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Does Economic Freedom Matter for Growth? (Empirical evidence from Sri Lanka)

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ABSTRACT

This study aims to examine whether economic freedom matter for economic growth in Sri Lanka using the annual time series data over the period 1996-2020. Exploratory data analysis and inferential data analysis techniques were employed as the analytical tools. The exploratory data analysis indicates a positive relationship between economic freedom and economic growth, the unit root tests confirm that the variables are I(1), the ARDL Bounds cointegration test finds a long-run relationship between the variables, the long-run estimated coefficient of variables used in this study point out that the key variable of economic freedom is statistically significant and positively different from zero, the estimated coefficient of error correction term implies that the response variable of economic growth moves towards the long-run equilibrium, the Granger causality test shows a one-way causality running from economic freedom to economic growth. The impulse response function analysis indicates that a positive shock to economic freedom has an immediate significant positive impact on economic growth.

Keywords: Economic Freedom, Economic Growth, ARDL, IRF, Sri Lanka

JEL classifications: O11, O38, O43

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1. Introduction

Ever since the era of classical economists, it is argued that the freedom of the competitive market is a central component for economic progress (AlNajjar, 2002; Ghosh, 2016). The concept of freedom was at first pronounced by the economist Adam Smith in his book "An Inquiry into the Nature and Causes of the Wealth of Nations". In this book, he states that "basic institutions that protect the liberty of individuals to pursue their economic interests result in greater prosperity for the larger society". However, freedom was not measured until to have been introduced the Economic Freedom Index (EFI).

Economic freedom is the fundamental and legitimate right of every person to control his or her labour and property (Sheikh et al., 2018). It is the vital obligatory way to obtain grand innovation, greater opportunities, risk-taking, entrepreneurship, and a healthy standard of living for all individuals in any economy (Pattanaik and Nayak, 2014). Economic freedom gives the strength to all persons to pursue their own choices and self-

needs (Corbi, 2007). Until 1995, there has no common statistical measurement to estimate economic freedom. However, the Heritage Foundation and Wall Street Journal (HF/WSI) in 1995 announced the unique index to measure the economic freedom of a country, is named as Economic Freedom Index. It is an annual index ranking the degree of economic freedom among the nations of the world (Hussain and Haque, 2016).

There is a heated debate regarding economic freedom among economists. In that respect, Adam Smith notes that economic freedom is a fundamental need to a country's economic growth and development, while Keynes in his book "The General Theory of Employment, Interest, and Money" notes the argument against Adam Smith. Keynes toughly states that the reason for "the world great economic depression of 1929" is the freedom policy in the economy. Therefore, the heated debate regarding economic freedom is unavoidable (Erdem and Tugcu, 2012). Whatever it is, scholars empirically investigate the relationship between economic freedom and economic growth by using country and cross-country data.

As all known, economic growth is an important term in the field of economics, which is defined as an increase in the production of goods and services in an economy. Economic growth is determined by traditional and untraditional factors. In the traditional factors, capital and labour force are included while the untraditional factors consist of economic freedom and other institutional factors.

On the subject of the relationship between economic freedom and economic growth, three findings have been received from the empirical investigation. In that respect, one states that there is a positive relationship, while others point out the negative and no relationship. However, there is no evidence of what type of relationship between economic freedom and economic growth in Sri Lanka. This is a research gap in Sri Lanka when considering the influence of economic freedom on economic growth.

As for Sri Lanka, there is an unforgettable history of war and civil violence. These situations directly affected the civilians of Sri Lanka. Therefore, in this situation, economic freedom cannot be expected, this lesson has been learned from world history. Therefore, it is needed that the relationship between economic freedom and economic growth should be scientifically confirmed in Sri Lanka. When considering previous studies related to economic freedom and economic growth, there is no evidence to have studied the relationship between economic freedom and economic growth in Sri Lanka.

