Sri Lanka Resilience, Stability and Economic Turnaround (RESET) Development Policy Operation

The $500 million **RESET Development Policy Operation (DPO)** for Sri Lanka supports foundational reforms needed to restore macroeconomic stability, mitigate the impact of current and future shocks on poor and vulnerable people, and support an inclusive and private-sector-led recovery.

> ***What is a development policy operation (DPO)?*** *— A DPO provides non-earmarked support to a country's budget, aimed at helping it meet actual or anticipated development financing requirements, as it undertakes reforms to strengthen its policies and institutions.*
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> *A DPO requires an adequate macroeconomic framework and a set of prior actions (reforms) to be fulfilled before the funds are disbursed.*

The RESET DPO—the first in a series of two operations—will be **disbursed in two equal tranches**, against the completion of agreed prior actions taken by the government related to their reform agenda. The **first tranche** will be available for disbursement upon effectiveness of the operation after Board approval. The **second tranche** will be available subject to the completion of remaining prior actions, continued adequacy of the macroeconomic policy framework, and acceptable progress in carrying out the reform program. Satisfactory progress in restoring debt sustainability—with particular attention given to progress towards an agreement with official bilateral creditors—will be a key element in determining the adequacy of the macroeconomic policy framework.

The RESET DPO has **three pillars**:

Improving Economic Governance	Enhancing Growth & Competitiveness	Protecting the Poor & Vulnerable

Improving Economic Governance. This pillar includes measures to address governance problems that contributed to the current crisis. Specific **actions** focus on policies to **increase tax revenues and strengthen debt management**, **improve tax administration**, and **reduce systemic risks in the financial and banking sectors**. Specific reforms include, for example, removing *concessionary corporate income tax* rates in some sectors and increasing the *fuel excise duty*, which will help expand the tax base and increase domestic revenues. This will be complemented by **tax administration reforms**, including mandatory e-filing and better sharing of information, which will improve coordination across financial institutions and boost revenues from high net-worth taxpayers. Systemic risks in the **financial sector** will be addressed by, among other things, the approval of an Emergency Liquidity Assistance (ELA) framework and the establishment of a financial sector crisis management committee. The stability of and confidence in the **banking system** will be reinforced by strengthening the deposit insurance and bank resolution framework.

Enhancing Growth and Competitiveness. This pillar includes reforms that are essential for Sri Lanka's medium to long-term competitiveness and growth performance. Specifically, this includes measures to reduce market distortions by initiating the process to **restructure and divest state-owned enterprises** (SOEs), which crowd out private sector participation and innovation and are a major source of fiscal and financial sector risks, through the approval of the SOE reform policy paper. It also includes measures to facilitate a more export-oriented and streamlined investment and trade regime—the World Bank estimates Sri Lanka's untapped merchandise exports at US$10 billion annually — by enacting a new investment law and simplifying the tariff structure.

Protecting the Poor and Vulnerable. This pillar includes improving the governance, effectiveness, and efficiency of the country's social protection system. A **revitalized social protection system** will help the poor and vulnerable better cope with the ongoing economic crisis and future shocks. Reform measures under this pillar will support the design and financing of a **new welfare benefit payment scheme** that is better targeted to those in need. This will help improve the transparency of the system and discourage political influence in the process.

The reforms under the DPO were sequenced and calibrated with the IMF Extended Fund Facility for Sri Lanka, which was approved in March 2023, and coordinated with the Asian Development Bank (ADB) and other development partners. In future years, the World Bank will continue to support further reforms in these areas, as well as other crucial reforms on debt management, foreign direct investment, digital development, and female labor force participation, including through the second operation in the DPO series.