Table 3: Government Macroeconomic Strategy, Main Indicators

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<thead>
<tr>
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<th>2003</th>
<th>2004e</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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</thead>
<tbody>
<tr>
<td>GDP growth, %y/y</td>
<td>3.8</td>
<td>5.7</td>
<td>5.0</td>
<td>4.8</td>
<td>5.6</td>
</tr>
<tr>
<td>Budget balance, % of GDP (1)</td>
<td>-3.9</td>
<td>-5.4</td>
<td>-3.9</td>
<td>-3.2</td>
<td>-2.2</td>
</tr>
<tr>
<td>Public Debt, % of GDP</td>
<td>45.4</td>
<td>45.9</td>
<td>47.6</td>
<td>48</td>
<td>47.3</td>
</tr>
<tr>
<td>Inflation - Harmonized Index of Consumer Prices (HICP)</td>
<td>0.7</td>
<td>3.5</td>
<td>4.76</td>
<td>4.8</td>
<td>47.3</td>
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<tr>
<td>Current Account Balance, % of GDP</td>
<td>-2.2</td>
<td>-1.9</td>
<td>-2.3</td>
<td>-3.0</td>
<td>-3.6</td>
</tr>
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(1) According to ESA95 but excluding the effect of pension reform
Source: EC

II. Government’s Development Program and Challenges

A. Development Priorities

16. The Government’s development strategy is contained in the NDP 2004-2006, and in the draft NDP 2007-2013. The overriding objective of the strategy is to put the economy on a path of high and sustainable growth, through improved competitiveness of firms and regions, to contribute to the recovery of employment, and promote strong social cohesion. The aim is to reach two-thirds of EU average income per capita by 2013.

17. The Government’s strategy provides a good basis for support from Poland’s partners, most notably the EU through Cohesion and Structural Funds, the European Investment Bank (EIB), the Council of Europe Development Bank (CEDB), the European Bank for Reconstruction and Development (EBRD), and the World Bank. The strategy recognizes the need to manage the economy prudently in order to increase employment and reduce poverty, converge in the medium to long-term to average European income levels, and meet the requirements for the adoption of the Euro. The following paragraphs highlight each of these three challenges as Poland implements its NDP and, in key areas of World Bank involvement, they review progress and identify remaining challenges.

B. Development Challenges – Sectoral Aspects and Macroeconomic Linkages

18. Poland aims to reduce its fiscal deficit to below 3 percent of GDP in 2007, while maintaining public debt below 60 percent of GDP in line with its convergence program as discussed in para. 15 above. The Government acknowledges that further public expenditure reforms, beyond those measures of the fiscal austerity plan which have already been approved, will be needed to make room for needed infrastructure investments and to achieve its medium-term fiscal targets. These measures should be implemented as soon as possible, including to ensure that the budget target for 2005 is met. Reforms of those sectors which have been a burden to the budget such as coal mining, railways and health should be pursued ambitiously, as well as further reforms of social transfers (notably the farmers’ pension system and disability pensions), with the particular objective of reducing disincentive effects in the labor market. Additionally, public expenditure management systems and tax administration require further improvement. Continued use over the medium-term of the implicit rule in the 2005 budget for limiting spending growth to 1 percent per annum in real terms would provide for the necessary restraint on the overall expenditure envelope.

19. Health sector reforms have been introduced (including approval of the Health Financing Act in August 2004), but they address primarily health financing, and they still need to be implemented. Beyond this process, the remaining reform agenda in the sector includes: (a) introduction of appropriate incentives for cost-saving and efficiency improvements in the financing and delivery of health services; (b) better performance of the National Health Fund (NHF) and its regional branches;
(c) reduction and eventual elimination of the high levels of indebtedness which pervade the health system; (d) improvements in clinical quality of health services; (e) rationalization of hospital capacity across regions; (f) strengthening of governance and management in hospitals; (g) introduction of comprehensive and effective regulatory and oversight mechanisms; and (h) improvement in collection and redistribution of health insurance premiums.