The elementary motivation of this study is to seek the answer to the research question of whether economic freedom matters for economic growth. to answer this research question, this study formulates the following objective. The objective of this study is to examine whether economic freedom matter for economic growth in Sri Lanka. To the best of our knowledge, this is the first research related to economic freedom and economic growth in Sri Lanka, because this topic was not so far investigated in Sri Lanka. Thus, we hope that the findings of this study will provide new information to existing literature.

This study is structured are as follows: Section 2 covers the review of literature; Data and methodology are given in Section 3; Section 4 provides results and discussion; Section 5 concludes this study with policy implication.

2. Review of Literature

The relationship between economic freedom and economic growth has been the focus of a rich variety of studies. However, this study critically reviews recent studies that have investigated economic freedom and economic growth. In that respect, Malanski and Póvoa, (2021) using GMM estimation panel data regressions confirmed that economic freedom is a moderator of economic growth in Latin America and Pacific Asia. Bergh and Bjørnskov (2021) found that economic freedom boosted economic growth. Another study was conducted by Rapsikevicius, et al., (2021) who showed the mixed performance of the economic freedom index on economic growth in European countries while Khan and Panjwani (2021) found that economic freedom

boosted the economic growth in the UAE. Nadeem, et al., (2019) using five South Asian countries' data sets during 1990-2015 found that economic freedom index positively increased economic growth. Ahmed and Ahmad (2020) investigated the impact of economic and political freedom on economic growth in Asian economies by employing Fixed effect and GMM techniques. This study indicated that economic freedom has a positive and statistically induce economic growth. Al-Gasaymeh et al., (2020) investigated the relationship between economic freedom and economic growth by using thirteen MENA countries data over the period 2010 to 2018. This study revealed that economic freedom positively increased economic growth. However, Santiago, et al., (2020) using the panel ARDL technique found economic freedom decreases economic growth in Latin American and Caribbean countries.

The previous works reviewed in this study were either single or cross-country studies. However, most studies were conducted in cross-countries and they used the general moment method (GMM) as the analytical technique. Only a few studies found a negative relationship between economic freedom and economic growth. However, none of the researchers so far examined the relationship between economic freedom and economic growth in the Sri Lankan context. Therefore, this study adopts the ARDL technique, causality test, and impulse response function analysis to test the relationship between economic freedom and economic growth in Sri Lanka.

3. Research Methods and Data

3.1 Model Specification

The objective of this study is to verify whether economic freedom is a matter for economic growth in Sri Lanka. A similar objective has been examined in previous literature by using several explanatory variables. Accordingly, (a) gross fixed capital formation, (b) labour force, and (c) economic freedom are common explanatory variables were used in previous studies. This study also considered the same variables to investigate the objective. Thus, the empirical model specification of this study can be written as follows:

$$EC_t = \beta_0 + \beta_1 GFCF_t + \beta_2 LBF_t + \beta_3 EFI_t + \varepsilon_t$$

Where EC_t, $GFCF_t$, LBF_t, and EFI_t represent economic growth, gross fixed capita formation, labour force and economic freedom index, respectively. β_1, β_2, and β_3 are the coefficients of such variables that are expected to be greater than zero ($\beta_i > 0$), ε_t represents the error term.

3.2 Data

The data for the variables used in this study were annual time series covering the period 1996-2020. All the data were collected from different sources (see Table 1). Further, the data series used in this study were transformed into natural logarithms to change normality and linearity.

Table 1. Detail of variables

Abbreviation	Description	Units	Source
EC	Economic growth	US dollar	The World Bank Database
GFCF	Gross Fixed Capital Formation	US dollar	The World Bank Database
LBF	Labour Force	No. of Person	Annual reports for the Censes Department
EFI	Economic Freedom Index	Index	The database of the global economy.com

3.3 Analytical tools

In this section, the analytical tools that were employed in this study are discussed. Accordingly, this study used two types of analytical tools that are (1) exploratory data analytical tools, (2) inferential data analytical tools. In the exploratory analysis, the visual inspection tools of scatter plots, confidence ellipse with Kernel fit were included whereas, the inferential data analysis consists of unit root test, ARDL cointegration technique, Pairwise Granger Causality test, and Impulse Response Function analysis.

