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C. F. (64) 121

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CABINET

EARNINGS-RELATED SHORT-TERM BENEFITSMemorandum by the Chancellor of the Exchequer
and the Chief Secretary to the Treasury and
Paymaster General

The paper (C. F. (64) 118) circulated by the Chancellor of the Exchequer as Chairman of the Committee on Pensions and National Insurance recommends as the majority view of the Committee,

- (i) that we should accept the policy of incorporating into the National Insurance Scheme a system of earnings related short-term benefits;
- (ii) that we should publish in the near future a White Paper containing the outlines of such a scheme.

2. This memorandum sets out our reasons for believing that we should not take any such decisions.

3. The decision sought on policy involves both a major recasting of a large part of the National Insurance Scheme and a commitment to additional expenditure of the order of £50 million a year. In our view a great deal of further thought is needed before committing the Government to steps of this kind.

4. Socially, it seems a doubtful proposition to give priority in respect of this large expenditure to improving the provision for highly paid industrial workers who suffer a limited period of unemployment. If this provision were contemplated from the point of view of improvement in sickness benefit, it would seem more sensible from the social and human point of view to move to a higher rate after the sickness had been prolonged rather than, as suggested by the Ministers, to reduce it to the basic rate after six months. From the point of view now adopted by those interested in social matters inside and outside our Party that social policy should concentrate additional resources on the areas of greatest need, the proposals would appear to involve a retrograde step. For although obviously a short interruption in the earnings of a highly paid worker involves him and his family in some difficulties, these difficulties are already mitigated in a number of ways. Apart from employers' redundancy payments which it is stated in paragraph 5 of the draft White Paper circulated with C. F. (64) 118 now cover $4\frac{1}{2}$ million workers, there are rebates of P. A. Y. E. made by the Inland Revenue. The higher the worker's previous pay the more significant these are. And above all, he will have a fully equipped household, and in these days in which all Governments seek to maintain the high level of employment, early opportunity for further work. His problems are nothing like so

grim as those of very old pensioners or the chronic sick, who will be old or sick until they die. Socially, sums of money of this order could be far better expended in other directions, and we have little doubt that this will be the view of most social thinkers and workers.

5. But it is argued in paragraph 4 of C.F. (64) 118 that there are economic arguments related to the mobility of labour in favour of wage related unemployment benefit. Although these arguments plainly do not apply to sickness benefit, it appears that the proponents of this scheme feel that they cannot provide one without the other. But we are very sceptical about these alleged economic benefits. It does not seem to us likely, for example, that a married man with two children, who is earning £18 a week will accept redundancy cheerfully because his income does not as a result fall below £10 8s. 6d. a week. And if there is any force in this contention, it is double-edged in that in so far as it makes the acceptance of unemployment easier, so it must diminish the willingness to accept new if different and less highly paid employment. After all, the main consideration in favour of assisting mobility of labour is not so much getting people out of the jobs in which they are not needed as in getting them into the ones where they are required. We do not therefore see in these proposals any such advantage from the point of view of the efficient running of the economy as to compensate for the substantial burden on industry whose competitive position is not strong, and neglect of social priorities which they involve.

6. There are a number of other major difficulties involved in these proposals to which we will refer only briefly, but which our colleagues may wish to consider further:-

- (i) in order to accommodate a system of general graduated contributions for short-term benefits within a scheme which at present allows the contracting out of the State graduated scheme of workers covered by satisfactory employer schemes, it is necessary, as the Minister of Pensions and National Insurance has explained to us to recast the whole system of graduated contributions under the National Insurance Act, 1959. This involves abolishing contracting out so far as graduated contributions are concerned and putting in its place a system under which it would be possible to contract out instead from a small part of the flat -rate contribution. Not only will this changeover involve a major administrative upheaval for employers but it may well diminish their desire to contract out and so weaken the growth of private occupational provision for old age which it has been the object of the present Government to encourage. The number of workers in contracted out schemes is now about $4\frac{3}{4}$ million;
- (ii) C.F. (64) 118 leaves obscure what would be the likely effect of the introduction of these proposals on the Industrial Injuries Scheme. In that Scheme, benefit is related to loss of faculty. To convert it to one related to earnings would be to revert to one of the features of the Workmen's Compensation Scheme, which the Industrial Injuries Act, 1946, superseded. On the other hand, it is difficult to see how the Industrial Injuries Scheme based on loss of faculty could continue as an alternative to sickness benefit based for a limited time on loss of earnings;

- (iii) the scheme proposed in C. P. (64) 118 is likely to be criticised on the ground that unlike the present National Insurance short-term benefits, the additional provision, being related to earnings and not to family circumstances, would give the biggest proportionate benefit to a single man. As single men are, on the whole, those who find it easiest to move to find other employment, this would seem to be a feature also working against mobility of labour;
- (iv) the proposed four weeks' gap before sickness benefit is paid on a wage related basis will be difficult to justify against the gap of only one week in respect of unemployment benefit. C. P. (64) 118 makes it clear that nearly half the workers are not yet covered by employers' short-term sickness schemes, and those not so covered will not understand their exclusion;
- (v) the scheme will be very costly to administer in relation to the benefits paid. Whereas the National Insurance scheme as a whole is administered at a cost of 3.7 per cent of the benefits distributed, it is estimated that to administer benefits under these proposals of £50 million a year the administrative cost would be £4 million a year;
- (vi) the exclusion of the self-employed from the benefits of the scheme, although it follows the 1959 Act in this respect, will revive criticisms on that point, and is somewhat harder to justify in view of the fact that very few of the less well off self-employed are likely to carry sickness policies;
- (vii) politically, the proposals are unattractive in as much as they do not seem to be really wanted by any section of society. The money which they they would cost could be expended in other directions attracting greater popular approval and support. For example, the T. U. C. are known to be in favour of increasing family allowances, and employers are unlikely to be enthusiastic about either the cost of the complexity of these proposals. Our own supporters increasingly favour greater concentration of resources on those in need.

7. For these reasons we do not think that the case has been made out for the acceptance by the Government of a commitment to adopt such a system. Nor, even if so convinced, would we think it prudent to embody proposals and publish them in a White Paper. The experience of the publication of the various Crossman plans provides a warning. The provision proposed could be made to seem small compared with what the Opposition would promise and the limitations of the scheme, particularly those set out above, would provide damaging grounds of attack. Moreover, as demonstrated in paragraphs 18-26 of C. P. (64) 83, the timing of the introduction of National Insurance changes is crucial. In our view there is no prospect whatsoever of keeping expenditure on benefits and assistance roughly in line with the forecast in last year's White Paper on Public Expenditure unless we can defer the next general increase in benefits

until the spring of 1966. We do not think it is realistic to think this can be done if the Government commits itself to specific improvement in National Insurance benefits (and increase in National Insurance contributions) at this stage.

8. We shall shortly be submitting to our colleagues the outcome of the current public expenditure survey which will indicate that the White Paper forecasts of expenditure in 1967-68 will be substantially exceeded, unless there are substantial modifications in the Government's present policies. The White Paper put the annual rate of increase in public expenditure between 1963-64 and 1967-68 at 4.1 per cent, but the new costings suggest that it will be of the order of 5 per cent.

R.M.
J.A.B-C.

16th June, 1964