Cabinet

Earnings-Related Short-Term Benefits

Memorandum by the Minister of Pensions and National Insurance

PART I - INTRODUCTORY

In February I was invited to submit to the Social Services Committee proposals for an interim scheme of earnings-related short-term benefits which could be brought into operation by the Autumn of 1966 in advance of the general review of the national insurance scheme. These proposals have been under consideration by the Social Services Sub-Committee on Social Security Cash Benefits and although discussions are continuing on matters of detail the stage has now been reached where it is both possible and, in view of the time factor, essential for me to seek the authority of the Cabinet to proceed with the type of scheme which, in the light of the Sub-Committee's discussion, I now propose.

2. The main features of the proposed scheme, which would cover sickness as well as unemployment, are:

(i) earnings-related supplements would be at the rate of one third of average weekly earnings between £9 and £30 (paragraph 10);

(ii) the supplements would be paid in addition to the personal benefit and dependency allowances payable under the flat-rate scheme up to a limit of 85 per cent of gross earnings (paragraph 10);

(iii) average weekly earnings would be the gross earnings assessable to P.A.Y.E. tax in the tax year preceding the claim to benefit divided by 50 (paragraph 13);

(iv) no allowances would be made for interruptions of earnings in the relevant tax year (paragraph 14);

(v) the maximum duration of earnings-related supplements would be six months; for this purpose spells of sickness and unemployment separated by less than thirteen weeks would be aggregated (paragraph 15);

(vi) there would be twelve "absolute" waiting days for earnings-related supplements (paragraph 16);
contracted-out employees, and their employers, would be liable for graduated contributions for pensions and short-term benefits at the same rates as everyone else and their contracted-out status would in future be recognised by an abatement of their flat-rate contributions and retirement pension (paragraph 23);

the minimum cost of the scheme including administration costs would be of the order of £50 million (paragraph 24);

the scheme would be financed by additional graduated contributions but the proceeds of the flat-rate abatement plan for the contracted-out would be applied to reduce flat-rate contributions (paragraph 26);

about 2,000 extra staff may be needed in the Ministry of Pensions and National Insurance and about 800 in the Ministry of Labour (paragraph 27).

PART II - AIMS AND ASSUMPTIONS

General

3. These proposals must be judged by reference to certain fundamental considerations of policy. We made it clear in our Election Manifesto that the rate at which we could carry out improvements in social security would have to depend on the progress of the economy. The need to keep additional expenditure to the minimum consistent with the provision of an acceptable and worthwhile scheme is borne out in the present proposals which fall short of those I should have been making had the financial situation permitted more radical changes. The scale of benefit is no better than that under discussion last year by the previous Government with both sides of industry and the proposals as they now stand represent in my view the bare minimum for a worthwhile scheme.

Timetable

4. If it is decided to go ahead with an interim scheme for operation from the Autumn of 1966 there is only just enough time available for the work to be done. The Bill would have to be passed by the end of March 1966, not only to allow time for the subsequent stages (regulation-making, preparation of working procedures, printing, recruitment and training of staff, etc.) but also to ensure that employers and employees retain the tax documents relating to the income tax year 1965/66 which will be needed to support claims under the new scheme when it starts. The legislation will be complicated and Parliamentary Counsel should be instructed as soon as possible after the main outline of the scheme has been approved and concurrently with the discussions about the broad details of it which I shall need to hold with the Trades Union Congress, The Confederation of British Industries and other interested bodies. Delay in any of these stages would prejudice the chance of starting the scheme in the following Autumn.
The need for simplification

5. I am concerned about the complexity of the existing national insurance scheme, and the burden it imposes on the local officers of both my Department and the Ministry of Labour, on employers and on the general public. The introduction of earnings-related short-term benefits will add to the existing burden the task of working out a personal benefit rate for each claimant based on his individual earnings. Although the proposed scheme must inevitably cause employers considerable additional work, it makes the minimum possible disturbance to their existing pay and record arrangements. I feel this is important, not only to avoid saddling employers with a good deal of additional cost for work not directly related to their business, but also because we shall need the ready co-operation of employers to make the scheme work at all. We can only expect this co-operation if we can demonstrate that we have done our best to minimise the additional burdens on them.