3.3.1 Unit root test

As for the time series analysis, testing the order of integration of the variables is a basic requirement. A number of the statistical tests were introduced in empirical studies to test the order of integration of the variables. However, both Augmented Dickey-Fuller (ADF) and Philips Perron (PP) unit root tests were employed to confirm the order of integration of the variables used in this study. In that respect, shown in Table 2 are the ADF and PP unit root tests results which confirm that all the variables used in this study are non-stationary at their level, I (1). Even though the variables used in this study are the same order, the sample observation of each variable used in this study is below fifty observations. Therefore, this study recommended the ARDL Bounds cointegration technique to test the objective of this study.

Table 2. Unit root test results

Series	at level		at 1st difference		Decision
	ADF	PP	ADF	PP	
$lnEC_t$	-1.237 (0.191)	-0.975 (0.284)	-7.124 (0.000)	-9.246 (0.000)	*I*(1)
$lnGFCF_t$	-0.345 (0.903)	-0.452 (0.884)	-3.274 (0.028)	-3.270 (0.028)	*I*(1)
$lnLBF_t$	-2.596 (0.107)	-2.702 (0.088)	-4.457 (0.000)	-4.673 (0.000)	*I*(1)
$lnEFI_t$	-1.211 (0.652)	-1.138 (0.683)	-5.891 (0.000)	-5.877 (0.000)	*I*(1)

Note: ADF-Augmented Dickey-Fuller unit root test; PP- Philips-Perron Unit root test; parenthesis consists of p-values

Source: Authors' calculation

3.3.2 Determination of optimal lag length

Having confirmed the order of integration of variables used in this study, the next step is to determine the optimal lag length to select an appropriate ARDL model. In Empirical studies, various lag-length criteria notably, Akaike Information Criterion (AIC), Schwarz Information Criterion (SIC), and Hannan-Quinn Information Criterion were widely used to select the appropriate lag length. However, this study employed the Akaike Information Criterion (AIC) as most of empirical researches used the Akaike Information Criterion (AIC) to select the optimal lag-length model. The decision rule on the Akaike Information Criterion (AIC) is that the lag having smallest value of the Akaike Information Criterion (AIC) was considered as an optimal lag-length for the appropriate model of this study.

3.3.3 ARDL technique

Having confirmed the order of integration and appropriate lag length of the variables used in this study, testing the long-run relationship between economic freedom and economic growth is the next step of this study. As pointed out earlier, the Autoregressive Distributed Lag (ARDL) Bounds cointegration technique was employed to test the long-run relationship between the variables used in this study. Compared to conventional cointegration techniques, the ARDL technique has some benefits (Pesaran et al., 2001).

The conditional error correction version of the ARDL model for this study can be written as follows:

$$\Delta EC_t = \beta_0 + \sum_{i=1}^{p} \beta_{1i}\, \Delta EC_{t-i} + \sum_{i=0}^{p1} \beta_{2i}\, \Delta GFCF_{t-i} + \sum_{i=0}^{p2} \beta_{3i}\, \Delta LBF_{t-i} +$$

$$\sum_{i=0}^{p3} \beta_{4i}\, \Delta EFI_{t-i} + \beta_5 EC_{t-1} + \beta_6 GFCF_{t-1} + \beta_7 LBF_{t-1} + \beta_8 EFI_{t-1} + \varepsilon_t$$

where Δ is 1st difference operator; $p - p3$ optimal lag length; ε_t is random error term; $\beta_0$is constant; $\beta_1 - \beta_4$ are short-run dynamics of the variables used in this study; and $\beta_5 - \beta_8$ are the long-run coefficient of the variables used in this study.