20. Reform of the coal sector has been under implementation for several years. While much has been achieved in terms of reduced staff levels, increased productivity, reduced fiscal drain, and restructuring of the industry, long-term sustainability of the sector will require further progress on all these fronts as well as actions to address the industry's environmental legacy. The key will be to accelerate privatization, on which progress has been slow and inconsistent. The 2004-2006 Reform Program approved in April 2004 has renewed the emphasis on further voluntary staffing reductions. It also targets lower production capacity, elimination of state subsidies, adherence to a hard budget constraint, and ultimately privatization of the sector. The impetus of the reform has slowed somewhat in recent months, largely because the coal companies see less need for employment and capacity downsizing due to buoyant coal prices, especially in the second half of 2004. Additionally, there is labor union opposition to privatization. The four key challenges are: (a) overstaffing - the target for staff reductions is unlikely to be met under the voluntary program, necessitating mandatory retrenchments to ensure long term viability of the sector; (b) capacity reduction - proceeding but with strong opposition from both workers and the (still state-owned) mining companies; (c) environmental legacy - mitigation of past mining damages has not received sufficient attention; and (d) privatization - delayed and proceeding slowly in spite of the unique opportunity provided by a buoyant coal market. The reforms will not be completed without concerted Government action. If these issues are not addressed in a proactive manner, the risk is that a downswing in coal prices could cause large parts of the industry to revert to financial losses which would become a major obstacle to successful privatization.

21. Convergence to European Income Levels. The Government recognizes that medium to long-term convergence to European income levels will require sustained high growth averaging 4.5 percent per year until 2013 to achieve the stated aim of two-thirds of EU average income per capita by 2013, and strong competitiveness in European and world markets. This will entail continuing structural reforms to: (a) improve the business environment, including broadening and deepening financial intermediation, initiating judicial system reform and deepening public administration reform, including being able to use the available resources from the EU effectively and efficiently; (b) improve the energy and transport infrastructure; (c) develop the knowledge economy, including initiating tertiary education reform.

22. Business Environment. Poland has benefited from large investment flows over the last 15 years, reflecting the many efforts that have helped improve the business environment. But this is an area in which continuous improvement is essential to stay competitive and attract new investors. Recent business environment surveys, as well as the Bank’s Investment Climate Assessment (ICA), Doing Business 2004 and 2005 reports, and the Foreign Investment Advisory Services (FIAS) work on administrative barriers to investment indicate that the Polish authorities need to improve the mechanisms for contract enforcement and dispute resolution, including out of court settlements. The quality of infrastructure services needs improvement, including developing mechanisms to enhance participation of the private sector in the provision of these services. There is also a need to enhance the predictability of the tax regime to allow businesses to plan for taxes, including ensuring consistency in interpretation of tax decisions across regions. To ensure that investment is employment-intensive, there is a need to reduce the high tax wedge for social security premiums. The costs of regulatory compliance are too high and administrative procedures could be streamlined. Overall, there should be a mechanism to monitor the business environment on a regular basis, compare it to competitors and provide direct feedback to policy formulation.

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23. A competitive market economy depends on effective support from the judicial system. In Poland, the judicial system needs to improve its efficiency by enhancing case-load management and overall judicial administration. Policy makers need better court statistics and better access to such information. Better case-load management would help shorten the excessive time now required for the resolution of contract and other disputes in Poland. There is also a need to undertake systematic impact assessments of new laws and regulations on the overall business environment and on the cost of doing business.

24. Poland has seen wide-ranging financial reforms with a private banking system now operating in a competitive environment. Financial sector growth, like competitiveness, requires, however, a continuous reform environment. Improvements in creditor rights, in the quality of financial statements, and in credit information top the list for the banking sector. Non-bank sources of financing need to be deepened, including leasing, factoring, venture capital, commercial paper and bond markets. Financial sector oversight needs to be strengthened and modernized, including preparations for Basel II, development of risk-based regulation and supervision of pension funds, and creation of an accounting standards board and a public oversight body for the audit profession. Mortgage finance, which remains an underdeveloped aspect of the financial system, may also require the attention of policy makers.