Implications of earnings-related benefits

6. Much of the criticism of flat-rate benefits relates to the level of the personal rate of benefit (at present £4) in relation to the needs of the higher-paid worker faced with a sudden and substantial drop in income during unemployment or sickness. Critics of the present scheme do not always appreciate that, for the lower-paid worker with a family, flat-rate benefit already provides a high proportion of normal earnings - at least as high as most earnings-related schemes in other countries. For example, a married man with four children who is earning £12 a week can get a national insurance weekly benefit (excluding family allowances) of £9 16s. - nearly 90 per cent of his take-home pay. Clearly, the scope for giving additional help to such workers is limited and the larger benefits of the new scheme must inevitably go to those with relatively high earnings and relatively few family responsibilities. This shift of emphasis is inseparable from earnings-related and the aim must be to strike a reasonable balance between the earnings-related element and the family-related element in the total benefit.

7. In the long run, the answer may lie in radical changes in the provision we make for children through family allowances and income tax so that more help is given to the low wage-earner with a large family whether he is at work or not. Such changes could not, however, be contemplated as part of an interim scheme of earnings-related short-term benefits for operation next year, and the new scheme has had to be made to fit the existing structure.

The problem of over-compensation

8. To create a situation where large numbers of sick and unemployed people could get as much, or even more, by way of national insurance benefits as they could get by working would be highly undesirable. It would invite abuse and expose the scheme to ridicule. In extreme cases of low earners with very large families the flat-rate scheme has already reached the point of over-compensation and my colleagues and I were all agreed that the new scheme, particularly as it will be related to earnings, must not make such a situation widespread.
9. It was clear from the start that in the absence of radical changes in family allowances a scheme such as proposed in "New Frontiers", under which an earnings-related supplement equal to one-quarter of an individual's total earnings would be added to his flat-rate benefit, would offend against this principle. We considered the possibility of eliminating or reducing the weekly allowance for a dependent wife of £2. 10s. at present payable under the flat-rate scheme but concluded that such a radical shift of emphasis from family responsibility to earnings-relation would be politically unacceptable. I therefore find it necessary to propose a somewhat less generous scale of earnings-related benefit. Although this does not create such a serious over-compensation problem, some financial incentive to get a job is obviously required and it will still be necessary to incorporate in the scheme an over-riding benefit maximum in order to ensure that the earnings-related supplement does not bring total benefit above something like 90 per cent of take-home pay (that is, gross earnings less income tax and national insurance contributions). This will not, however, affect the existing rights of those who can already get flat-rate benefit in excess of 90 per cent of take-home pay.

PART III - DETAILS OF THE PROPOSED SCHEME

The benefit formula

10. Within the limits imposed by the considerations referred to in the first part of this memorandum my aim has been to devise a benefit formula which would give something like half-pay to the single man on average earnings without producing an acute over-compensation problem for the lower-paid and without giving the higher-paid a proportionately better benefit than the lower-paid. The formula proposed to meet this situation would give an earnings-related supplement of one-third of the amount of gross earnings between £9 and £30 subject to a ceiling where the total benefit (flat-rate personal benefit plus dependency allowances plus supplement) would otherwise exceed about 90 per cent of take-home pay. (For practical purposes 90 per cent of take-home pay can be expressed as 85 per cent of the gross earnings of those affected who pay little or no income tax.)

11. For the single man on average earnings this formula would produce a total benefit of 51 per cent of take-home pay. For the single man on higher or lower earnings the proportion would not be significantly different. The married man with three children would get a proportion of take-home pay ranging from 90 per cent for the worker on £12 a week or less to 65 per cent at the earnings maximum of £30 a week. The effect of the benefit ceiling would be that the £12 a week worker with more than three children would be limited to the rate appropriate to the three-child family. A fuller range of examples is given in Appendix A.
12. The minimum of the reckonable earnings range of £9 is that used for contributions and benefits in the existing graduated pension scheme. The £13 maximum of the earnings range under that scheme would not, however, provide an acceptable level of benefit for the higher-paid worker. Although it will probably be desirable eventually to have the same maximum for both short-term benefit and graduated pension purposes, I see no serious difficulty in having a different maximum for the two schemes for the time being. A £30 maximum would cover in full the earnings of well over 90 per cent of employed men and is likely to fit in with long-term developments for pension.