To confirm whether economic freedom matter for economic growth in Sri Lanka, the joint null hypothesis that there is no long-run relationship between the variables used in this study $H_0: \beta_5 = \beta_6 = \beta_7 = \beta_8 = 0]$ was tested against the alternative hypothesis that there exists a long-run relationship between the variables $[H_0: \beta_5 \neq \beta_6 \neq \beta_7 \neq \beta_8 \neq 0]$. The statistical decision on the joint null hypothesis was taken by comparing the calculated F-statistic (test statistic) with the critical values proposed by Pesaran et al., (2001).

As for the critical values of the ARDL Bounds cointegration technique, Pesaran et al., (2001) proposed two asymptotic critical value at each level of significance. One set of critical value represents the lower bound critical value which assumes that all regressors are I(0) and the other set show the upper bound critical values which assume that all regressors are I(1). Thus, to decide on the long-run relationship between the variables used in this study, the test statistic was compared to critical values at the 5 percent significance level. Accordingly, if the test statistic is greater than the upper bound critical value at the 5 percent level, the null hypothesis can be rejected, therefore, it can be concluded that there is a long-run relationship between the variables used in this study. On the other hand, if the test statistic is less than the lower bound critical value at the 5 percent significance level, the null hypothesis cannot be rejected, meaning that there is no long-run relationship between the variables used in this study. If the test statistic lays between lower and upper bounds, no decision can be taken about the long-run relationship between the variables.

Once confirmed the long-run relationship between the variables used in this study, the next step is to estimate the short-run dynamics of the variables using the error correction model (ECM). The error correction model (ECM) specification can be written as follows

$$\Delta EC_t = \beta_0 + \sum_{i=1}^{p} \beta_{1i}\, \Delta EC_{t-i} + \sum_{i=0}^{p1} \beta_{2i}\, \Delta GFCF_{t-i} + \sum_{i=0}^{p2} \beta_{3i}\, \Delta LBF_{t-i} + \sum_{i=0}^{p3} \beta_{4i}\, \Delta EFI_{t-i} + \theta ECT_{t-1} + \varepsilon_t$$

where θ is the coefficient of error correction term which is expected to be significance with negative sign; ECT is the error correction term.

ECT given in ECM was used to explain the disequilibrium and long-run Granger causality. Accordingly, the coefficient of ECT (θ) is expected to be negative, statistically significant, and less than one in order to move towards the long-run equilibrium.

3.3.4 Diagnostic test

To check whether the estimated ARDL model is robust, the Breusch-Godfrey serial correlation Lagrange Multiplier (LM) test, the Heteroskedasticity: Breusch-Pagan-Godfrey test, the Jarque-Bera normality test, the cumulative sum of recursive residuals (CUSUM) test and the cumulative sum of recursive residuals square (CUSUMSQ) test were employed.

3.3.5 Granger's causality test

Granger's causality from one variable to another means that the conditional forecast for the latter can be significantly improved by adding lagged variables of the former to the information set.

To test the short-run causality between the variables, the pairwise Granger causality test was employed. Causality is defined as X_t is said not to Granger cause Y_t if

$$E(Y_{t+h}|J_t, X_t) = E(Y_{t+h}|J_t)$$

where: J_t denotes the information sets considering the past observation of X_t and Y_t up to and including time (t).

Granger (1988) postulates that the coefficient of error correction term used in the cointegration analysis can be considered to test the long-run causality between the variables. This study, therefore, employed the coefficient of error correction term to confirm the presence and direction of long-run Granger causality between the variables.

