important consideration distinguishing sickness benefit from unemployment benefit is that while an unemployed person is available in person to provide
details of his previous employment, a sick person is not. He is usually confined to bed, or at least to his home, and in his case all enquiries about his earnings would have to be conducted by post. This would inevitably make the process more protracted. In view of all these factors, and the extra cover already provided in many cases by employers' sick pay schemes during the early weeks of sickness, the Government proposes that graduated sickness benefit supplements should not be paid for spells which last for four weeks or less, nor for the first four weeks of longer spells. Only in this way would the task of paying graduated supplements to sickness benefit become manageable.

23. There is no need for a waiting period for the graduated supplements to widow's allowance. These supplements would be paid as quickly as possible with effect from the date of the husband's death and they would go on for the period of six months now proposed for this allowance.

24. The earnings to which graduated supplements would be related

The earnings to which graduated supplements would be related

25. Studies made so far suggest that the period which would most nearly satisfy all these requirements would be the last tax year. The Government therefore proposes that graduated supplements should be calculated by reference to gross earnings (or the graduated contributions paid on such earnings) for P.A.Y.E. purposes in the last tax year before the date of claim. The precise method of doing this needs further study. One of the problems to be considered would be the treatment of absences during the year due to unemployment or sickness.

Cost and contributions

26. The Government proposes to finance the new short-term benefits, which would cost about £50 million a year, by adding 1/2 per cent to the graduated contributions (now 41/2 per cent) which employers and employees are already paying on earnings between £9 and £18 a week. For those earning £18 a week or more this would represent 11d. a week each from employee and employer; and correspondingly less for those with lower earnings.

27. Employees who are contracted out of the part of the scheme providing graduated retirement pensions do not at present pay graduated contributions. The Government believes it would be wrong to withhold the new benefits from contracted-out employees. A way must therefore be found to collect the appropriate graduated contributions from them and their employers. It is not practicable to collect two separate rates of graduated contributions, one from ordinary contributors, counting both for retirement pension and short-term benefits; and the other from contracted-out contributors, counting for short-term benefits only. Among other difficulties, there would be no means of
ensuring that the two kinds of contributions were kept absolutely distinct at
all stages. Any failure to distinguish between them would inevitably lead to
erors in the payment of pensions and other graduated benefits.

28. This means that the contracted-out would have to pay the same graduated
contributions as other contributors. Some rearrangement of the provision for
contracting-out would be necessary, but the studies that have already been
made have convinced the Government that the changes necessary for this
purpose could be introduced without departing from the essential principle
that the employer undertakes to provide certain benefits through a recognized
occupational pension scheme in place of part of the national insurance retire­
ment pension. No change would be necessary in the amount of occupational
pension which employers must provide in order to contract out, and existing
certificates of non-participation would remain valid without employers having
to modify their occupational pension schemes. The Government proposes to dis­
cuss the detailed application of these revised arrangements for contracting-out
with representatives of employers, employees and others concerned with
occupational pensions.