25. The Energy Sector. This sector has undergone a major transformation in preparation for EU accession and integration into global markets. Poland’s recently adopted Energy Policy Framework until the Year 2025 emphasizes three key objectives: ensuring energy safety, increasing economic competitiveness, and protecting the environment. This Framework recognizes the need to increase emphasis on energy efficiency, expand the use of indigenous renewable energy sources, establish a 90-day fuel reserve capacity, accelerate coal sector reform (discussed in para. 20 above), and increase the use of natural gas, thereby reducing excessive levels of coal-fired emissions. Balancing the cost and security advantages of using indigenous coal against the environmental benefits of using cleaner but increasingly imported natural gas will involve difficult policy tradeoffs. There is progress on most fronts; but major challenges remain in restructuring and privatizing the power, coal, and gas sectors. Power and gas markets, dominated by monopolies and contract-based market structures, will prove challenging to shift to a competitive pricing model. Poland’s aging power and gas infrastructure needs expansion and investment, and attracting large-scale private investment into the sector is difficult given continuing uncertainties about market structure and slow progress in privatization. Integration into Europe and achieving economic competitiveness will require progress on this agenda in the near term. Despite major gains in energy intensity, Poland still uses around 2.5 to 3 times more energy per unit of GDP than the EU average. Over time, this will undermine the competitiveness of the Polish economy. The potential for energy savings is very large in all sectors of the economy, and many investments in energy efficiency will be feasible without direct subsidies. Activities to tap the efficiency potential, and the level and type of Government intervention required to achieve these targets will need to be analyzed, and appropriate measures to scale up energy efficiency investments should be taken.

26. Modernization and Reform of Transport Infrastructure. Three subsectors are included: railways, roads, and ports. The reform of the railway sector has been under implementation since 1999 with ambitious objectives, but mixed results. There has been progress in productivity growth due principally to a first round of layoffs to reduce chronic overstaffing. There has also been progress in the financial and operational restructuring of the industry, resulting in the reconfiguration of the traditional monolithic monopoly structure into several independent operating companies. Despite these achievements, the sector is far from sustainable; in addition to the current levels of compensation

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for public service obligations, the railways continue to require periodic debt relief, write-off of other financial obligations to the State, and support for new capital expenditures. This is due mainly to underfunded, financially non-viable regional services. These constitute social obligations and result in large accounting losses and short-term liquidity constraints. Finally, progress on privatization has been slow and further complicated by repeated changes in strategy.

27. The railway reform strategy was revised in December 2003. It called for a renewed push towards privatization and the devolution of responsibilities for regional passenger services to local governments with appropriate budget funding. Unfortunately, little progress has been made in its implementation. Another strategy revision has been adopted by the Government in February 2005. It reflects a policy change aimed at boosting the future role of railways in the Polish transport sector while continuing with privatization. Access fees will be reduced by one-third in order to lower tariffs and encourage rail utilization. At the same time, to avoid burdening the state budget or taxpayers, one-third of the least used network (7,000 km) will be closed. The Government will assume responsibility for most of the maintenance and renewal of the remaining network. This will be funded from a new National Railway Fund (beginning in 2006), a major source of which will be 20 percent of the receipts from fuel charges collected in the National Road Fund. Operating companies will be further strengthened by the transfer of all operating assets currently owned by the holding company, Polish National Railway Company (PKP S.A.), and changes in their organizational and capital structure. A new major stations company will be created as a subsidiary of the infrastructure company to exploit the real estate potential of railway property. In terms of privatization, while preparations continue for cargo services, the priority is the trade sale of intercity passenger services. The Government needs to play a more decisive role in pushing network rationalization, rapid privatization of cargo and intercity passenger services, and devolution of regional passenger services to local governments.

28. Changes in the roads sector have focused on institutional restructuring to improve planning and implementation capacity, measures to finance the large maintenance backlog and on the substantial investments required to extend Poland’s minimal highway system. Some progress has been made with the creation of a single roads agency, the General Directorate of National Roads and Highways (GDDKiA), through the merger of the General Directorate of Public Roads and the Agency for Construction and Operation of Motorways, and with the creation of the National Road Fund, financed by a fuel surcharge. A more ambitious plan for the introduction of a user tax based on a vignette system was rejected by Parliament, partly because of lack of proper communication and information to the public. It is unlikely that the current Road Fund will generate sufficient resources to meet the full needs of the sector, even with increased private sector involvement. Attempts to involve the private sector in the financing of roads through concessions or public-private partnerships (PPPs) have as yet been quite limited, partly because of the lack of an adequate legal and regulatory framework. The four key challenges are to: (a) improve GDDKiA’s investment planning capacity to enhance the quality and pace of project implementation; (b) build GDDKiA’s capacity for prioritization and selection of investments on the basis of economic criteria using modern programming tools; (c) eradicate the large road maintenance backlog; and (d) enhance the capacity to mobilize and coordinate private sector involvement in road infrastructure development.