3.3.6 Impulse Response Function

To provide dynamic simulations of the effects of shocks known size and duration in the economic freedom index on economic growth in Sri Lanka, this study used the impulse response function (IRF) analysis. An IRF traces the response of present and future values of the endogenous variables to a one standard deviation shock through the dynamic structure of the vector auto-regression (VAR). Plots of the IRF over time provide a graphical illustration of the period-by-period simulation, describing both the adjustment path and long-run effect on economic growth in response to the shock in the economic freedom index. They can be expressed in a vector moving average (VMA) representation as

$$Y_{t+s} = \sum_{i=0}^{\infty} \psi_{t+n-i}$$

Then, the IRF is defines as:

$$\{\psi_n\}_{i,j} = \frac{\partial Y_{i,t+n}}{\partial \varepsilon_{i,j}}$$

The matrix can be interpreted as that its (i,j) element measures the consequences of one unit increase in the jth variable's innovation at date t, (ε_{jt}) for the value of the ith variable at time $t+n$ holding all other innovations at all dates constant. The IRF is derived by plotting these elements as a function of s. The advantage of examining impulse response functions is that they show the size of the impact of the shock plus the rate at which the shock dissipates, allowing for interdependencies.

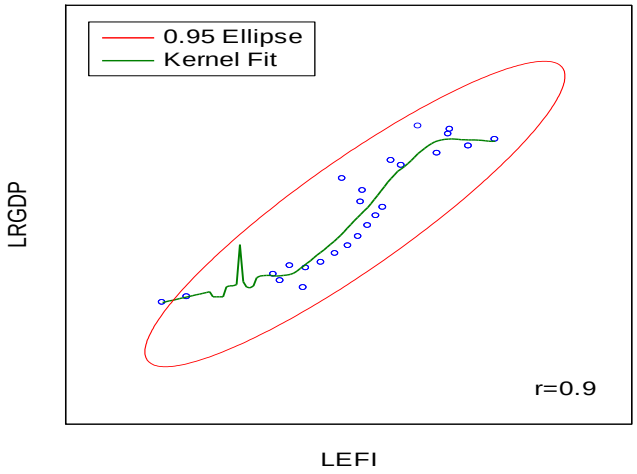
4. Results and discussions

In this section, the empirical findings derived from the analytical tools used in this study are presented.

4.1 Visual inspection

To confirm the instant relationship between economic freedom and economic growth, exploratory data analysis (EDA) tools such as scatter plots, confidence ellipse with kernel fit are used. Accordingly, exhibited in Figure 1 is the test result of EDA which confirms that economic freedom in Sri Lanka augments economic growth at 95 percent of the confidence region.

Figure 1. Association between economic freedom index and economic growth



Source: Eviews software

4. 2 Lag selection

Table 3 shows the test results of optimal lag selection criteria. All three criteria such as AIC, SIC, and HQIC inform us that lag 4 is optimal lag compared to other lags. Thus, lag 4 under the Akaike Information Criterion (AIC) is considered to select the appropriate ARDL model for this study.

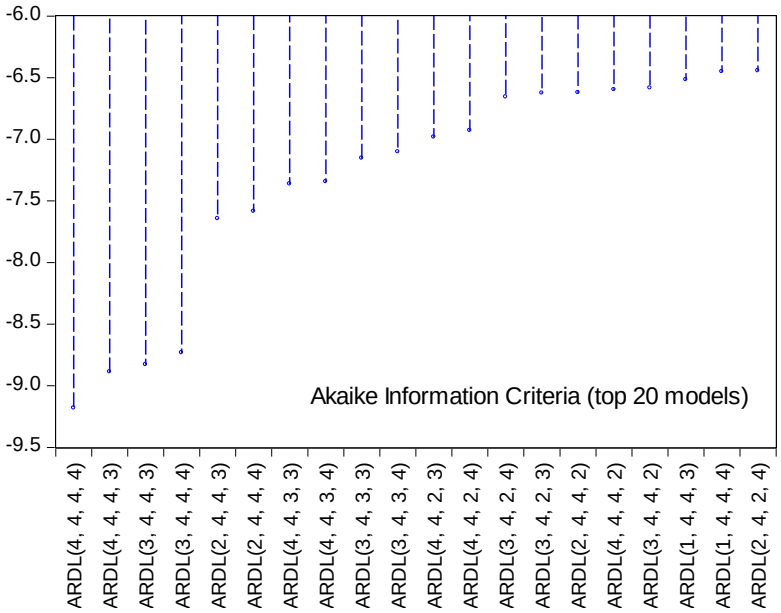
Table 3. VAR leg order selection criteria