Reckonable Earnings

13. The earnings which would count for benefit (and contributions) would be the gross earnings assessable to P.A.Y.E. tax, as already defined for the purpose of the graduated pension scheme. Benefit would be based on earnings in the tax year preceding the claim to benefit. The benefit ceiling, where this applied, would also be related to the same earnings figure. In recognition of the fact that the current level of earnings may be somewhat higher, I propose that the amount of average weekly earnings should be arrived at by dividing this annual figure by 50 rather than 52, i.e. equivalent to about a 4 per cent rise in earnings. I should have liked to have been able to base the benefit on earnings in the twelve months preceding each claim for benefit but after studying the possibilities in detail I am convinced that the previous tax year is the only practicable reference period. My colleagues in the Sub-Committee support this view. Any other basis would create an enormous amount of additional work for employers without necessarily producing better results.

14. Only actual earnings in the previous tax year would count for benefit. Where earnings are reduced by sickness or unemployment (or any other interruption of earnings such as absence abroad or imprisonment) this would be reflected in a lower rate of earnings-related benefit. This proposal may disappoint some of our supporters particularly as "New Frontiers" indicated that the scheme would make allowance for weeks of sickness and unemployment. The T.U.C. will certainly press for this. There are three powerful counter-arguments: the first is that the principle of deeming earnings is questionable if it means that low wage-earners in regular employment have to subsidise those with higher incomes but a greater risk of unemployment. Secondly, the flat-rate system under which contributions are credited for weeks of sickness and unemployment will continue to provide the basic protection during periods of sickness and unemployment. Thirdly - and in the context of an interim scheme this must, I think, be conclusive - a system of allowances for earnings lost as a result of sickness or unemployment in the relevant tax year would be a complication involving considerable extra work. We shall have acute difficulties in some areas in recruiting sufficient staff to operate even the most straightforward scheme of earnings-related benefits by the Autumn of 1966. I should be most reluctant to put the whole scheme in jeopardy for the sake of what is no more than a refinement of the benefit formula however desirable it might be if time and resources were not at a premium. Eventually, with the increasing use of computers in my Department, it may be possible to cope with the additional work involved should this be thought desirable.
Duration of earnings-related benefit

15. Earnings-related benefit would be paid for up to six months in a "period of interruption of employment" (a period which covers any spells of sickness or unemployment separated by less than 13 weeks). Sickness and unemployment would be aggregated for this purpose so that there would be no advantage to be gained from drawing one benefit rather than the other. It was suggested in "New Frontiers" that wage-related benefits should cover the first year of absence from work. However, my colleagues and I thought that a six-month period would be adequate, particularly in an interim scheme, and that to pay earnings-related unemployment benefit for longer than six months might have an adverse effect on the economy in discouraging unemployed people from seeking or accepting new jobs promptly. This may also provide the opportunity for some rationalisation of the duration of flat-rate unemployment benefit so that instead of the present variable period of seven to nineteen months based on the claimant's insurance record these would be six months of earnings-related benefit followed by six months of flat-rate benefit. Twelve months would thus become the standard maximum duration of unemployment benefit for everybody.

Waiting days

16. For flat-rate benefits, there would, as now, be three "waiting days" at the start of any period of interruption of employment. Benefit is paid for these days if the period of interruption of employment lasts for 12 days or more. For earnings-related benefit, it would be necessary to serve 12 waiting days at the start of a period of interruption of employment. These waiting days would be "absolute", that is, benefit would not be paid retrospectively for them. Thus earnings-related benefit would not normally be payable for spells of sickness or unemployment lasting less than a fortnight.

17. My original hope was to be able to treat the flat-rate and earnings-related elements as a single benefit with a standard waiting period but the only practicable way to do this would have been by imposing six absolute waiting days for both parts of both benefits. This would have meant a substantial reduction in existing rights to flat-rate benefits. Most people would have made up on the earnings-related swings what they lost on the flat-rate roundabouts but there would have been some claimants, especially those with low earnings and large families who would lose more than they gained. Although the proportion of cases would be relatively small they would be the claimants in greatest need, and my colleagues and I concluded that this approach was politically unacceptable. Without the substantial saving of both cost and administrative resources which would have accrued from not paying flat-rate benefit for the first six days it would not have been feasible to pay earnings-related benefits without a longer waiting period than six days. It is highly desirable, in order to avoid anomalies and confusion to claimants, that the supplements to both benefits should be governed by the same conditions, and we concluded that there should be a 12-day waiting period for the earnings-related element of both benefits. On this approach, the new scheme can be presented as appropriate to the more serious interruptions of earnings where sickness or unemployment lasts for more than a fortnight.