29. Reform and modernization of the ports have been under implementation since the early 1990s, with approval in 1996 of a new legal and regulatory framework which aimed to modernize the sector, increase its competitiveness and improve the quality of services provided by the ports. State-owned enterprises were restructured to act as ‘landlords’ of the facilities with commercial activities to be carried out by separate private operators independent of the port authorities and regulated by the Ministry of Infrastructure in line with best practice. Joint-stock companies were created for each of the three main Polish ports with responsibility to manage the land and port infrastructure, including maintenance services, modernization, and investment planning. As a consequence of these changes,
municipal authorities gained more responsibility to make efficient use of port infrastructure. However, in the absence of direct incentives, with the exception of the port of Gdynia which has been able to attract a private investor to develop and to operate its container terminal, this responsibility has not yet translated into better management of port assets which therefore remains an urgent task.

30. **Knowledge Economy and Innovation.** The Bank’s Knowledge Economy Assessment concluded that a key element in a successful competition strategy for Poland must be increases in the overall expenditure on research and development (R&D) and, most important, in the share of R&D financed by the private sector. Currently, Poland spends only 0.7 percent of GDP on R&D and only one-third of this is spent by the private sector. Poland’s private sector will need to increase its R&D spending substantially, and this will require a range of R&D financing instruments from grants for innovation at the very early stages to venture capital. There is also a need to improve the regime for intellectual property rights. The quality and relevance of formal education needs to be assessed critically, life-long learning systems need to be improved, and the linkages between academia and the scientific and business communities need to be strengthened. Lastly, there is a need to complete the liberalization of the telecommunication sector in order to reduce costs, increase access to services such as internet, and facilitate the introduction of e-Government for businesses and citizens.

31. While the Education Development Strategy has been approved within the framework of the NDP 2007-2013, its implementation is only just starting, and many improvements are needed to contribute to competitiveness and social inclusion. The report on tertiary education produced jointly with EIB identifies the need to strengthen the capacity of the Ministry of National Education and Sports for analytical work and for decision-making as an important requirement for dealing with some of the key remaining challenges in the sector, which include: (a) better orienting education to labor market needs with emphasis on greater flexibility; (b) improving access to high quality educational services; (c) developing a life-long learning system that takes into account the changing demographic profile of learners in Poland; and (d) embedding the tertiary education system within a national innovation strategy.

32. **Increasing Employment and Reducing Poverty.** Increasing employment and reducing poverty are two sides of the same coin in Poland, given the strong correlation between family income levels and employment status of heads of household. Currently, however, employment creation remains sluggish, and it is indeed lower than it had been in the past when it had offset the considerable job destruction associated with transition. As a result, unemployment is high, and long-term unemployment is increasing, leading to growing pockets of long-term poverty and social exclusion. To stimulate new job creation, labor market reforms are needed, and small and medium enterprises (SME) development needs to be revitalized. It may also be necessary to support the creation of sustainable employment where markets are currently failing, both in rural areas and in depressed urban areas. Large inequalities in education and skills are a key barrier to citizens’ capacity to find and hold a job and, thus, to staying out of poverty. There is also a need to examine the system of social transfers for better targeting, as evidence suggests that in some circumstances social transfers have created a disincentive to more active participation in the labor market. However, growing pockets of long-term unemployment and poverty must also be dealt with, requiring actions to increase the level of social inclusion.

33. The Bank’s Living Standards Assessment has shown unemployment to be closely linked to large regional disparities and high inequality in educational outcomes across individuals and between regions. High non-wage labor costs also played important roles. Indeed, employment opportunities in Poland are highly correlated to individuals’ level of education, and for low-skilled individuals, they appear to be impaired by a combination of a binding minimum wage, high labor taxes, and a structure of the social transfers that, while helping to alleviate poverty in the earlier years of transition, has also proved a disincentive to active participation in the job market in low wage, high unemployment areas.
There is also evidence that uniform national minimum wages may be a barrier to employing some people with low skills given the regional variations in price levels which translates into significantly higher real minimum wages in poorer regions.