Lag	LL	LR	FPE	AIC	SIC	HQIC
0	104.3313	NA	8.33×10^{-10}	-9.555365	-9.356409	-9.512187
1	207.7507	157.5913	2.09×10^{-13}*	-17.88101	-16.88623	-17.66512
2	216.2163	13.10364	3.93×10^{-13}	-17.44918	-15.65857	-17.06057
3	236.9374	13.50177	6.08×10^{-13}	-17.61309	-15.02665	-17.05176
4	323.5788	33.00625*	3.96×10^{-13}	-24.34084*	-20.95858*	-23.60680*

Source: Authors' calculation

Shown in Figure 2 is the graph of the top 20 ARDL models, produced by lag 4 of Akaike Information Criterion. In these models, the ARDL (4, 4, 4, 4) model is the best compared to others due to having a low lag length. Hence, the ARDL (4, 4, 4, 4) model is employed to test the relationship between economic freedom and economic growth in Sri Lanka.

Figure 2. Model Selection Criteria Graph for AIC



Source: Authors' estimation

4.3 Diagnostic test

Once selected the appropriate ARDL model for this study, testing the selected model whether robust is the next step of this study. In order to do so, several techniques have been employed in empirical studies. Accordingly, Table 4 illustrates the residual diagnostic test results of the estimated model of this study. Based on the test results given in Table 4, the corresponding p-value of all the diagnostic tests shown in the table is greater than the 5 percent significance level. Therefore, it is confirmed that the estimated ARDL (4, 4, 4, 4) model does not suffer from serial correlation, is homeostatic (or constant variance) and the residuals are normally distributed.

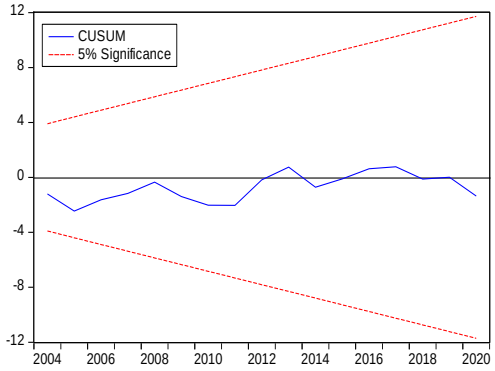
Table 4. Diagnostic test results

ARDL (4, 4, 4, 4) model					
Breusch-Godfrey serial correlation LM test		Heteroscedasticity test: Breusch-Pagan-Godfrey		JB normality test	
F-statistic	Prob. $F(1, 14)$	F-statistic	Prob. $F(19, 1)$	χ^2_{NOR}	p-value
3.401	0.086	3.800	0.386	2.246	0.325

Source: Authors' calculation

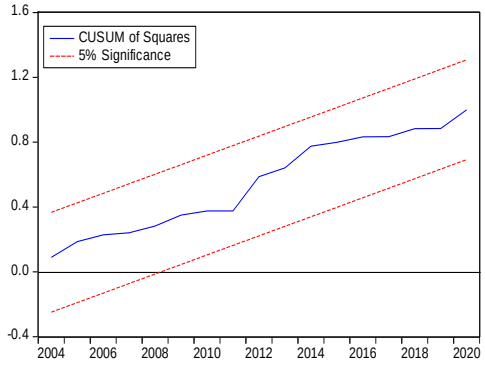
Figures 3 and 4 illustrate the stability test results of the estimated ARDL model of this study. Accordingly, Figure 3 is the cumulative sum of recursive residuals (CUSUM) plots, and Figure 4 is the cumulative sum of recursive residuals squared (CUSUMSQ) plots. Based on both figures, as CUSUM and CUSMSQ lines are laid within the critical bounds of 5 percent significant level, the results suggest that the parameter of the estimated ARDL model of this study is consistent.