-6-
Consequential Matters

18. There are many detailed aspects of the scheme which are still under discussion and I should not wish to trouble the Cabinet with these matters unless serious differences of opinion were to emerge in the Sub-Committee. There are, however, two other short-term benefits which may be affected by the introduction of a scheme of earnings-related sickness and unemployment benefit and these are, I think, sufficiently important politically to merit consideration at this stage.

Injury Benefit

19. Injury benefit under the Industrial Injuries scheme is payable as an alternative to sickness benefit for the first six months of incapacity resulting from an accident at work or an industrial disease. The rate has been maintained at about 70 per cent above standard sickness benefit since the start of the schemes, and is now £6. 15s. a week. Injury benefit is followed by a disablement benefit in those cases (about 15 per cent) where some measurable disability remains when injury benefit ceases. Supplementation of sickness benefit as proposed would mean that sickness benefit would be higher than injury benefit for everyone with earnings of £17. 5s. or more - that is, on the estimated figures for April, 1965, some 56 per cent of men and 1 per cent of women.

20. In my view it would not be sufficient merely to allow injured people to draw the supplemented sickness benefit or injury benefit, whichever was the better. This would effectively abolish for a large part of the employed population a preference which has existed for very many years (and which is paralleled in nearly every other industrialised country), which would be wrong, and would in any case stand no chance of acceptance by the T. U. C. To my mind the right course, and administratively the simplest one, would be to allow the sickness benefit supplement, where payable, to be added to flat-rate injury benefit. The existing £2. 15s. differential would thus be preserved, and this can be justified on the view that it represents the element of compensation for the injury. It follows that the benefit ceiling for the industrial injury case should be £2. 15s. above that proposed for sickness benefit. The levels of benefit produced by this proposal are shown in Appendix B. It will be noticed that in the range where the benefit ceiling operates, many beneficiaries are already receiving more by way of flat-rate injury benefit than the amount allowed by the proposed benefit ceiling and this entitlement would be preserved.

Widow's Allowance

21. Widow's allowance is at present a flat-rate resettlement allowance paid for the first 13 weeks of widowhood at a higher rate than the standard widow's benefit. As "New Frontiers" recognised, there is a case for graduating this allowance by reference to the husband's earnings and for extending its duration to six months. This would do something positive for widows. Furthermore, the Opposition's 1964 Election Manifesto committed them to extending
earnings-related benefit to the early months of widowhood and if our scheme does not provide for this we can certainly expect an amendment on Committee which would be difficult to resist. For all these reasons I should like to include widow's allowance in the scheme from the outset but against this must be reckoned the additional cost — see paragraph 24 below. The Sub-Committee considered that the inclusion of widow's allowance was a desirable, but not essential, feature of the scheme and that the question of its inclusion should be referred to the Cabinet for decision.

Contracting-Out

22. At present employees who are not contracted-out of the national insurance graduated pension scheme, and their employers, pay both a flat-rate contribution and a graduated contribution (4\(\frac{3}{4}\) per cent a side) on earnings between £9 and £18 a week. Additional graduated contributions will be needed to pay for the new earnings-related benefits but employees who are contracted-out of the graduated pension scheme by virtue of their rights to an occupational pension, and their employers do not at present pay graduated contributions. They are, however, required to pay a substantially higher flat-rate contribution than that paid by those who are not contracted-out.

23. There is no question of excluding employees contracted-out of the graduated pension scheme from the new earnings-related short-term benefits but there are compelling reasons against superimposing on their flat-rate contribution a very small graduated contribution. Not only would the amount appear derisory and be costly to administer in relation to its yield but once people in contracted-out employment are required to pay graduated contributions it would be indefensible to make them go on paying their higher rate of flat-rate contribution which bears heavily and unfairly on the lower-paid contracted-out worker. Accordingly my colleagues on the Sub-Committee agreed with me that the opportunity should be taken for reshaping the contracting-out arrangements so as to make the contracted-out liable to pay graduated contributions for pensions as well as short-term benefits. This would have the following advantages:

(a) It would remove present inequities whereby the higher flat-rate contribution payable by the contracted-out imposes an unfair burden on the lower-paid worker and his employer whereas the higher-paid worker is charged too little.

(b) It would ensure that the contracted-out employee enjoyed the protection which the State scheme provides so far as graduated retirement pension for widows is concerned (a point we made in our Election Manifesto).