34. Polish legislation provides for equal treatment of women and men in the labor market and ensures gender equality in access to professional training and promotion. Yet gender inequalities continue to prevail as shown in the report on Gender and Economic Opportunities in Poland prepared by the Bank in collaboration with the Government Plenipotentiary for Equal Status for Men and Women and numerous Polish experts. The gross gender pay gap is low by international standards (17 percent in the 2002 Labor Force Survey) but, contrary to other EU countries, it is not linked to gender differences in productivity-related characteristics. Moreover, Poland is unique among the Central European countries in experiencing an increasing female disadvantage in employment opportunities, with the rate of unemployment growing much faster for women than for men. These findings suggest the need to go beyond legislation by focusing on improved implementation and increased employers’ accountability in the selection and promotion process and to eradicate the social and cultural stereotypes that lead to the unequal treatment of men and women in the labor market and social protection system and promote the disadvantage of women in public and political life.

35. In rural and depressed areas, efforts should be continued to support the creation of employment but with a focus on the creation of sustainable employment where market responses have thus far been weak. This includes incentives for the creation of off-farm sources of employment, as well as enhancing the incentives and possibilities to seek urban employment. Reducing barriers to labor mobility (i.e., finance, transportation including commuting, housing, and income transfer mechanisms including KRUS) are key in this regard. These actions need to be supplemented in rural areas with efforts to increase the productivity and value-added of the agricultural sector in general. In the agriculture sector, while large farms are operating effectively and use modern production and marketing techniques, several challenges remain, in particular in supporting the development of small and medium sized farms to increase their productivity and value-added. Particular areas of focus include sustainable mechanisms for supporting marketing efforts, as well as introducing production techniques that improve profitability, salability and environmental friendliness of production for this group of farms.

III. Poland and the World Bank: Past Relationship and Lessons

A. Past World Bank Assistance

36. Poland rejoined the World Bank in 1986, but the first lending operation occurred only in 1990 (after the end of the communist period). Lending was substantial in the 1990s but decreased in the early years of this decade before recovering in 2004, coincident with a pickup in reform implementation. Demand is expected to remain at a level of about US$350-400 million per year for the next two to three years. A sizeable amount of technical assistance and capacity building was, and continues to be, embedded in lending in addition to the Bank’s analytical and advisory activities (AAA) and activities supported by Institutional Development Fund (IDF) grants. Policy advice and analytic work have been well received by the authorities throughout the Bank’s involvement in Poland.

37. Bank lending has responded with lower volumes and greater selectivity to the completion of Poland’s transition to a market economy, its increased access to EU funds, and its achievement of investment grade (BBB+) rating as a sovereign borrower. At the same time, TA financed from the Bank’s budget has become increasingly sophisticated. A total of 66 loans have been approved since 1990 for total lending (commitments less cancellations) of US$4.7 billion. As of the end of calendar year 2004, US$2.8 billion have been repaid, and US$297 million remain undisbursed. Financing
under the last CAS has supported government-led reform and modernization efforts, for which the
Bank lent modest amounts, but in which it could add value in terms of technical expertise,
implementation and management skills for complex activities, and helping to leverage larger financial
resources from other partners such as EIB. The portfolio includes 11 loans, which support reform
efforts, including privatization (coal and railways) and strengthening and modernization of institutions
(ports and the roads agency, GDDKiA), and programs for road maintenance, rural development,
energy efficiency, geothermal energy, regional water supply, and flood reconstruction and prevention. All projects are rated satisfactory for implementation progress and development objectives.