Figure 3. CUSUM plot



Source: Authors' estimation

Figure 4. CUSUMSQ plot



Source: Authors' estimation

4.4 Cointegration test

Having confirmed the estimated model is robust, the next step of this study is to test the long-run relationship between the variables. Accordingly, given in Table 5 is the ARDL Bounds test results which indicate that the calculated F-statistic is 28.07. Further, Table 5 shows that the calculated F-statistic is greater than the upper bound critical value of the 5 percent significant level. Therefore, since the calculated F-statistic is greater than the upper bound critical value at 5 percent significant level, the null hypothesis that there is no long-run relationship between economic freedom and economic growth is rejected. Hence, the long-run relationship between economic freedom and economic growth is confirmed at 5 percent significant level.

Table 5. ARDL Bounds test results

Test statistic	Value	
F-statistic	28.07	
K	3	
Significance	I(0) Bounds	I(1) Bounds
10%	2.01	3.1
5%	2.45	3.63
2.5%	2.87	4.16
1%	3.42	4.94

Source: Authors' calculation

Presented in Table 6 are the estimated long-run coefficients of regressors given in this study. All the regressors are statistically significant and different from zero. In that respect, the estimated coefficient of gross fixed capital formation indicates that 1 percent increases in gross fixed capital formation increase economic growth by 0.66 percent. This finding is in line with the findings of Ugochukwu and Chinyere (2013); Kanu and Ozurumba (2014). The labour force is one of the regressors used in this study which indicates that 1 percent increase in the labour force positively pushes economic growth by 0.65 percent. This finding is confirmed by the findings of Raleva (2014); Yakubu, et al., (2020). As for this study, the key regressor is economic freedom, the estimated coefficient of economic freedom given in Table 6 shows that 1 percent increases in economic freedom induce 3.89 percent of economic growth in Sri Lanka. This finding is consistent with the study of Gwartney et al., (1999), Doucouliagos and Ulubasoglu, (2006), Hussain and Haque (2016).

In addition to the long-run coefficient. Table 6 shows the test result of error correction term $(\boldsymbol{ECT_{t-1}})$. The test result of $(\boldsymbol{ECT_{t-1}})$ shows a negative sign, statistically significant, and different from zero at the 5 percent

level. Since the estimated coefficient of error correction term satisfies all the requirements of theory, it can be concluded that the response variable of economic growth moves towards the long-run equilibrium path and corrects 22 percent of errors every year.

Table 6. Estimated Coefficients of regressor

Dependent variable: $\boldsymbol{lnEC_t}$			
Regressor	Coefficient	Standard Error	p-value
$\boldsymbol{lnGFCF_t}$	0.665	0.168	0.058
$\boldsymbol{lnLBF_t}$	0.656	0.057	0.007
$\boldsymbol{lnEFI_t}$	3.897	0.635	0.025
$\boldsymbol{lnECT_{t-1}}$	-0.229	0.355	0.023

Source: Authors' calculation

4.5 Granger causality test

Table 7 exhibits the test results of Pairwise Granger Causality (F- test) from a single-equation. Accordingly, (1) the null hypothesis of "economic growth does not Granger Cause economic freedom" cannot be rejected as the corresponding p-value of the null hypothesis is greater than 5 percent significant level; (2) the null hypothesis of "economic freedom does not Granger Cause economic growth" is rejected since the corresponding p-value of the null hypothesis is less than 5 percent significant level. Therefore, it can from the test results given in Table 7 be confirmed that there is a unidirectional causality running from economic freedom to economic growth in Sri Lanka, and not vice versa.