(c) It would pave the way for the later introduction of our own earnings-related pension scheme or for the next general uprating which is almost bound to require an increase in the span, if not the rate, of graduated pension contributions.

Under this plan the contracted-out would pay the same graduated contributions as everyone else and would earn graduated additions to pension accordingly. They would, however, pay a lower flat-rate contribution than those not contracted-out and their total State pension
Both these deductions would be related to the value of the occupational pension which the employer is required to provide as a condition for contracting-out of the State scheme. The change would involve no alterations in the conditions which at present have to be satisfied by an occupational pension scheme to qualify for contracting-out and no further change would be required in these conditions to match future changes in the State provisions.

Finance

24. The basic cost of a scheme of earnings-related sickness and unemployment benefit on the lines proposed above is estimated at £44 million a year of which some £30 million is attributable to sickness benefit and £14 million to unemployment benefit (assuming 1.5 per cent unemployment). To this must be added the cost of administration which might be of the order of £3 million and a minimum of £1.5 million to enable the industrially injured to draw earnings-related sickness benefit instead of injury benefit where this was to the claimant’s advantage. A further £3.5 million would be needed to pay earnings-related supplements on top of injury benefit. The minimum cost of the scheme would therefore be of the order of £50 million. Earnings-related widow’s allowance payable for 6 months instead of the present flat-rate allowance payable for 3 months would cost about a further £7 million.

25. The change in the arrangements for contracting-out (paragraphs 22-23 above) would produce additional contribution income of about £43 million a year most of which would come from higher-paid workers and their employers, many of them in the public sector. This amount is substantially a measure of the extent to which the higher-paid contracted-out at present escape their fair share of the total cost of national insurance. Ultimately this change-over will lead to some increased expenditure in the form of extra graduated retirement and widows’ pensions to which contracted-out employees will become entitled; but in the next few years there will be no significant expenditure involved.

26. Earnings-related short-term benefits, on the scale proposed, would require a graduated contribution of about 0.4 per cent a side of earning between £9 and £30. The principle that there should be additional graduated contributions to support the new scheme is certainly one that we should wish to maintain and it is proposed that we should use the proceeds of the change in the contracting-out arrangements to reduce the flat-rate contribution payable by everyone. A reduction of about 4d. a side should be possible. These arrangements are still to be worked out in detail.

Administration

27. It is provisionally estimated that a scheme on these lines would require about 2,000 additional staff in my Department, mainly to handle sickness benefit claims. The number of additional staff needed by the Ministry of Labour might be about 800. The extension of graduated contributions to the contracted-out and the wider span of earnings attracting contributions will mean more work for the Inland Revenue. Some extra staff will be needed but it is not expected that the number will be large.
PART IV - QUESTIONS FOR DECISION

28. I now invite the decision of the Cabinet whether I am to proceed with the preparation of a scheme of earnings-related short-term benefits on the lines I have described in this memorandum, including consultations with the T. U. C., the C. B. I. and other interested bodies. I should also welcome decisions on the following questions on which the Social Services Sub-Committee on Social Security Cash Benefits was not able to reach final conclusions:-

(i) Should earnings-related widow's allowance be included in the scheme? (paragraph 21).

(ii) Should earnings-related supplements be paid on top of injury benefit? (paragraphs 19 and 20).

M. H.


23rd July, 1965
<table>
<thead>
<tr>
<th>Gross earnings of £12 a week</th>
<th>Gross earnings of £15 a week</th>
<th>Gross earnings of £18 a week</th>
<th>Gross earnings of £25 a week</th>
<th>Gross earnings of £30 a week</th>
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<td>(1) Total benefit plus family allowances</td>
<td>(1) as of take-home pay plus family allowances</td>
<td>(1) Total benefit plus family allowances</td>
<td>(1) as of take-home pay plus family allowances</td>
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*Gross pay less income tax and graduated and flat-rate contributions.

In these cases the amount of earnings-related supplement would be reduced or extinguished by the operation of a benefit ceiling of 85 of gross earnings, i.e., about 90 of take-home pay.
### Gross Weekly Earnings

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<th>Gross weekly earnings of:</th>
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<th>£20</th>
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### Notes
- Gross pay less income tax and graduated flat-rate contributions
- Benefit would be reduced to ceiling (at head of column) plus family allowances
- Benefit would be reduced to flat rate plus family allowances, as shown in first column.

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