38. TA financed from the Bank budget has also changed in nature, responding to Poland’s
growing capacity and increasingly specialized needs by moving into more sophisticated areas where
the Bank’s global expertise has been particularly relevant and appreciated. Indeed, as Poland has
progressed, there has been an opportunity to pilot initiatives with relevance for other countries
confronting similar challenges and for Bank staff to learn from Poland’s experiences. Some examples
include the work on banking supervision which led to the establishment, within the structures of the
NBP, of TIBS (Training Initiative for Banking Supervision) through which Poland now supports the
training of bank supervisors not only from neighboring countries in transition in Eastern, Central and
Southern Europe but also from Central Asia and from as far as Vietnam. Poland’s experience with
decentralization and establishment of local governments has been analyzed by the Bank and
documented for use in other developing countries. Some ongoing work in the areas of accounting and
auditing as well as corporate governance as part of updating the Reports on Observance of Standards
and Codes (ROSCs) also have the potential for wider Bank use.

B. Implementation of the Previous CAS

39. An evaluation of the implementation of the FY03 CAS must take into account that the
changes in Poland’s circumstances which led to the preparation of this CPS also affected the
implementation of the previous CAS. Two factors were particularly important in CAS
implementation. The first was the delays and uncertainties associated with political instability through
mid-2004, and the second was the momentous changes associated with EU accession. The latter, in
particular, has led to a period of redefining of the relationship between the World Bank and the Polish
authorities in which the role of the World Bank inevitably accommodates the primacy of Poland’s
partnership with the EU and other European institutions, not least in improving access to resources at
increasingly attractive terms. However, the basic priorities set in the FY03 CAS demonstrated their
robustness and remained at the core of dialogue with the Polish authorities during the intervening
period. In particular, as reform efforts were re-initiated in late 2003 (roughly a year into CAS
implementation), the Bank’s operational focus on the coal sector, road administration and
maintenance, health financing and administration, higher education, and rural development was
confirmed.

40. Recognizing the changing nature of the Bank’s operational relationship with Poland, the FY03
CAS had anticipated that Poland would not be interested in traditional investment lending in these
priority areas. It anticipated instead a potential series of sector adjustment operations related to
specific sectoral benchmarks and a common single macroeconomic trigger. The authorities clearly
gave first priority to Bank support to coal and roads, and progress on the related sector benchmarks
was satisfactory by the end of 2003. However, the sector adjustment instrument turned out to be ill-
suited to Poland’s evolving situation. In both prospective operations in coal and roads, the authorities
wanted stronger linkages with the actual administration of the reform and related expenditure
programs than sector adjustment operations would normally entail. Furthermore, the conditionality
itself was not so much a set of policy changes as it was the implementation of institutional changes
linked to specific expenditures. Clearly, a more flexible and innovative approach than had been
foreseen at the time of the CAS was necessary. As a result, the roads operation was successfully
designed as a SWAP which pooled World Bank resources with those of the Government and other financial partners such as EIB, linked to the implementation of specific budget lines. In the case of coal, two operations evolved. One directly supported retrenchment packages in the budget, thereby linking disbursement to the actual implementation of the reform program, and the second followed a modified SWAP for mine closure expenditures over a multi-year period. These innovative approaches were also implemented within a very short timeframe—less than six months once the appropriate instrument had been identified.

41. The CAS contained a specific quantitative macroeconomic trigger defined as an increase in central government savings without a deterioration in general government recurrent balances. Although this trigger had been met in 2003, it became apparent in early 2004 that it would not be met in that year in spite of the generally improved performance of the economy and the implementation of the Hausner Plan (see para. 10), which made real progress toward fiscal sustainability. Considering the direct links between the proposed operations and an improved composition of public expenditure, this trigger was judged to be no longer a critical indicator of improved policy performance when the Government requested in early 2004 that the Bank proceed with support to the coal and roads sectors.

42. The envisaged dialogue in other sectors and AAA were also broadly confirmed during the FY03 CAS implementation, but delays and some shifts in priorities linked to the process of redefining the Bank-Poland partnership led to a consolidation of some activities and, in some cases, a shift in focus to TA from economic and sector work (ESW) or lending. The rural development dialogue evolved based on initial experience with structural funds and has strengthened the focus on social inclusion at the community level. Health and education have primarily focused on TA, although the jointly-produced sector report on tertiary education with EIB was a notable output. Labor market issues were melded into the Living Standards Assessment which also builds more strongly than anticipated on regional differentials. Competition, SME and regulatory policy were considered in a comparative context with the ICA, FIAS work on administrative barriers to investment, and the Knowledge Economy Assessment rather than a free-standing competition policy review. A program of financial issues has been agreed with the NBP including elements of judicial reform that affect contract enforcement for banks. Finally, based on the request of the Government, the Bank is endeavoring to assist with the formulation of the next NDP rather than undertake its own review of development policy. In general, these changes reflect a greater attention to the specific requests of the authorities and less emphasis on ESW outputs.