Table 7. Pairwise Granger Causality Test

Null hypothesis	Obs.	F-Statistic	P-value
$\Delta\boldsymbol{lnEC_t}$ does not Granger Cause $\Delta\boldsymbol{lnEFI_t}$	23	0.286	0.754
$\Delta\boldsymbol{lnEFI_t}$ does not Granger Cause $\Delta\boldsymbol{lnEC_t}$		3.502	0.051*

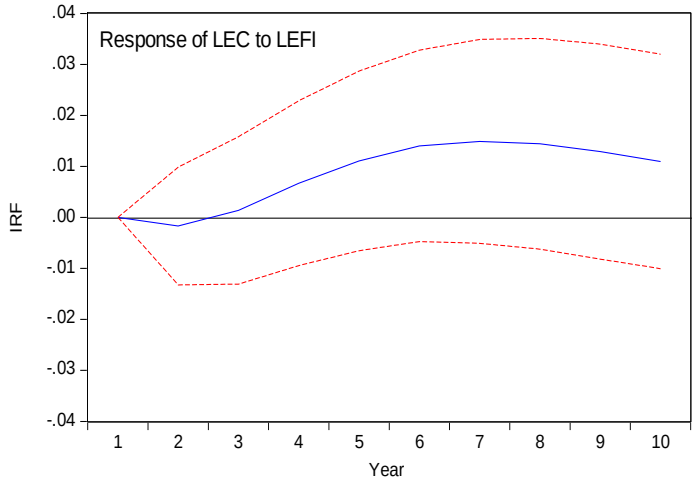
Source: Authors' estimation

Further to the short-run Granger causality, the error correction term presented in Table 6 indicates the long-run causal relationship between the variables used in this study. In that respect, the estimated coefficient of the error correction term ($\boldsymbol{ECT_{t-1}}$) is, based on the corresponding p-value, statistically significant and different from zero at the 5 percent level. Therefore, it can be concluded that there is a long-run Granger causal relationship between the variables used in this study.

4.6 Impulse Response Function Analysis

Reported in Figure 5 is the test result of impulse response function analysis. It indicates a positive standard deviation shock to the economic freedom index is stimulated. The vertical axis shows the time horizon in years over which the IRF is performed. The solid line represents the point estimates of the IRF with 5 percent standard error bands on either side of the IRF to judge the statistical significance of the IRF. In that respect, the test result of IRF given in Figure 4 shows that a positive shock to the economic freedom index has an immediate significant positive impact on the economic growth from the 3rd year to 10 years.

Figure 5. Impulse response of $lnEC_t$ to $lnEFI_t$



Source: Authors' Derivation

5. Conclusion and policy recommendation

This study has investigated whether economic freedom matter for economic growth in Sri Lanka by using the time series data over the period 1996-2020. In this study, exploratory data analysis and inferential data analysis tools were employed to analysis the data set. The exploratory data analysis tools showed that there was a positive relationship between economic freedom and economic growth in Sri Lanka. Before applying the ARDL Bounds cointegration technique, all the variables used in this study were tested their order of integration by using ADF and PP unit root tests. The unit root tests results confirmed that the variables used in this study are non-stationary at their level, become stationary at their 1st difference. The ARDL Bounds cointegration test showed clear evidence of cointegration among the variables used in this study. The diagnostic test results of this study for the estimated model confirm that the model is healthy. The estimated coefficients of variables used in this study illustrated that the economic freedom index statistically matters for economic growth. The results of the Granger causality test exhibit that there is a unidirectional causality running from the economic freedom index to economic growth whereas the estimated coefficient of error correction term implies that there is a long-run causal relationship. Impulse response function analysis confirms that a positive standard deviation shock to the economic freedom index has an immediate significant positive impact on economic growth. This study based on the analytical techniques used in this study confirms that economic freedom is an important factor for economic growth in Sri Lanka. Therefore, as it is the first study in the Sri Lankan context, this study suggests that development policymakers should consider the findings of this study when they formulate the development policies**.**

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