43. The benchmarks for evaluating progress of the Bank program were largely met, in spite of the delays and shifts in priorities that affected Bank operations and AAA. Exceptions were policy dialogue and possible TA for raising productivity in the agriculture sector and TA and dialogue on strengthening regulatory capacity. On the other hand, policy dialogue on competition and labor market reforms and on the environment for SME development did occur in the context of the ICA, the Living Standards Assessment and the Knowledge Economy Assessment.

44. Overall, the lessons from the implementation of the FY03 CAS are the following: (a) the underlying analysis and priorities in the CAS were sound and remained robust in light of Poland’s improved performance and accession to the EU; (b) the instruments foreseen in the CAS were too rigid for Poland’s changing circumstances, but flexibility in implementation and support from the Region and Bankwide Middle-Income Country (MIC) and Simplification agendas helped keep the Bank program relevant; (c) in spite of the Bank’s higher financial costs relative to Poland’s other sources of funds, the Bank can provide sufficient value-added in selected areas in which it brings technical expertise combined with rapid and flexible implementation to justify modest levels of lending.
C. Rationale for Future Partnership

45. Although Poland's recent developments could soon lead the authorities to initiate graduation from World Bank borrower status, there is still an agenda of important reforms in areas in which the Bank has been, and continues to be, the key technical partner and where Bank operational activity including, in some cases, modest financing can add value from the perspective of the client. This includes activities supporting privatization in the coal and railway sectors, modernization of roads and ports administration, public finance management, social inclusion, health, education, the development of the financial sector and of systems for knowledge transfers to industry. Additionally, the capacity to design and implement reforms is still constrained by the speed at which public administration and institutions can be reformed. World Bank support in the form of analytic work and TA embedded in modest lending has helped, and can continue to help, address this constraint. Furthermore, the Bank's engagement in the form of an operational program has been, and continues to be, a significant factor to leverage and promote as well as endorse needed reforms. Consequently, there remains an opportunity for continued, selective Bank involvement, particularly in the form of technical support, either free standing or embedded in lending and financial partnerships in Government programs.

IV. World Bank's Proposed Strategy

A. CPS – Principles for Engagement

46. World Bank's activities in Poland under the partnership arrangement will need to be both strategic and demand driven, focusing on areas that are consistent with the development priorities of Poland as laid out in the NDP and where:

(a) Significant policy or structural issues are involved;
(b) The Bank can add value, as perceived by the Polish authorities in terms of technical excellence and comparative advantage, taking into account the cost of financing; and
(c) Effective partnerships are continued both with Polish partners, including private sector, youth and civil society organizations, and with external partners, including the EU, EIB, EBRD, CEDB, the International Monetary Fund, and the Organization for Economic Cooperation and Development.

B. Operational Approaches

47. Operational approaches consistent with the above criteria require the evolution of the relationship towards a partnership for development in which the Bank continues to support the Government with a full set of instruments to tackle elements of the remaining agenda and in which Poland increasingly contributes with the lessons of its experience for broader dissemination by the Bank to other member countries. To fulfill its role in this partnership, the Bank will need to increase its flexibility and responsiveness in a manner consistent with the priorities and recommendations from the Bank's Middle-Income Country Bankwide Working Group\(^4\) and those contained in the Framework for World Bank Support to the EU New Members Countries of Central and Eastern Europe\(^5\).

48. The evolution from CAS to CPS entails: (a) a single lending case based on a macroeconomic framework consistent with Poland's convergence program under the SGP described in para. 15; and (b) shifts from a largely pre-determined program of lending and nonlending activities to a more

\(^4\) Enhancing World Bank Support to Middle-Income Countries (SecM2004-0071/1), April 20, 2004; and Management Action Plan (SecM2004-0071), February 26, 2004.